Pension Fund Committee

Date **Thursday 15 March 2018**
Time **10.00 am**
Venue **Committee Room 2, County Hall, Durham**

Business

Part A

Items during which the Press and Public are welcome to attend. Members of the Public can ask questions with the Chairman's agreement.

1. Apologies for Absence
2. Declarations of interest (if any)
3. The Minutes of the Meeting held on 7 December 2017 (Pages 5 - 8)
4. Overall Value of Pension Fund Investments to 31 December 2017 (Pages 9 - 14)
5. Short Term Investments for the Period Ended 31 December 2017 (Pages 15 - 16)
6. Performance Measurement of Pension Fund Investments to 31 December 2017 (Pages 17 - 28)
7. Investment of the Pension Fund's Cash Balances (Pages 29 - 32)
8. Agreement of Accounting Policies for Application in the 2017/2018 Financial Statements of the Pension Fund (Pages 33 - 38)
9. Procedure for Reporting Breaches (Pages 39 - 54)
10. Internal Audit Plan 2018/2019 (Pages 55 - 56)
11. Audit Strategy Memorandum for Year Ending 31 March 2018 (Pages 57 - 72)

12. Feedback from Local Pension Board
13. Such other business as, in the opinion of the Chairman of the Meeting is of sufficient urgency to warrant consideration
14. Any resolution relating to the exclusion of the public during the discussion of items containing exempt information

Part B

Items during which it is considered the meeting will not be open to the public (consideration of exempt or confidential information)

15. The Minutes of the Meeting held on 7 December 2017 (Pages 73 - 82)
16. Report of the Pension Fund Adviser (Pages 83 - 120)
17. Investment Strategy Review Update (Pages 121 - 122)
18. Report of Aberdeen Asset Management (Pages 123 - 148)
19. Report of Walter Scott (BNY Mellon) (Pages 149 - 158)
20. Report of Mondrian Investment Partners Ltd (Pages 159 - 164)
21. Report of AB (Pages 165 - 182)
22. Report of CBRE Global Investment Partners (Pages 183 - 190)
23. Report of Royal London (Pages 191 - 192)
24. Report of BlackRock (Pages 193 - 208)
25. Internal Audit Progress Report to 31 December 2017 (Pages 209 - 212)
26. Investment Benchmarking (Pages 213 - 366)
27. Such other business as, in the opinion of the Chairman of the meeting, is of sufficient urgency to warrant consideration

Helen Lynch
Head of Legal and Democratic Services

County Hall
Durham
7 March 2018

To: The Members of the Pension Fund Committee

County Council Members:
Councillors M Davinson, O Temple, J Atkinson, C Carr, J Carr, J Lethbridge, H Liddle, S Hugill, J Nicholson, J Shuttleworth and M Wilson

Darlington Borough Council Members
Councillor S Harker
Councillor I G Haszeldine

Scheduled Bodies Representative
(vacant)

Admitted Bodies Representative:
(vacant)

Pensioner Representative
(vacant)

Active Members Representative
(vacant)

Further Education Colleges Representative
(vacant)

Advisers: County Council Officers

Chief Executive	T Collins
Corporate Director of Resources	J Hewitt
Head of Legal and Democratic Services	H Lynch
Pensions Manager	N Orton

Independent Adviser
J Holden – Mercer
S Dickson - Mercer

Investment Managers
Walter Scott (BNY Mellon)
Aberdeen Asset Management
Mondrian Investment Partners Ltd
AB
CBRE Global Investment Partners
Royal London
BlackRock

Staff Observers

UNISON	N Hancock
GMB	D Clegg

Contact: Jill Errington **Tel: 03000 269703**

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DURHAM COUNTY COUNCIL

PENSION FUND COMMITTEE

At a Meeting of **Pension Fund Committee** held in Committee Room 2, County Hall, Durham on **Thursday 7 December 2017 at 10.00 am**

Present:

Councillor M Davinson (Chairman)

Members of the Committee:
Councillors O Temple (Vice-Chairman), J Atkinson, C Carr, J Carr and S Hugill

Also Present:
Advisers: County Council Officers
Nick Orton – Pensions Manager
Beverley White – Finance Manager – Pensions and Technical

Independent Adviser:
Jo Holden – Mercer

Observers:
Councillor Amanda Hopgood – Local Pension Board
Ian R Densham – Local Pension Board
David Clegg – GMB
Neville Hancock – UNISON and Local Pension Board

1 Apologies for Absence

Apologies for absence were received from Councillors J Lethbridge, H Liddle, J Nicholson, J Shuttleworth and M Wilson.

2 Declarations of interest

There were no declarations of interest.

3 Minutes

The Minutes of the meeting held on 7 September 2017 were agreed as a correct record and were signed by the Chairman.

Matter Arising from the Minutes

Implementation of the Markets in Financial Instruments Derivative (minute no. 9 refers)

Nick Orton advised that as agreed at the meeting, the Committee had been asked to complete a self-assessment to identify training requirements, and asked those Members who had not already done so to return the information.

4 Overall Value of Pension Fund Investments to 30 September 2017

The Committee considered a report of the Corporate Director of Resources which informed Members of the overall value of the Pension Fund's investments at 30 September 2017, the movement in the cash balance during the last four quarters and the projected cash flow position up to 31 December 2018 (for copy see file of Minutes).

Councillor Carr referred to the cash flow position and asked if employers in the scheme informed the Fund of forthcoming early retirements. The Member was advised that this information would be difficult to collect but that it did not have a material impact on cash flow which was affected in the main by the way in which cash was recovered from the Fund Managers, and the Fund's Investment Strategy. Officers were discussing a cash strategy with the Independent Advisers for the pooled arrangements.

Beverley White added that the early deficit settlement by Darlington Borough Council had affected the net cash flow position.

Resolved:

That the information contained in the report be noted.

5 Performance Measurement of Pension Fund Investments to 30 September 2017

The Committee considered a report of the Corporate Director of Resources which provided an overview for Members of the performance of the Fund to 30 September 2017 (for copy see file of Minutes).

Resolved:

That the information contained in the report produced by JP Morgan be noted.

6 Short Term Investments for the Period Ended 30 September 2017

The Committee considered a report of the Corporate Director of Resources which provided information on the performance of the Pension Fund's short term investments as at 30 September 2017 (for copy see file of Minutes).

Councillor Temple noted the position and thanked those involved in negotiating an improved rate of return.

Resolved:

That the position at 30 September 2017 regarding the Pension Fund's short term investments where £34,166 net interest was earned in the three month period, be noted.

7 Border to Coast Pensions Partnership Responsible Investment Policy

The Committee considered a report of the Corporate Director of Resources which advised of the Responsible Investment Policy and the associated Shareholder Voting Policy that Border to Coast Pensions Partnership (BCPP) would adopt once it became the legal owner of pension fund assets (for copy see file of Minutes).

Councillor Atkinson noted that the Committee must act with the best financial interest of the beneficiaries in mind, and in view of this asked if the report should read that companies 'must' be aware of the potential risks associated with adopting practices that were socially, environmentally or ethically unacceptable. The Member was advised that it would be difficult for the Committee to require this of the Managers but that there was an expectation that Fund Managers would look at the behaviour of companies they invested in, in line with the ESG policy.

The Member then asked about the voting arrangements in the BCPP and was referred to Appendix 2 of the report which set out the principles for voting, which the BCPP would adopt.

Rachel Elwell, Chief Executive of the pool assured the Member that responsible investment was a fundamental part of the investment process and transparency was key in areas such as voting. Any ESG concerns the Committee had about a company could be addressed through the pool's Joint Committee, of which Councillor Davinson was a member. In addition a representative of the pool would attend every meeting of the Committee.

Resolved:

That the Responsible Investment Policy and Corporate Governance Policy included in Appendices 1 and 2 that the BCPP would operate on behalf of the Pension Fund as assets were transferred to the pool, be noted and agreed.

8 Feedback from Local Pension Board

There were no recommendations from the Local Pension Board to report to the Committee.

The Chairman agreed that consideration be given to the following item of business in order to progress the filling of vacancies on the Committee.

9 Committee Membership

The Committee considered a report of the Corporate Director of Resources which asked the Committee to agree to a set of steps aimed at filling the current vacancies on the Committee (for copy see file of Minutes).

Resolved:

That

a) The process set out in paragraphs 4 to 11 in the report to fill the current vacancies on the Committee, be agreed.
b) The two scheme member representative positions on the Committee be filled by pensioner representatives.
c) Councillors M Davinson, O Temple, J Atkinson, C Carr and J Carr form a pool from which the Corporate Director of Resources or the Pensions Manager could draw an interview panel including at least one of the Members to select from the candidates (Officers also to be present on the Panel to advise and assist in the selection process).
d) A progress report be brought to the next meeting of the Committee.

Pension Fund Committee

15 March 2018

Overall Value of Pension Fund Investments to 31 December 2017

John Hewitt, Corporate Director of Resources

Purpose of the Report

1. To provide an update to Members on the:

   (a) overall value of the Pension Fund's investments at 31 December 2017;
   (b) movement in the cash balance during the last four quarters;
   (c) projected cash flow position up to 31 March 2019.

Value of the Pension Fund

2. Reports from the seven appointed Fund Managers, namely:
   - Aberdeen
   - AB
   - BlackRock
   - Bank of New York Mellon (Walter Scott)
   - CB Richard Ellis
   - Mondrian
   - Royal London

   are included in other papers within this agenda.

3. The value of the Fund at 31 December 2017 was £2.827 billion compared to £2.748 billion at 30 September 2017. This is an increase of £79.82 million (or 2.91%) in the fourth quarter of 2017/18.

Allocation of New Investment Money/ Withdrawal of Investment Money to Deal with Estimated Shortfall

4. New investment money is allocated to Fund Managers when the Pension Fund has cash which is not needed to be available as a working cash balance, for example for the payment of pensioners or fees.

5. When it is estimated that the Pension Fund will not have sufficient cash available as a working cash balance, cash is withdrawn from Fund Managers.

6. Appendix 1 details the working cash balance position of the Pension Fund and actual cash flow for the last four quarters. As at 31 December 2017 the cash balance held in the Durham County Council Pension Fund bank account

was £23.096 million. In addition to this, not included in this table, Fund Managers were holding cash of £35.294 million at 31 December 2017.

Cash Flow Forecast 2017/18

7. Appendix 2 shows the projected cash flow for the Pension Fund for the period January 2018 to March 2019. It should be noted that this is only in respect of cash held in the Pension Fund bank account and that income earned from investments is currently retained by Managers.

8. The forecast includes the recovery of £20 million from Fund Managers, in each of the quarters ending 31 March 2018, 30 September 2018 and 31 March 2019. Without the recovery of the aforementioned amounts, the Pension Fund is estimated to be in a cash negative position in all quarters to 31 March 2019.

9. The forecast indicates net cash outflows in future quarters of between £10 million and £11 million. The size of the outflows are exacerbated due to the early receipt of Durham County and Darlington Borough Councils' deficit contributions in April 2017, the impact of which is an apparent reduction in future contributions receivable of £6.375 million per quarter.

10. The following assumptions have been used to calculate the cash flow forecast:

    (a) Annual dividend income receivable is estimated to be £28 million and profiled to be received as follows:

(i)	Quarter ended 31 March 2018	26%
(ii)	Quarter ended 30 June 2018	17%
(iii)	Quarter ended 30 September 2018	33%
(iv)	Quarter ended 31 December 2018	24%

    (b) Increases in contributions are included in line with the actuarial valuation.

    (c) Transfer values due in, are estimated at £1.0 million per quarter. It is anticipated that transfers in will continue as the LGPS remains relatively attractive to employees.

    (d) Pensions increase will be 3% with effect from 1 April 2018.

    (e) Payroll paysheets (payments to pensioners) are forecast to increase by £0.25 million per quarter, from 1 April 2018. This figure will alter if there are large numbers of retirements from the employing authorities. It is anticipated however that the actual figure will not be materially different to the forecast since the position of the County Council, being the largest employer in the Fund, has been taken into account.

(f) Payable paysheets are forecast on the basis of the previous year's profile and adjusted for known one-offs, although this can be the most volatile figure as it includes payments of lump sums and fees to Managers. This assumption errs on the side of prudence, in that this is an average figure taken from previous quarterly payments.

11. Appendix 2 provides an early indication of the likely impact on the Pension Fund's cash flow position over the next 15 months. It is continuously under review and is refined to take any new information into account as it becomes available.

Fund Rebalancing

12. Fund rebalancing is the mechanism by which the Pension Fund would ensure that the asset allocation to Investment Managers is maintained at the target levels previously agreed by the Pension Fund Committee and as set out in the Investment Strategy Statement (ISS). It is also the means by which cash is moved to or from Managers as a consequence of the cash flow forecasts.

13. Due to the current suspension of Fund rebalancing, there was no rebalancing exercise this quarter.

Recommendation

14. Members are asked to note the information contained in this report.

Contact: Beverley White Tel: 03000 261900

Appendix 1

Actual Cash Flow – For the period 1 January 2017 to 31 December 2017

Quarter Ended	31.03.17		30.06.17		30.09.17		31.12.17	
	Estimate	Actual	Estimate	Actual	Estimate	Actual	Estimate	Actual
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	£	£	£	£	£	£	£	£
Cash Inflows								
Contributions - DCC	16,650,000	17,930,972	70,970,000	70,523,690	13,805,000	13,689,270	13,775,000	13,793,663
Contributions - Other	8,200,000	8,245,096	14,611,000	15,336,280	8,610,000	8,496,465	8,665,000	8,659,201
Unfunded pensions recharges	1,120,000	1,153,285	1,131,000	1,111,670	1,145,000	1,168,998	1,145,000	1,111,703
Transfer Values	500,000	1,836,603	500,000	1,947,317	750,000	1,119,502	1,000,000	2,245,256
Other income	2,000,000	2,801,351	2,000,000	2,394,996	2,000,000	1,021,246	2,000,000	2,398,751
Funds recovered from Managers	0	0	0	0	0	0	15,000,000	15,000,000
Interest on short term investments	3,500	5,255	9,000	14,818	9,000	34,166	35,000	31,895
Total Cash Inflow	28,473,500	31,972,562	89,221,000	91,328,771	26,319,000	25,529,648	41,620,000	43,240,469
Cash Outflows								
Payroll Paysheets	23,600,000	23,494,968	23,800,000	23,842,253	24,000,000	24,164,845	24,400,000	24,294,397
Payables Paysheets (incl. Managers' fees)	11,000,000	11,828,106	11,000,000	14,736,537	11,250,000	12,798,593	12,000,000	12,225,874
Funds transferred to Managers	0	0	32,000,000	32,000,000	0	0	0	0
Other Expenditure	0	15,268	1,000	3,855	1,000	1,485	1,000	1,337
Total Cash Outflows	34,600,000	35,338,342	66,801,000	70,582,644	35,251,000	36,964,923	36,401,000	36,521,608
Net Cash Inflow / (-) Outflow	-6,126,500	-3,365,780	22,420,000	20,746,127	-8,932,000	-11,435,275	5,219,000	6,718,861
Balance at Bank (opening)		12,526,070		8,638,064		28,879,256		16,915,978
Balance at Bank (closing)		8,638,064		28,879,256		16,915,978		23,095,655

Appendix 2

Projected Cash Flow (including forecast dividends receivable by Fund Managers) - for the period 1 January 2018 to 31 March 2019

Quarter Ended	**31.03.18**	**30.06.18**	**30.09.18**	**31.12.18**	**31.03.19**
	Estimate	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£	**£**	**£**	**£**	**£**
Cash Inflows					
Contributions - DCC	13,775,000	13,800,000	13,810,000	13,810,000	13,810,000
Contributions - Other	8,665,000	8,925,000	9,055,000	9,055,000	9,055,000
Unfunded pensions recharges	1,135,000	1,170,000	1,170,000	1,170,000	1,170,000
Transfer Values	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Other income	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000
Funds recovered from Managers	20,000,000	0	20,000,000	0	20,000,000
Interest on short term investments	30,000	30,000	30,000	25,000	25,000
Total Cash Inflow	46,605,000	26,925,000	47,065,000	27,060,000	47,060,000
Cash Outflows					
Payroll Paysheets	24,600,000	25,500,000	25,750,000	26,000,000	26,250,000
Payables Paysheets (incl. Managers' fees)	12,000,000	12,000,000	12,000,000	12,000,000	12,000,000
Funds transferred to Managers	0	0	0	0	0
Other Expenditure	1,000	1,000	1,000	1,000	1,000
Total Cash Outflows	36,601,000	37,501,000	37,751,000	38,001,000	38,251,000
Net Cash Inflow / (-) Outflow	10,004,000	-10,576,000	9,314,000	-10,941,000	8,809,000
Balance at Bank (opening)	23,095,655	33,099,655	22,523,655	31,837,655	20,896,655
Balance at Bank (closing)	33,099,655	22,523,655	31,837,655	20,896,655	29,705,655
Dividends Received by Managers	7,280,000	4,760,000	9,240,000	6,720,000	7,280,000

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Pension Fund Committee

15 March 2018

Short Term Investments for the period ended 31 December 2017

John Hewitt, Corporate Director Resources

Purpose of Report

1. To provide the Committee with information on the performance of the Pension Fund's short term investments as at 31 December 2017.

Short Term Investments

2. Durham County Council (the Council) invests the short term cash balances on behalf of the Pension Fund; this is done in line with the Council's Treasury Management Policy and Annual Investment Strategy. This investment strategy sets out the maximum amounts and time limits in respect of deposits which can be placed with each financial institution.

3. The Pension Fund's surplus cash holding as at 31 December 2017 was £23.096 million which was held in the institutions listed in the table below alongside their credit rating at 31 December 2017.

Financial Institution	**Short-term Rating**	**Amount Invested £m**
Bank Deposit Accounts		
Handelsbanken	F1+	1.352
Santander UK Plc	F1	1.104
Fixed Term Deposits		
First Bank of Abu Dhabi	F1+	1.104
Leeds Building Society	F1	0.552
Bank of Scotland	F1	5.521
Nationwide Building Society	F1	2.760
Goldman Sachs	F1	3.864
UK Local Authorities	N/A	4.416
National Savings & Investments	N/A	0.110
Money Market Funds	N/A	2.313
Total		**23.096**

4. The following table provides information on the net interest earned during the three month period to 31 December 2017, the average daily investment balance and the average return earned in comparison to the average bank base rate.

5. The quarterly interest paid to the Pension Fund is based upon a rate of 0.70% which was earned on cash balances up to £19 million, as agreed with the Council's Treasury Management team, and at the London Interbank Bid (LIBID) three month rate on balances in excess of £19 million. The fixed term investment yielding 0.70%, matured on 21 December 2017. Total quarterly interest received, is net of the fees of £2,500, paid for the Council undertaking the Treasury Management function for the Pension Fund.

	Total
Net Interest Earned	£31,895
Average Return Earned	0.56%
Average Bank of England base rate	0.41%
Average Daily Balance of Investments	£22,521m

Recommendation

6. Members are asked to note the position at 31 December 2017 regarding the Pension Fund's short term investments where £31,895 net interest was earned in the three month period.

Contact: Beverley White Tel: 03000 261900

Pension Fund Committee
15 March 2018

Performance Measurement of Pension Fund Investments to 31 December 2017

John Hewitt, Corporate Director of Resources

Purpose of the Report

1 To provide an overview for Members of the performance of the Fund to 31 December 2017.

Background

2 The performance of the seven Managers is measured against personalised benchmarks chosen at the inception of the Fund. The attached report from JP Morgan, the Fund's custodian, shows:

(a) The Managers benchmarks;

(b) The total Fund performance, for the quarter to 31 December 2017, year to date and since inception;

(c) The Managers' performance in absolute and relative terms against the relevant benchmarks, for the quarter to 31 December 2017, year to date and since inception;

(d) A portfolio comparison for the quarter ended 31 December 2017 and for the period since inception.

Recommendation

3 Members note the information contained in the attached report produced by JP Morgan.

Contact: Beverley White Tel: 03000 261900

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J.P.Morgan

Durham Quarterly Report

Report Package

Published 30-Jan-2018 08:35:18

Table of Contents

J.P.Morgan

Index and Benchmark Report - Monthly
Durham CC (UK005)
As at December 2017

Name	Month Return
Business Unit Indices	
Equities	
FT-All Share +3%	5.04
FTSE-Ftse All-Share (Gross)	4.78
FTSE-Ftse Aw Developed (Gross)	1.54
MSCI AC World Index (Gross) + 2.5%	1.93
MSCI AC World Index (Gross) + 3%	1.97
MSCI EM (Emerging Markets) (Net)	3.66
MSCI EM (Emerging Markets) (Net) + 2.5%	3.88
MSCI-Acwi (Gross)	1.71
MSCI-Em (Emerging Markets) (Gross) + 2.5%	3.92
MSCI-World (Gross)	1.45
Fixed Income	
British Gov Index Linked over 5 Yr + 0.5%	2.24
Cash And Cash Equivalent	
3 MONTH GBP LIBOR	0.04
3Month GBP Libor +4%	0.37
3Month libor in GBP plus 3%	0.29
GBP Zero Return Index	0.00
RPI + 5%	1.24
Retail Price Index (UK)	0.83

J.P.Morgan

Executive Summary

Durham CC (UK005)

As of December 2017

Gross of Fee

Total Fund Composite (0UK00501)

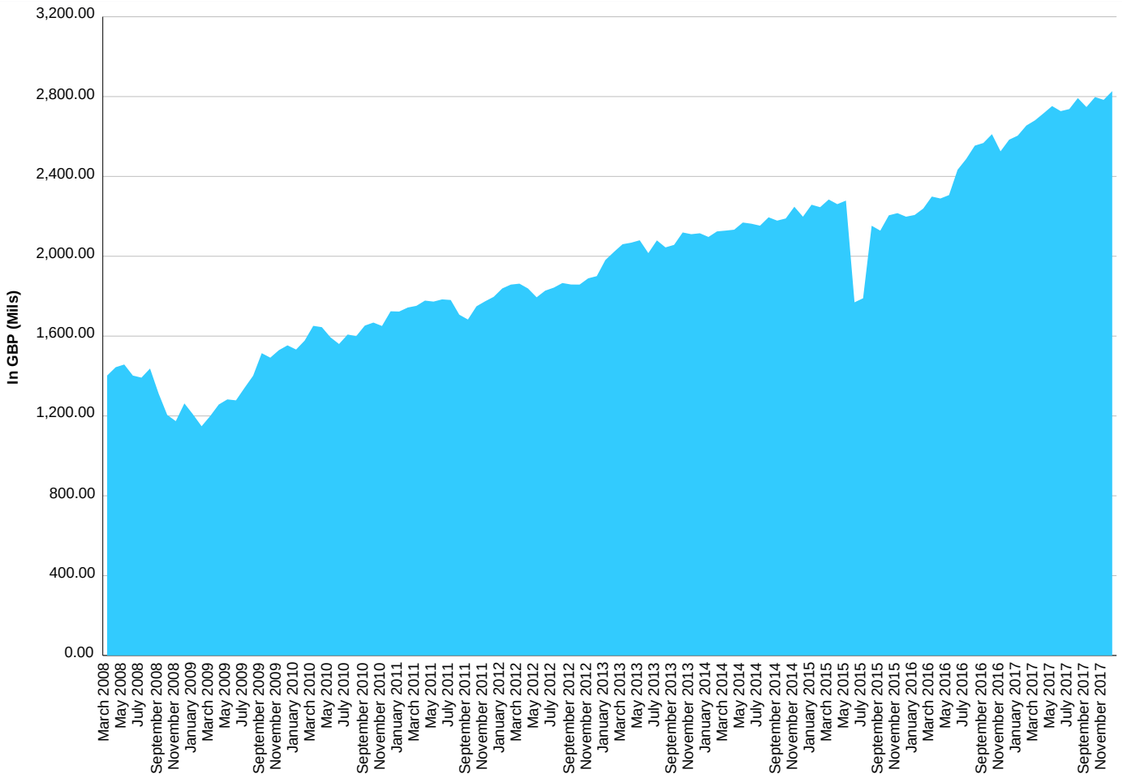
Market Value Overview

	In GBP (Mils)				
	December 2017	September 2017	June 2017	March 2017	December 2016
Market Value	2,827.45	2,747.63	2,727.25	2,680.74	2,584.02
Net Cash Flow	(14.98)	0.00	31.77	(0.10)	(0.23)
Net Income / Appreciation	94.79	20.38	14.74	96.82	16.73

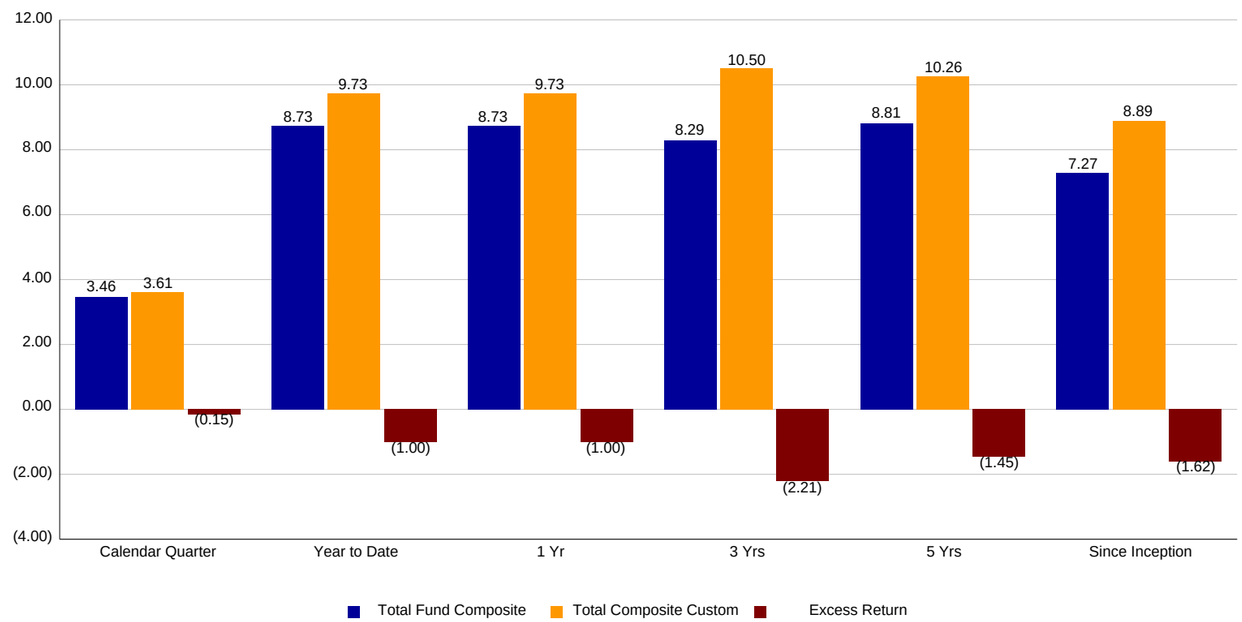
Performance Overview

	Performance (Annualised > 1 Year)					
	Calendar Quarter	Year to Date	1 Yr	3 Yrs	5 Yrs	Since Inception
Total Fund Composite	3.46	8.73	8.73	8.29	8.81	7.27
Total Composite Custom	3.61	9.73	9.73	10.50	10.26	8.89
Excess Return	(0.15)	(1.00)	(1.00)	(2.21)	(1.45)	(1.62)

Development of Market Value - Since Inception



Performance Returns



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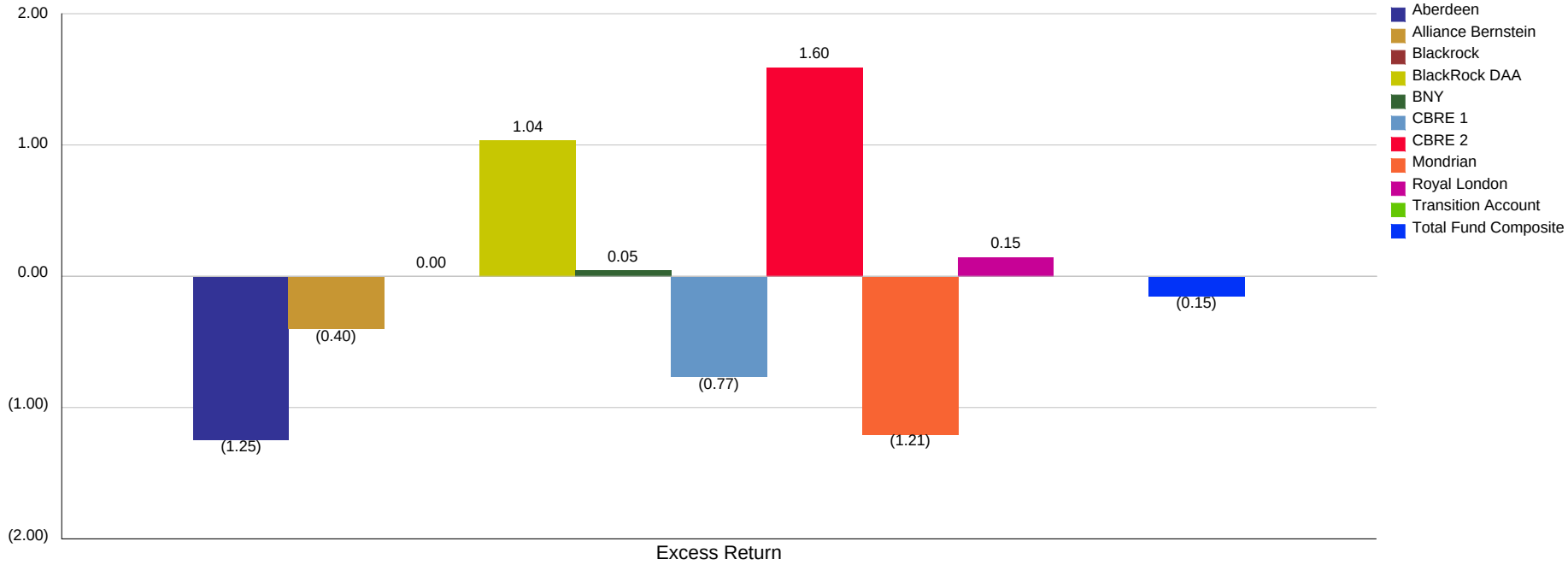
Portfolio Comparison

Durham CC (UK005)
As of December 2017
Gross of Fee
Excess Return - Additive
Primary - Pound Sterling

Manager	Benchmark	Market Value (mils)	Weight	Trailing 3 Months Return	Benchmark Trailing 3 Months Return	Excess Returns	Current Contribution to Return
Aberdeen	MSCI-Acwi (Gross) + 3%	473.39	16.74	4.51	5.75	(1.25)	0.75
Alliance Bernstein	3 Month Libor in GBP +3% pa	397.12	14.05	0.46	0.86	(0.40)	0.06
Blackrock	Zero Return - Historically FTSE All Share (Gross) +3% pa	0.01	0.00	0.00	0.00	0.00	0.00
BlackRock DAA	3 Month Libor in GBP +3% pa	500.99	17.72	1.90	0.86	1.04	0.34
BNY	MSCI AC World Index (Gross) + 2.5%	481.05	17.01	5.68	5.62	0.05	0.97
CBRE 1	Headline RPI +5% pa (CBRE1)	188.71	6.67	1.56	2.33	(0.77)	0.10
CBRE 2	Headline RPI +5% pa (CBRE2)	36.46	1.29	3.92	2.33	1.60	0.05
Mondrian	MSCI EM (Emerging Markets) (Gross) + 2.5%	211.24	7.47	6.06	7.27	(1.21)	0.45
Royal London	FTSE index Linked more than 5 years +0.5% pa	538.46	19.04	4.04	3.89	0.15	0.77
Transition Account	Not Applicable	0.02	0.00	0.00	-	-	0.00
Total Fund Composite	**Total Composite Custom**	**2,827.45**	**100.00**	**3.46**	**3.61**	**(0.15)**	**3.46**

Excess Returns - Trailing 3 Months



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Relative Performance

Durham CC (UK005)

For Period Ending December 2017

Gross of Fee

Excess Return - Additive

Primary - Pound Sterling

Total Fund Composite (0UK00501)

ID	Name	Market Value	Month Return	Trailing 3 Months	Year to Date	Trailing 1 Year	Trailing 3 Years	Trailing 5 Years	Since Inception
00047880	Blackrock	10,317.74	0.00	0.00	0.00	0.00	0.00	3.76	4.53
	Zero Return - Historically FTSE All Share (Gross) +3% pa		0.00	0.00	0.00	0.00	0.00	4.50	6.02
	Excess Return		0.00	0.00	0.00	0.00	0.00	(0.74)	(1.49)
00047881	Royal London	538,460,094.89	2.19	4.04	3.66	3.66	9.20	9.69	9.23
	FTSE index Linked more than 5 years +0.5% pa		2.24	3.89	2.51	2.51	9.17	9.91	9.24
	Excess Return		(0.05)	0.15	1.14	1.14	0.04	(0.22)	(0.01)
00047882	Alliance Bernstein	397,122,183.89	0.09	0.46	2.99	2.99	3.01	2.78	3.90
	3 Month Libor in GBP +3% pa		0.29	0.86	3.28	3.28	3.46	3.49	4.09
	Excess Return		(0.20)	(0.40)	(0.29)	(0.29)	(0.45)	(0.72)	(0.19)
00047885	CBRE 1	188,707,107.07	0.26	1.56	4.45	4.45	8.39	9.18	3.76
	Headline RPI +5% pa (CBRE1)		1.24	2.33	9.31	9.31	7.72	7.53	7.96
	Excess Return		(0.98)	(0.77)	(4.85)	(4.85)	0.67	1.65	(4.20)
00051183	CBRE 2	36,460,302.09	1.70	3.92	1.70	1.70	7.45	9.23	6.19
	Headline RPI +5% pa (CBRE2)		1.24	2.33	9.31	9.31	7.72	7.53	7.96
	Excess Return		0.46	1.60	(7.61)	(7.61)	(0.28)	1.70	(1.76)
00082265	Transition Account	21,654.16	0.00	0.00	0.00	0.00	0.00	0.00	2.62
	Not Applicable		-	-	-	-	-	-	-
	Excess Return		-	-	-	-	-	-	-

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Relative Performance

Durham CC (UK005)

For Period Ending December 2017

Gross of Fee

Excess Return - Additive

Primary - Pound Sterling

Total Fund Composite (0UK00501)

ID	Name	Market Value	Month Return	Trailing 3 Months	Year to Date	Trailing 1 Year	Trailing 3 Years	Trailing 5 Years	Since Inception
00301582	BlackRock DAA	500,989,922.31	0.90	1.90	8.52	8.52	2.96	-	2.96
	3 Month Libor in GBP +3% pa		0.29	0.86	3.28	3.28	3.83	-	3.83
	Excess Return		0.61	1.04	5.24	5.24	(0.87)	-	(0.87)
00301629	Mondrian	211,244,317.96	5.81	6.06	17.44	17.44	9.08	-	7.35
	MSCI EM (Emerging Markets) (Gross) + 2.5%		3.92	7.27	28.91	28.91	17.65	-	15.64
	Excess Return		1.90	(1.21)	(11.47)	(11.47)	(8.57)	-	(8.29)
00301630	Aberdeen	473,385,127.36	1.87	4.51	14.17	14.17	11.36	-	10.81
	MSCI-Acwi (Gross) + 3%		1.97	5.75	17.25	17.25	18.68	-	18.68
	Excess Return		(0.09)	(1.25)	(3.08)	(3.08)	(7.32)	-	(7.87)
00301691	BNY	481,048,949.04	1.26	5.68	13.56	13.56	15.37	-	15.64
	MSCI AC World Index (Gross) + 2.5%		1.93	5.62	16.68	16.68	18.10	-	18.25
	Excess Return		(0.67)	0.05	(3.12)	(3.12)	(2.74)	-	(2.61)
0UK00501	Total Fund Composite	2,827,449,976.51	1.57	3.46	8.73	8.73	8.29	8.81	7.27
	Total Composite Custom		1.56	3.61	9.73	9.73	10.50	10.26	8.89
	Excess Return		0.02	(0.15)	(1.00)	(1.00)	(2.21)	(1.45)	(1.62)

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Pension Fund Committee

15 March 2018

Investment of the Pension Fund's Cash Balances

John Hewitt, Corporate Director of Resources

Purpose of Report

1. To update the Committee of the Treasury Management service provided to the Pension Fund and to review the charges for the services and the calculation of interest on short term investments administered by Durham County Council (the Council) for 2018/19.

Background

2. The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (the 2009 Regulations) introduced changes which ended the use of Pension Fund money by the administering authority. (The 2009 Regulations have since been superseded by the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, however the same principle applies).

3. As a result of these regulations, a report was presented to the Pension Fund Committee in June 2010. At this meeting, the Committee gave its agreement to the Council continuing to invest the cash balances of the Pension Fund in line with the Council's Treasury Management Strategy and Annual Investment Strategy. This agreement is reviewed annually and the Council continues to invest the balances of the Pension Fund on its behalf.

4. The Council's Treasury Management Strategy (approved by Council annually each February) sets out the maximum amounts and time limits in respect of deposits which can be placed with each financial institution.

5. The Pension Fund's cash balances are invested along with the Council's cash balances at the most advantageous rate that can be achieved using approved counterparties.

6. Quarterly reports on the return on short term investments are presented to the Pension Fund Committee.

Administration of the Treasury Management Function

7. The Treasury Management team administer the cash balances of the Pension Fund in line with the Council's procedures.

8. The prime objective of the Council's investment strategy is to ensure prudent investment of surplus funds. The Council's investment priorities are therefore the security of capital, liquidity of investments and, within those objectives, to secure optimum performance.

9. The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration.

10. After this main principle, the Council will ensure that it:

    (i) maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security.

    (ii) has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

    (iii) maintains a counterparty list in compliance with the CIPFA Treasury Management Code of Practice and credit rating information supplied by the Council's Treasury Management advisers and will revise the criteria and submit them to the Council for approval as necessary.

11. The Treasury Management team review and monitor the Council's Treasury Management Strategy on behalf of the Council and implement it on behalf of the Pension Fund. The team also update counterparties in line with information supplied by the Council's Treasury Management Advisers.

12. The Council's treasury management team monitors the cash, the bank account balances and the cash codes for the Council and the Pension Fund and actions the necessary transfers and coding adjustments. The Pension Fund balance is corrected for any incorrect banking of funds prior to calculation of the interest on the cash balance.

13. The Treasury Management Team maintains full and accurate records in the performance of this service and makes them available for inspection by the Pension Fund Accounting Team, Internal and External Audit.

14. It is recommended that the charge for this service is increased slightly to the flat fee of £2,600 per quarter (for the last 4 years the fee remained at £2,500 per quarter).

Calculation of Interest on Cash Balances

15. The interest paid previously to the Pension Fund in respect of its cash balances was based upon the LIBID three month rate. It is recommended that for 2018/19 interest will be paid to the Pension Fund at the average three month rate of return earned by the Council on its own short term investments.

16. The choice of rate would however be subject to review by the Treasury Management team, to ensure an appropriate rate is applied.

Investments

17. It was also agreed by the Committee, that the Pension Fund's cash balances would be invested as part of the Council's overall investments.

18. As a result of this however, in the event of an investment being lost, for example due to the failure of a financial institution in which the cash is invested, the Council would be liable for the loss. This is due to the investment being in the name of the Council although the investment would include Pension Fund balances.

19. It was therefore agreed that the Pension Fund Committee share the risk of any investment in proportion to the value of cash balances at the time of investment. Any losses incurred as a result of impairment would then be split proportionately between the Council and the Pension Fund.

20. It is recommended that this arrangement continues.

Recommendations

21. It is recommended that, with effect from 1 April 2018:

    (i) the Pension Fund continues to invest its cash balances with the Council in line with the Council's Treasury Management Strategy;

    (ii) interest be paid quarterly to the Pension Fund at a rate based on the daily cash balance and the 3 month rate of return earned by the Council on its own short term investments;

    (iii) an administration fee of £2,600 per quarter be paid to the Council for Treasury Management services; and

    (iv) in the event of the loss of an investment, the Pension Fund will bear the loss in proportion of the value of cash balances held at the time of the investment with Durham County Council.

Background Papers

(a) Pension Fund Committee - 21 June 2010 - The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.

(b) Pension Fund Committee – 5 June 2017 - Investment of the Pension Fund's Cash Balances

(c) DCC's Treasury Management Strategy 2018/19 approved 21 February 2018.

(d) The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016

Contact: Beverley White Tel: 03000 261900

Pension Fund Committee

15 March 2018

Agreement of Accounting Policies for Application in the 2017/18 Financial Statements of the Pension Fund

John Hewitt, Corporate Director of Resources

Purpose of the Report

1. To inform the Pension Fund Committee of the accounting policies to be applied in the preparation of the 2017/18 Final Accounts and to seek confirmation from the Committee that appropriate policies are being applied.

Background

2. Although the Audit Committee have responsibility for the approval of the Statement of Accounts which contains the Pension Fund Accounts, the Pension Fund Committee ought to approve the Accounting Policies to be used in the preparation of those accounts.

Accounting Policies

3. It is a requirement of the Local Government Act 2003 and the Accounts and Audit (England) Regulations 2015 for the Statement of Accounts to be produced in accordance with proper accounting practices. The 'Code of Practice on Local Authority Accounting 2017/18' (the Code) as published by the Chartered Institute of Public Finance and Accountancy (CIPFA) incorporates these requirements and therefore must be followed in completing the Accounts.

4. Accounting policies are defined in the Code as *"the specific principles bases, conventions, rules and practices applied by an authority in preparing and presenting financial statements"*.

5. Accounting policies need not be applied if the effect of applying them would be immaterial. Materiality is defined in the Code as it applies to omissions and misstatements:

   Omissions or misstatements of items are material if they could, individually or collectively, influence the decisions or assessments of users made on the basis of the financial statements. Materiality depends on the nature or size of the omission or misstatement judged

in the surrounding circumstances. The nature or size of the item, or a combination of both, could be the determining factor.

6. The accounting policies applicable to the Pension Fund, in the main, relate to the valuation of assets held and the recognition of the contributions and benefits.

7. The proposed accounting policies are in line with those used in the preparation of the 2016/17 accounts and there have been no changes to the Code necessitating a change for 2017/18.

8. The full list of accounting policies for the Pension Fund that it is proposed to disclose in the Statement of Accounts notes is detailed in Appendix 1.

Recommendations

9. The Committee is recommended to:

- review the accounting policies;
- approve their use in the preparation of the 2017/18 financial statements for the Pension Fund; and
- authorise the Corporate Director of Resources to revise the accounting policies as necessary and report any significant changes to the Committee.

Contact: Beverley White Tel: 03000 261900

Appendix 1: Accounting Policies for 2017/18

Significant accounting policies

The accounting policies set out below will be applied consistently to all periods presented in the accounts. The accounts will be prepared on the accruals basis of accounting (except individual transfer values to and from the scheme, which are accounted for on a cash basis).

FUND ACCOUNT

Contributions receivable
Contribution income is categorised and recognised as follows:

- normal contributions, from both members and employers, are accounted for on an accruals basis;
- employers' augmentation contributions are accounted for in the year in which they become due;
- employers' deficit funding contributions are accounted for in the year in which they become due in accordance with the Rates and Adjustment Certificate set by the actuary or on receipt, if earlier than the due date.

Transfers to and from other schemes
Transfer values represent amounts paid to or received from other local and public authorities, private, occupational or personal pension schemes in respect of pension rights already accumulated by employees transferring from or to the participating authorities.

Individual transfer values paid and received are accounted for on a cash basis as the amount payable or receivable is not determined until payment is made and accepted by the recipient. Bulk (Group) transfers, both out and in, are accounted for in full in the year in which the transfer value is agreed by Durham County Council Pension Fund.

Pension benefits payable
Pension benefits are recognised and recorded in the accounting records and reported in the financial statements as an expense in the period to which the benefit relates. Any amounts due, but yet to be paid, are disclosed in the Net Assets Statement as current liabilities.

Management expenses
All management expenses, which include administrative expenses, investment management expenses and oversight and governance costs, are accounted for on an accruals basis.

All staffing and overhead costs of the pensions administration team are allocated to the Pension Fund as administrative expenses.

Fees of the external Investment Managers and Custodian are agreed in the respective mandates governing their appointments. Note 11 provides further information regarding the basis of Investment Managers' Fees. Where an Investment Manager's fee note has not been received by the balance sheet date, an estimate based upon the market value of their mandate as at the end of the financial year is used for inclusion in the Fund Account.

Oversight and governance costs include costs relating to the pension fund accounting team, which are apportioned on the basis of staff time spent on the Fund and include all associated overheads, plus legal, actuarial and investments advisory services.

Investment income
Investment income is accounted for as follows:

- income from equities is recognised in the fund account on the date stocks are quoted ex-dividend;
- income from fixed interest and index-linked securities, cash and short-term deposits is accounted for on an accruals basis;
- interest income is recognised in the fund account as it accrues;
- income from other investments is accounted for on an accruals basis;
- income from overseas investments is recorded net of any withholding tax where this cannot be recovered;
- foreign income has been translated into sterling at the date of the transactions, when received during the year, or at the exchange rates applicable on the last working day in March, where amounts were still outstanding at the year end;
- changes in the net market value of investments are recognised as income and comprise all realised and unrealised profits/ losses during the year.

Taxation
The Fund is a registered public service scheme under Section 1(1) of Schedule 36 of the Finance Act 2004 and as such is exempt from UK income tax on interest received and from capital gains tax on the proceeds of investments sold. Income from overseas investments suffers withholding tax in the country of origin, unless exemption is permitted. Irrecoverable tax would normally be accounted for as a fund expense as it arises, however when Investment Managers are not able to supply the necessary information, no taxation is separately disclosed in the Fund Account.

NET ASSETS STATEMENT

Valuation of Investments
Investments are included in the accounts at their fair value as at the reporting date. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

All prices in foreign currency are translated into sterling at the prevailing rate on the last working day of March.

An investment asset is recognised in the Net Assets Statement on the date the Fund becomes party to the contractual acquisition of the asset. From this date any gains or losses arising from changes to the fair value of the asset are recognised by the Fund.

The values of investments as shown in the Net Assets Statement have been determined as follows:

- Quoted equity securities, traded on an exchange, are accounted for on a bid market price basis, where Investment Managers provide valuations in this manner;

- Fixed interest securities, traded on an exchange, are accounted for at bid market price where Investment Managers provide valuations in this manner;

- Index linked securities are valued at bid market value where Investment Managers provide valuations in this manner;

- Unitised managed funds are valued at the closing bid price if bid and offer prices are reported by the relevant exchange and in the Investment Manager's valuation report. Single priced unitised managed funds are valued at the reported price;

- Unitised, unquoted managed property funds are valued at the net asset value adjusted for cash flows or a single price advised by the fund manager.

- Unquoted equity investments are accounted for on an estimated price of the investments held. Investment Managers use valuation techniques to establish a price at the year end date based on an arm's length exchange given normal business considerations;

- Derivative contracts outstanding at the year end are included in the Net Assets Statement at fair value (as provided by Investment Managers) and gains and losses arising are recognised in the Fund Account as at 31 March. The value of foreign currency contracts is based on market forward exchange rates at the reporting date; all other derivative contracts are valued using exchange prices at the reporting date.

Where Investment Managers are unable to supply investment valuations in line with the above policies, valuations will be included as supplied by the Investment Manager, usually at mid-market price.

Cash and Cash Equivalents
Cash comprises cash in hand and demand deposits. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash with insignificant risk of change in value.

Contingent Assets
A contingent asset arises where an event has taken place that gives a possible asset which will only be confirmed by the occurrence of uncertain future events not wholly within the control of the Pension Fund. Contingent assets are not recognised in the Net Assets Statement however details are disclosed in a Note within the accounts.

Investment transactions
Investment transactions arising up to 31 March but not settled until later are accrued in the accounts. All purchases and sales of investments in foreign currency are accounted for in sterling at the prevailing rate on the transaction date.

Acquisition costs of investments
Acquisition costs of investments are added to book cost at the time of purchase.

Financial liabilities
The Fund recognises financial liabilities at fair value as at the reporting date. A financial liability is recognised in the Net Assets Statement on the date the Fund becomes party to the liability. From this date any gains or losses arising from changes in the fair value of the liability are recognised by the Fund.

Actuarial present value of promised retirement benefits
The actual present value of promised retirement benefits is assessed on a triennial basis by the scheme actuary in accordance with the requirements of IAS 19 and relevant actuarial standards. As permitted under IAS 26 the Pension Fund has opted to disclose the actuarial present value of promised retirement benefits by way of a note to the accounts.

Additional Voluntary Contributions (AVCs)
The Fund provides an additional voluntary contribution (AVC) scheme for its members, the assets of which are invested separately from those of the Fund. In accordance with LGPS Regulations, AVCs are not recognised as income or assets in the Pension Fund Accounts, however a summary of the scheme and transactions are disclosed in a note to the accounts.

If, however, AVCs are used to purchase extra years' service from the Pension Fund, this is recognised as contribution income in the Fund's accounts on an accruals basis. Amounts received in this way can be found in a note in the accounts as additional contributions from members.

Pension Fund Committee

15 March 2018

Procedure for Reporting Breaches

Durham County Council

John Hewitt, Corporate Director Resources

Purpose of the Report

1. This report is to provide the Committee with a copy of the Council's Procedure for Reporting Breaches in relation to the Pension Fund, and to explain how it operates.

Background

2. There is a requirement for those with a role in administering or overseeing the Local Government Pension Scheme (LGPS) – including Committee members, Local Pension Board members and officers – to report breaches of the law to the Pensions Regulator when they have reasonable cause to believe a breach of 'material signficance' has occurred.

3. The Council has set out a procedure (enclosed at Appendix A) which explains when and how breaches or suspected breaches should be reported and recorded. The procedure takes into account the guidance on the subject provided by the Pensions Regulator.

Procedure for Reporting Breaches

4. Individuals with a role in the LGPS have a duty to report breaches of law when they have reasonable cause to believe that:

   - A legal duty relevant to the administration of the scheme has not been, or is not being, complied with; and

   - The failure to comply is likely to be of material significance to the Pensions Regulator.

5. Breaches can potentially take place in relation to a wide variety of tasks associated with the administering a pension scheme such as record keeping, internal controls and benefit calculation, as well as making decisions relating to investments.

6. In line with guidance issued by the Pensions Regulator, the Council has developed a policy and procedure for ensuring those responsible for reporting can identify, assess and report (or record if not reported) a breach of law relating to the Pension Fund. The guidance includes examples of potential breaches and a flowchart showing the process to following in determining whether to report or merely record a suspected breach.

7. The procedure also includes an example breaches record. Future Committee meetings (and Local Pension Board meetings) will be provided with updates on the breaches record.

Recommendations

8. That the Committee notes this report including the attached Reporting Breaches Procedure.

Contact:	**Nick Orton**	**Tel:**	**03000 269798**

APPENDIX A

Durham County Council Pension Fund

Reporting Breaches Procedure

1. Introduction

1.1 This document sets out the procedure to be followed by certain persons involved with the Durham County Council Pension Fund ('the Pension Fund'), the Local Government Pension Scheme managed and administered by Durham County Council ('the Council') in relation to reporting breaches of the law to the Pensions Regulator.

1.2 Breaches can occur in relation to a range of tasks associated with the administrative function of a pension scheme such as keeping records, internal controls, calculating benefits and making investment or investment-related decisions.

1.3 This procedure applies to:

- The scheme manager (the Council in its role as administering authority to the Pension Fund)
- all members of the Council's Local Pension Board;
- all members of the Council's Pension Fund Committee
- all Council officers involved in the administration or management of the Pension Fund;
- any professional advisers including auditors, actuaries, legal advisers and fund managers;
- officers of employers participating Pension Fund who are responsible for pension matters; and
- any person otherwise involved in advising the Council in relation to the Pension Fund.

2. Requirements

2.1 This section clarifies the full extent of the legal requirements and to whom they apply.

2.2 Pensions Act 2004

Section 70 of the Pensions Act 2004 (the Act) imposes a requirement on the following persons:

- a trustee or manager of an occupational or personal pension scheme;
- a person who is otherwise involved in the administration of such a scheme;
- the employer in relation to an occupational pension scheme;
- a professional adviser in relation to such a scheme;

- a person who is otherwise involved in advising the trustees or managers of an occupational or personal pension scheme in relation to the scheme

to report a matter to The Pensions Regulator as soon as reasonably practicable where that person has reason to believe that:

a) a legal duty relating to the administration of the scheme has not been or is not being complied with, and
b) the failure to comply is likely to be of material significance to The Pensions Regulator.

The Act states that a person can be subject to a civil penalty if he or she fails to comply with this requirement without a reasonable excuse. The duty to report breaches under the Act overrides any other duties the individuals listed above may have. However the duty to report does not override 'legal privilege'. This means that, generally, communications between a professional legal adviser and their client, or a person representing their client, in connection with legal advice being given to the client, do not have to be disclosed.

2.3 The Pension Regulator's Code of Practice

Practical guidance in relation to this legal requirement is included in The Pension Regulator's Code of Practice including in the following areas:

- implementing adequate procedures.
- judging whether a breach must be reported.
- submitting a report to The Pensions Regulator.
- whistleblowing protection and confidentiality.

3 Reporting Breaches Procedure

The following procedure details how individuals responsible for reporting and whistleblowing can identify, assess and report (or record if not reported) a breach of law relating to the Pension Fund. It aims to ensure individuals responsible are able to meet their legal obligations, avoid placing any reliance on others to report. The procedure will also assist in providing an early warning of possible malpractice and reduce risk.

3.1 Clarification of the law

Individuals may need to refer to regulations and guidance when considering whether or not to report a possible breach. Some of the key provisions are shown below:

- Section 70(1) and 70(2) of the Pensions Act 2004:
- http://www.legislation.gov.uk/ukpga/2004/35/section/70
- Employment Rights Act 1996: www.legislation.gov.uk/ukpga/1996/18/contents

- Occupational and Personal Pension Schemes (Disclosure of Information) Regulations 2013 (Disclosure Regulations): www.legislation.gov.uk/uksi/2013/2734/contents/made
- Public Service Pension Schemes Act 2013: www.legislation.gov.uk/ukpga/2013/25/contents
- Local Government Pension Scheme Regulations (various): http://www.lgpsregs.org/timelineregs/Default.html (pre 2014 schemes) http://www.lgpsregs.org/index.php/regs-legislation (2014 scheme)
- The Pensions Regulator's Code of Practice: http://www.thepensionsregulator.gov.uk/codes/code-governance-administration-public-service-pension-schemes.aspx
  In particular, individuals should refer to the section on 'Reporting breaches of the law', and for information about reporting late payments of employee or employer contributions, the section of the code on 'Maintaining contributions'.

Further guidance and assistance can be provided by the Council's Pensions Manager provided that requesting this assistance will not result in alerting those responsible for any serious offence (where the breach is in relation to such an offence).

3.2 Clarification when a breach is suspected

Individuals need to have reasonable cause to believe that a breach has occurred, not just a suspicion. Where a breach is suspected the individual should carry out further checks to confirm the breach has occurred. Where the individual does not know the facts or events, it will usually be appropriate to check with the Council's Corporate Director of Resources or Pensions Manager, a member of the Pension Fund Committee or Local Pension Board or others who are able to explain what has happened. However there are some instances where it would not be appropriate to make further checks, for example, if the individual has become aware of theft, suspected fraud or another serious offence and they are also aware that by making further checks there is a risk of either alerting those involved or hampering the actions of the police or a regulatory authority. In these cases The Pensions Regulator should be contacted without delay.

If the suspected breach relates to potential fraud within an organisation, individuals should also be aware of any procedures relating to fraud that they should follow within their organisation and consider whether the breach should also be reported under those procedures. If the suspected breach relates to a possible data breach within an organisation, individuals should consider whether they also need to follow the data breach policy within their organisation.

3.3 Determining whether the breach is likely to be of material significance

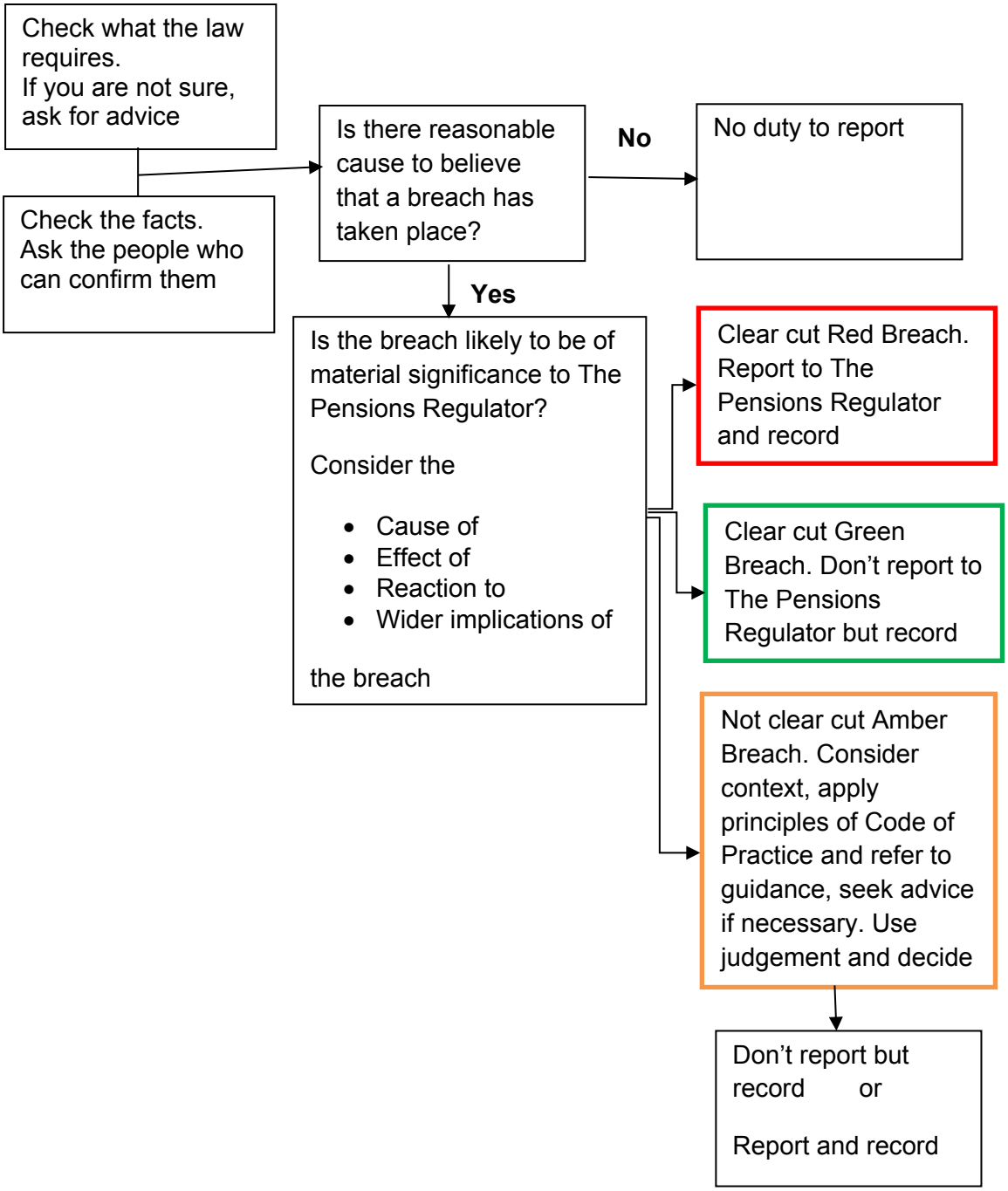
To decide whether a breach is likely to be of material significance an individual should consider the following, both separately and collectively:

- cause of the breach (what made it happen);
- effect of the breach (the consequence(s) of the breach);
- reaction to the breach; and

- wider implications of the breach.

Further details on the above four considerations are provided in Appendix A to this procedure. Individuals should use the traffic light framework described in Appendix B to help assess the material significance of each breach and to formally support and document their decision.

3.4 A decision tree is provided below to show the process for deciding whether or not a breach has taken place and whether it is materially significant and therefore requires to be reported.



3.5 Referral to a level of seniority for a decision to be made on whether to report

The Council's Pensions Manager is designated to ensure this procedure is appropriately followed as they have appropriate experience to help investigate whether there is reasonable cause to believe a breach has occurred, to check the law and facts of the case, to maintain records of all breaches and to assist in any reporting to The Pensions Regulator, where appropriate. If breaches relate to late or incorrect payment of contributions or pension benefits, the matter should be highlighted to the Pensions Manager at the earliest opportunity to ensure the matter is resolved as a matter of urgency. Individuals must bear in mind, however, that the involvement of the Pensions Manager is to help clarify the potential reporter's thought process and to ensure this procedure is followed. The reporter remains responsible for the final decision as to whether a matter should be reported to The Pensions Regulator.

The matter should not be referred to any officer if doing so will alert any person responsible for a possible serious offence to the investigation (as highlighted in section 2). If that is the case, the individual should report the matter to The Pensions Regulator setting out the reasons for reporting, including any uncertainty – a telephone call to the Regulator before the submission may be appropriate, particularly in more serious breaches.

3.6 Dealing with complex cases

The Council's Corporate Director of Resources or Monitoring Officer may be able to provide guidance on particularly complex cases. Information may also be available from national resources such as the Scheme Advisory Board or the LGPC Secretariat (part of the LG Group - http://www.lgpsregs.org/). If timescales allow, legal advice or other professional advice can be sought and the case can be discussed at the next Resources Management Team, Local Pension Board or Pension Fund Committee meeting.

3.7. Timescales for reporting

The Pensions Act and Pension Regulator's Code of Practice require that if an individual decides to report a breach, the report must be made in writing as soon as reasonably practicable. Individuals should not rely on waiting for others to report, nor is it necessary for a reporter to gather all the evidence which The Pensions Regulator may require before taking action. A delay in reporting may exacerbate or increase the risk of the breach. The time taken to reach the judgements on "reasonable cause to believe" and on "material significance" should be consistent with the speed implied by 'as soon as reasonably practicable'. In particular, the time taken should reflect the seriousness of the suspected breach.

3.8 Early identification of very serious breaches

In cases of immediate risk to the scheme, for instance, where there is any indication of dishonesty, The Pensions Regulator does not expect reporters to seek an explanation or to assess the effectiveness of proposed remedies. They should only make such immediate checks as are necessary. The more serious the potential breach and its consequences, the more urgently reporters should make these necessary checks. In cases of potential dishonesty the reporter should avoid, where possible, checks which might alert those implicated. In serious cases, reporters should use the quickest means possible to alert The Pensions Regulator to the breach.

3.9 Recording all breaches even if they are not reported

The record of past breaches may be relevant in deciding whether to report a breach (for example it may reveal a systemic issue). The Council will maintain a record of all breaches identified by individuals and reporters should therefore provide copies of reports to the Pensions Manager. Records of unreported breaches should also be provided as soon as reasonably practicable and certainly no later than within 20 working days of the decision made not to report. These will be recorded alongside all reported breaches. The record of all breaches (reported or otherwise) reported to the next Local Pension Board and Pension Fund Committee meeting.

3.10 Reporting a breach

Reports must be submitted in writing via The Pensions Regulator's online system at www.tpr.gov.uk/exchange, or by post (The Information Team, The Pensions Regulator, Napier House, Trafalgar Place, Brighton, BN1 4DW) or email wb@tpr.gov.uk and should be marked urgent if appropriate. If necessary, a written report can be preceded by a telephone call. Reporters should ensure they receive an acknowledgement for any report they send to The Pensions Regulator. The Pensions Regulator will acknowledge receipt of all reports within five working days and may contact reporters to request further information. Reporters will not usually be informed of any actions taken by The Pensions Regulator due to restrictions on the disclosure of information.

As a minimum, individuals reporting should provide:

- full scheme name (Durham County Council Pension Fund);
- description of breach(es);
- any relevant dates;
- name, position and contact details;
- role in connection to the scheme; and
- employer name or name of scheme manager (the scheme manager is Durham County Council)

If possible, reporters should also indicate:

- the reason why the breach is thought to be of material significance to The Pensions Regulator;
- scheme address (Durham County Council Pension Fund, County Hall, Durham, DH1 5UE)
- scheme manager contact details (postal address as above, telephone 03000 269798, email: pensions@durham.gov.uk)
- pension scheme registry number (10079166)
  and
- whether the breach has been reported before.

The reporter should provide further information or reports of further breaches if this may help The Pensions Regulator in the exercise of its functions. The Pensions Regulator may make contact to request further information.

3.11 **Confidentiality**

If requested, The Pensions Regulator will do its best to protect a reporter's identity and will not disclose information except where it is lawfully required to do so. If an individual's employer decides not to report and the individual employed by them disagrees with this and decides to report a breach themselves, they may have protection under the Employment Rights Act 1996 if they make an individual report in good faith.

3.12 **Reporting to the Pension Fund Committee and Local Pension Board**

A report will be presented to the Pension Fund Committee and Local Pension Board setting out:

- all breaches, including those reported to The Pensions Regulator and those unreported, with the associated dates;
- in relation to each breach, details of what action was taken and the result of any action (where not confidential);
- any future actions for the prevention of the breach in question being repeated; and
- highlighting new breaches which have arisen in the last year/since the previous meeting.

This information will also be provided upon request by any other individual or organisation (excluding sensitive/confidential cases or ongoing cases where discussion may influence the proceedings). An example of the information to be included in the quarterly reports is provided in Appendix C to this procedure.

3.13 **Review**

This Reporting Breaches Procedure will be kept under review and updated as considered appropriate. It may be changed as a result of legal or regulatory changes, evolving best practice and ongoing review of the effectiveness of the procedure.

Appendix A

1. Determining whether a breach is likely to be of material significance

1.1 To decide whether a breach is likely to be of material significance individuals should consider the following elements, both separately and collectively:

- cause of the breach (what made it happen);
- effect of the breach (the consequence(s) of the breach);
- reaction to the breach; and
- wider implications of the breach.

2. The cause of the breach

2.1 Examples of causes which are likely to be of concern to The Pensions Regulator are provided below:

- acting, or failing to act, in deliberate contravention of the law;
- dishonesty;
- incomplete or inaccurate advice;
- poor administration, i.e. failure to implement adequate administration procedures;
- poor governance; or
- slow or inappropriate decision-making practices.

2.2 When deciding whether a cause is likely to be of material significance individuals should also consider:

- whether the breach has been caused by an isolated incident such as a power outage, fire, flood or a genuine one-off mistake.
- whether there have been any other breaches (reported to The Pensions Regulator or not) which when taken together may become materially significant.

3. The effect of the breach

3.1 Examples of the possible effects (with possible causes) of breaches which are considered likely to be of material significance to The Pensions Regulator in the context of the LGPS are given below:

- Pension Fund Committee or Local Pension Board members not having enough knowledge and understanding, resulting in pension boards not fulfilling their roles, the scheme not being properly governed and administered and/or scheme managers breaching other legal requirements.

- Conflicts of interest of Pension Fund Committee or Local Pension Board members, resulting in them being prejudiced in the way in which they

carry out their role and/or the ineffective governance and administration of the scheme and/or scheme managers breaching legal requirements.

- Poor internal controls, leading to schemes not being run in accordance with their scheme regulations and other legal requirements, risks not being properly identified and managed and/or the right money not being paid to or by the scheme at the right time.
- Inaccurate or incomplete information about benefits and scheme information provided to members, resulting in members not being able to effectively plan or make decisions about their retirement.
- Poor member records held, resulting in member benefits being calculated incorrectly and/or not being paid to the right person at the right time.
- Misappropriation of assets, resulting in scheme assets not being safeguarded.
- Other breaches which result in the scheme being poorly governed, managed or administered.

4. The reaction to the breach

4.1 A breach is likely to be of concern and material significance to The Pensions Regulator where a breach has been identified and those involved:

- do not take prompt and effective action to remedy the breach and identify and tackle its cause in order to minimise risk of recurrence;
- are not pursuing corrective action to a proper conclusion; or
- fail to notify affected scheme members where it would have been appropriate to do so.

5. The wider implications of the breach

5.1 Reporters should also consider the wider implications when deciding whether a breach must be reported. The breach is likely to be of material significance to The Pensions Regulator where the fact that a breach has occurred makes it more likely that further breaches will occur within the Fund or, if due to maladministration by a third party, further breaches will occur in other pension schemes.

6. Examples of breaches

Example 1

An employer is late in paying over employee and employer contributions, and so late that the employer is in breach of the statutory period for making such payments. The employer is contacted by officers from the administering authority, and immediately makes the payment that is overdue, as well as improving its procedures so that in future contributions are paid over on time. In this instance there has been a breach but members have not been adversely affected and the employer has put its house in order regarding future payments.

The breach is therefore not material to The Pensions Regulator and need not be reported but it will be recorded.

Example 2
An employer is late in paying over employee and employer contributions, and so late that it is in breach of the statutory period for making such payments. The employer is also late in paying Additional Voluntary Contributions (AVCs) to the AVC provider (Prudential or Standard Life). The employer is contacted by officers from the administering authority, and it eventually pays the moneys that are overdue, including AVCs. This has happened before, with there being no evidence that the employer is putting its house in order. In this instance there has been a breach that is relevant to The Pensions Regulator, in part because of the employer's repeated failures, and also because those members paying AVCs will typically be adversely affected by the delay in the investing of their AVCs.

The breach is therefore material to The Pensions Regulator and needs to be reported and recorded.

Example 3
An employer is late in submitting its statutory year end return of pay and contributions in respect of each of its active members and as such it is in breach. Despite repeated reminders the employer still does not supply its year end return. Because the administering authority does not have the year end data it is unable to supply, by 31 August, annual benefit statements to the employer's members. In this instance there has been a breach which is relevant to The Pensions Regulator, in part because of the employer's failures, in part because of the enforced breach by the administering authority, and also because members are being denied their annual benefits statements.

The breach is therefore material to The Pensions Regulator and needs to be reported and recorded.

Example 4
A member of the Pension Fund Committee owns a property. A report is made to the Pension Fund Committee about a possible investment by the Fund, in the same area in which the member's property is situated. The member supports the investment but does not declare an interest and is later found to have materially benefitted when the Fund's investment proceeds. In this case a material breach has arisen, not because of the conflict of interest, but rather because the conflict was not reported.

The breach is therefore material to The Pensions Regulator and needs to be reported and recorded.

Example 5
A pension overpayment is discovered and thus the administering authority has failed to pay the right amounts to the right person at the right time. A

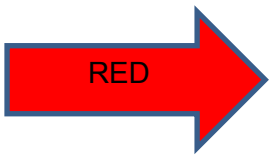
breach has therefore occurred. The overpayment is however for a modest amount and the pensioner could not have known that (s)he was being overpaid. The overpayment is therefore waived. In this case there is no need to report the breach as it is not material.

The breach is therefore not material to The Pensions Regulator and need not be reported but it will be recorded.

Appendix B

Traffic light framework for deciding whether or not to report

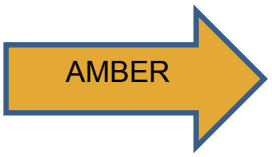
It is recommended that those responsible for reporting use the traffic light framework when deciding whether to report to The Pensions Regulator. This is illustrated below:



Where the cause, effect, reaction and wider implications of a breach, when considered together, are likely to be of material significance.

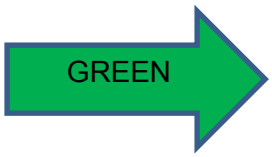
These must be reported to The Pensions Regulator.

Example: Several members' benefits have been calculated incorrectly. The errors have not been recognised and no action has been taken to identify and tackle the cause or to correct the errors.



Where the cause, effect, reaction and wider implications of a breach, when considered together, may be of material significance. They might consist of several failures of administration that, although not significant in themselves, have a cumulative significance because steps have not been taken to put things right. You will need to exercise your own judgement to determine whether the breach is likely to be of material significance and should be reported.

Example: Several members' benefits have been calculated incorrectly. The errors have been corrected, with no financial detriment to the members. However the breach was caused by a system error which may have wider implications for other public service schemes using the same system.



Where the cause, effect, reaction and wider implications of a breach, when considered together, are not likely to be of material significance. These should be recorded but do not need to be reported.

Example: A member's benefits have been calculated incorrectly. This was an isolated incident, which has been promptly identified and corrected, with no financial detriment to the member. Procedures have been put in place to mitigate against this happening again.

All breaches should be recorded even if the decision is not to report.

When using the traffic light framework individuals should consider the content of the red, amber and green sections for each of the cause, effect, reaction and wider implications of the breach, before you consider the four together. Some useful examples of this is framework is provided by The Pensions Regulator at the following link:

http://www.thepensionsregulator.gov.uk/codes/code-related-report-breaches.aspx

Appendix C

Example Record of Breaches

Date	Category (e.g. administration, contributions, funding, investment, criminal activity)	Description and cause of breach	Possible effect of breach and wider implications	Reaction of relevant parties to breach	Reported / Not reported (with justification if not reported and dates)	Outcome of report and/or investigations	Outstanding actions

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Pension Fund Committee

15 March 2018

Internal Audit Plan 2018/2019

Report of Paul Bradley, Chief Internal Auditor & Corporate Fraud Manager

Purpose of the report

1 To present the proposed Annual Audit Plan for 2018/19 for approval.

Background

2 The Public Sector Internal Audit Standards (PSIAS), which came into effect from April 2013, define internal audit as, "an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes."

3 The agreed terms of reference for the internal audit service to fulfil this objective are detailed in the Internal Audit Charter.

2018/19 Audit Plan

4 The Audit Plan for 2018/19 has been developed following discussions between officers from Internal Audit and officers who have responsibility for the Pension Fund, using the strategic audit plan as the basis of the discussion. The proposed plan is shown in the table below.

Audit Title	Audit Type
Pension System ICT Controls, Data Quality and Performance	Assurance
Transfers in/out	Assurance
Additional Voluntary Contributions (Follow Up)	Assurance
Governance Arrangements	Assurance
Bank reconciliation	Assurance
Debt Recovery	Assurance
National Fraud Initiative – Identification of potential error/fraud	Counter Fraud
Management time and ad hoc advice	Advice and Consultancy

Recommendation

5 Members are asked to approve the proposed audit plan for 2018/19.

Contact: Paul Monaghan Tel: 03000 269662

Appendix 1: Implications

Finance

The audit fee for the 2018/19 internal audit plan, to be delivered by the DCC Internal Audit Service, which is chargeable direct to the Pension Fund, remains the same as 2017/18 at £19,500.

Staffing

None

Risk

None

Equality and Diversity/Public Sector Equality Duty

None

Accommodation

None

Crime and disorder

None

Human rights

None

Consultation

None

Procurement

None

Disability Issues

None

Legal Implications

None

Agenda Item 11

Audit Strategy Memorandum

Durham County Council Pension Fund

Year ending 31 March 2018

MAZARS

CONTENTS

Mazars LLP
Salvus House
Aykley Heads
Durham
DH1 5TS

Audit Committee
Durham County Council
County Hall
Durham
DH1 5UQ

February 2018

Dear Audit Committee Members

Audit Strategy Memorandum – Year ending 31 March 2018

We are pleased to present our Audit Strategy Memorandum for Durham County Council Pension Fund (the Fund) for the year ending 31 March 2018.

The purpose of this document is to summarise our audit approach, highlight significant audit risks and areas of key judgements and provide you with the details of our audit team. As it is a fundamental requirement that an auditor is, and is seen to be, independent of its clients, Section 6 of this document also summarises our considerations and conclusions on our independence as auditors.

We consider two-way communication with you to be key to a successful audit and important in:

- reaching a mutual understanding of the scope of the audit and the responsibilities of each of us;
- sharing information to assist each of us to fulfil our respective responsibilities;
- providing you with constructive observations arising from the audit process; and
- ensuring that we, as external auditors, gain an understanding of your attitude and views in respect of the internal and external operational, financial, compliance and other risks facing the Fund which may affect the audit, including the likelihood of those risks materialising and how they are monitored and managed.

This document, which has been prepared following our initial planning discussions with management, is the basis for discussion of our audit approach, and any questions or input you may have on our approach or role as auditor.

This document also contains specific appendices that outline our key communications with you during the course of the audit, and forthcoming accounting issues and other issues that may be of interest.

Client service is extremely important to us and we strive to continuously provide technical excellence with the highest level of service quality, together with continuous improvement to exceed your expectations so, if you have any concerns or comments about this document or audit approach, please contact me on 0191 383 6300.

Yours faithfully

{{_es_:signer1:signature }}

Mark Kirkham

Mazars LLP

MAZARS

1. ENGAGEMENT AND RESPONSIBILITIES SUMMARY

Overview of engagement

We are appointed to perform the external audit of Durham County Council Pension Fund for the year to 31 March 2018. The scope of our engagement is set out in the Statement of Responsibilities of Auditors and Audited Bodies, issued by Public Sector Audit Appointments Ltd (PSAA) available from the PSAA website: www.psaa.co.uk/audit-quality/terms-of-appointment/

Our responsibilities

Our responsibilities are principally derived from the Local Audit and Accountability Act 2014 (the 2014 Act) and the Code of Audit Practice issued by the National Audit Office (NAO), as outlined below.

Audit opinion

We are responsible for forming and expressing an opinion on the financial statements.

Our audit is planned and performed so to provide reasonable assurance that the financial statements are free from material error and give a true and fair view of the financial performance and position of the Fund for the year.

Consistency report

We are also required to form and express an opinion on the consistency of the Pension Fund financial statements within the Pension Fund Annual Report with the Pension Fund financial statements in the Statement of Accounts of Durham County Council.

We review the financial statements and other information contained in the Pension Fund Annual Report.

Electors' rights

The 2014 Act requires us to give an elector, or any representative of the elector, the opportunity to question us about the accounting records of the Council and consider any objection made to the accounts. This would include an objection made to the accounts of the Fund included in the administering authority's financial statements We also have a broad range of reporting responsibilities and powers that are unique to the audit of local authorities in the United Kingdom.

Our audit does not relieve management or the Audit Committee, as those charged with governance, of their responsibilities. The responsibility for safeguarding assets and for the prevention and detection of fraud, error and non-compliance with law or regulations rests with both those charged with governance and management. In accordance with International Standards on Auditing (UK), we plan and perform our audit so as to obtain reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. However our audit should not be relied upon to identify all such misstatements.

As part of our audit procedures in relation to fraud we are required to enquire of those charged with governance as to their knowledge of instances of fraud, the risk of fraud and their views on management controls that mitigate the fraud risks.

The Fund is required to prepare its financial statements on a going concern basis by the Code of Practice on Local Authority Accounting. As auditors, we are required to consider the appropriateness of the use of the going concern assumption in the preparation of the financial statements and the adequacy of disclosures made.

2. YOUR AUDIT ENGAGEMENT TEAM

- Mark Kirkham, Engagement Partner
- mark.kirkham@mazars.co.uk
- 0191 383 6300

- Sharon Liddle, Engagement Manager
- sharon.liddle@mazars.co.uk
- 0191 383 6311

- Daniel Reay, Engagement Team Leader
- daniel.reay@mazars.co.uk
- 0191 383 6346

In addition as outlined in our engagement pack an engagement quality control reviewer has been appointed for this engagement.

3. AUDIT SCOPE, APPROACH AND TIMELINE

Audit scope

Our audit approach is designed to provide an audit that complies with all professional requirements.

Our audit of the financial statements will be conducted in accordance with International Standards on Auditing (UK), relevant ethical and professional standards, our own audit approach and in accordance with the terms of our engagement. Our work is focused on those aspects of your business which we consider to have a higher risk of material misstatement, such as those affected by management judgement and estimation, application of new accounting standards, changes of accounting policy, changes to operations or areas which have been found to contain material errors in the past.

We will also review the financial statements and other information included in the Pension Fund Annual Report

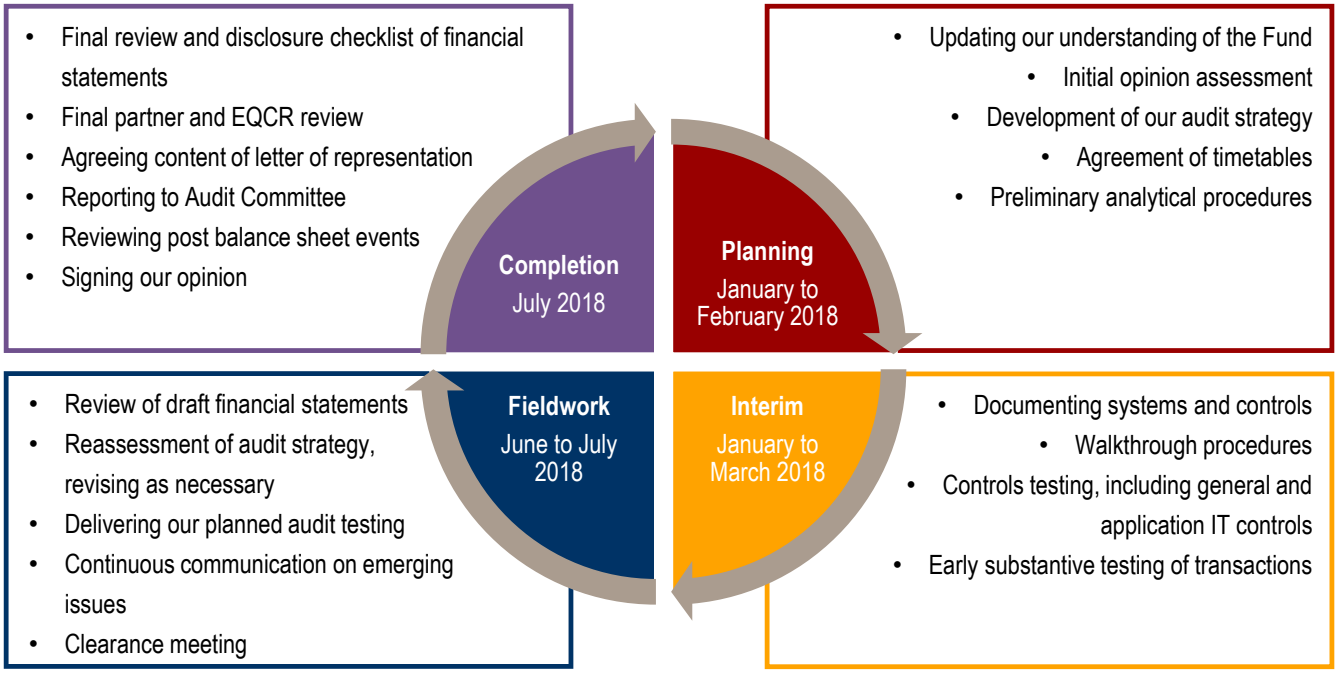
Audit approach

Our audit approach is a risk-based and primarily driven by the matters we consider could result in a higher risk of material misstatement of the financial statements. Once we have completed our risk assessment, we develop our audit strategy and design audit procedures in response to this assessment.

If we conclude that appropriately designed controls are in place then we may plan to test and rely upon these controls. If we decide controls are not appropriately designed, or we decide it would be more efficient to do so, we may take a wholly substantive approach to our audit testing. Substantive procedures are audit procedures designed to detect material misstatements at the assertion level and comprise tests of details (of classes of transactions, account balances, and disclosures) and substantive analytical procedures. Irrespective of the assessed risks of material misstatement, which take into account our evaluation of the operating effectiveness of controls, we are required to design and perform substantive procedures for each material class of transactions, account balance, and disclosure.

Our audit will be planned and performed so as to provide reasonable assurance that the financial statements are free from material misstatement and give a true and fair view. The concept of materiality and how we define a misstatement is explained in more detail in section 7.

The diagram below outlines the procedures we perform at the different stages of the audit.



3. AUDIT SCOPE, APPROACH AND TIMELINE (CONTINUED)

Reliance on internal audit

Where possible we will seek to utilise the work performed by internal audit to modify the nature, extent and timing of our audit procedures. We will meet with internal audit to discuss the progress and findings of their work prior to the commencement of our controls evaluation procedures.

Where we intend to rely on the work on internal audit, we will evaluate the work performed by your internal audit team and perform our own audit procedures to determine its adequacy for our audit.

Management's and our experts

Management makes use of experts in specific areas when preparing the Fund's financial statements. We also use experts to assist us to obtain sufficient appropriate audit evidence on specific items of account.

Items of account	Management's expert	Our expert
Disclosure notes on the funding arrangements and actuarial present value of promised retirement benefits.	Aon Hewitt	NAO Consulting actuary PWC
Financial instrument disclosures	Mercer Limited	None.

Service organisations

International Auditing Standards define service organisations as third party organisations that provide services to the Fund that are part of its information systems relevant to financial reporting. We are required to obtain an understanding of the services provided by service organisations as well as evaluating the design and implementation of controls over those services. The table below summarises the service organisations used by the Fund and our planned audit approach.

Items of account	Service organisation	Audit approach
Investment valuations and related disclosures	Investment managers	Substantive testing of in year transactions and valuations applied to investments at the year end.
Investment income and related disclosures	Custodian	

Reporting deadlines

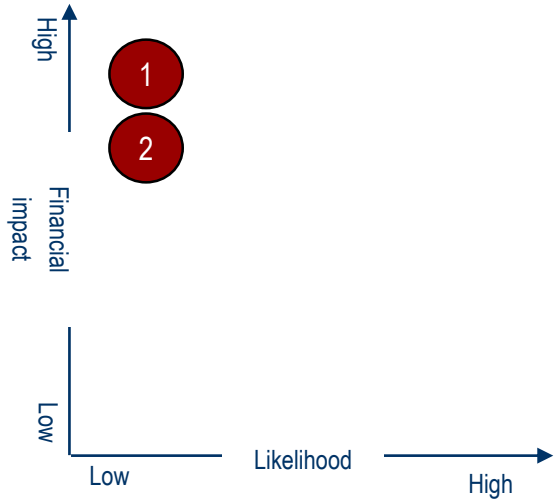
As we have previously discussed with the Audit Committee, the statutory timetable for the production and audit of the Fund's financial statements changes for 2017/18. The Fund is now required to produce accounts by 31 May 2018 (1 month earlier) and to publish audited accounts by 31 July 2018 (2 months earlier). For the year ended the 31 March 2017 the Fund successfully met the accounts production deadline of 31 May and the audit was substantially completed by 31 July 2017.

4. SIGNIFICANT RISKS AND KEY JUDGEMENT AREAS

Following the risk assessment approach discussed in section 3 of this document, we have identified relevant risks to the audit of financial statements. The risks that we identify are categorised as significant, enhanced or standard, as defined below:

Significant risk	A significant risk is an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration. For any significant risk, the auditor shall obtain an understanding of the entity's controls, including control activities relevant to that risk.
Enhanced risk	An enhanced risk is an area of higher assessed risk of material misstatement ('RMM') at audit assertion level other than a significant risk. Enhanced risks incorporate but may not be limited to: • key areas of management judgement, including accounting estimates which are material but are not considered to give rise to a significant risk of material misstatement; and • other audit assertion risks arising from significant events or transactions that occurred during the period.
Standard risk	This is related to relatively routine, non-complex transactions that tend to be subject to systematic processing and require little management judgement. Although it is considered that there is a risk of material misstatement (RMM), there are no elevated or special factors related to the nature, the likely magnitude of the potential misstatements or the likelihood of the risk occurring.

The summary risk assessment, illustrated in the audit risk continuum below, highlights those risks which we deem to be significant.. We have summarised our audit response to these risks on the next page.



Risk	
1	Management override of control
2	Valuation of unquoted investments

4. SIGNIFICANT RISKS AND KEY JUDGEMENT AREAS (CONTINUED)

We provide more detail on the identified risks and our testing approach with respect to significant risks in the table below. An audit is a dynamic process, should we change our view of risk or approach to address the identified risks during the course of our audit, we will report this to the Audit Committee.

Significant risks

	Description of risk	Planned response
1	**Management override of controls** Management at various levels within an organisation are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Due to the unpredictable way in which such override could occur there is a risk of material misstatement due to fraud on all audits.	We plan to address the management override of controls risk through performing audit work over accounting estimates, journal entries and significant transactions outside the normal course of business or otherwise unusual.
2	**Valuation of unquoted investments for which a market price is not readily available** As at 31 March 2017 the fair value of investments which were not quoted on an active market was £165.5m, which accounted for 6.2 per cent of net investment assets. The values used in the accounts are those provided by fund managers which are based on Net Asset Value statements. This results in an increased risk of material misstatement.	In addition to our standard program of work we will: • agree holdings from fund manager reports to the global custodian's report; • agree the valuation to supporting documentation including investment manager valuation statements and cashflows for any adjustments made to the investment manager valuation; • agree the investment manager valuation to audited accounts. Where these are not available, agree the investment manager valuation to other independent supporting documentation; • where audited accounts are available, check that they are supported by a clear opinion; and • agree the price to independent evidence, for those valuations not supported by valuation statements.

Key areas of management judgement

Key areas of management judgement include accounting estimates which are material but are not considered to give rise to a significant risk of material misstatement. We have not identified any such judgements.

5. FEES FOR AUDIT AND OTHER SERVICES

Fees for work as the Fund's appointed auditor

At this stage of the audit we are not planning any divergence from the scale fees set by PSAA as communicated in our fee letter of 24 April 2017.

Service	2016/17 fee	2017/18 fee
Code audit work	£25,918	£25,918

Fees for non-PSAA work

We have not been engaged by the Fund to carry out additional work.

6. OUR COMMITMENT TO INDEPENDENCE

We are committed to independence and are required by the Financial Reporting Council to confirm to you at least annually, in writing, that we comply with the Financial Reporting Council's Ethical Standard. In addition, we communicate any matters or relationship which we believe may have a bearing on our independence or the objectivity of the audit team.

Based on the information provided by you and our own internal procedures to safeguard our independence as auditors, we confirm that in our professional judgement there are no relationships between us and any of our related or subsidiary entities, and you and your related entities creating any unacceptable threats to our independence within the regulatory or professional requirements governing us as your auditors.

We have policies and procedures in place which are designed to ensure that we carry out our work with integrity, objectivity and independence. These policies include:

- all partners and staff are required to complete an annual independence declaration;
- all new partners and staff are required to complete an independence confirmation and also complete computer-based ethical training;
- rotation policies covering audit engagement partners and other key members of the audit team;
- use by managers and partners of our client and engagement acceptance system which requires all non-audit services to be approved in advance by the audit engagement partner.

We confirm, as at the date of this document, that the engagement team and others in the firm as appropriate, and Mazars LLP are independent and comply with relevant ethical requirements. However, if at any time you have concerns or questions about our integrity, objectivity or independence please discuss these with Mark Kirkham in the first instance.

Prior to the provision of any non-audit services Mark will undertake appropriate procedures to consider and fully assess the impact that providing the service may have on our auditor independence.

7. MATERIALITY AND MISSTATEMENTS

Definitions
Materiality is an expression of the relative significance or importance of a particular matter in the context of financial statements as a whole. Misstatements in financial statements are considered to be material if they, individually or in aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Summary of initial materiality thresholds

Threshold	Initial threshold (£'000s)
Overall materiality	27,690
Specific materiality: Fund Account	15,750
Trivial threshold for errors to be reported to the Audit Committee	831

Materiality
Judgements on materiality are made in light of surrounding circumstances and are affected by the size and nature of a misstatement, or a combination of both. Judgements about materiality are based on consideration of the common financial information needs of users as a group and not on specific individual users.

The assessment of what is material is a matter of professional judgement and is affected by our perception of the financial information needs of the users of the financial statements. In making our assessment we assume that users:

- have a reasonable knowledge of business, economic activities and accounts;
- have a willingness to study the information in the financial statements with reasonable diligence;
- understand that financial statements are prepared, presented and audited to levels of materiality;
- recognise the uncertainties inherent in the measurement of amounts based on the use of estimates, judgement and the consideration of future events; and
- will make reasonable economic decisions on the basis of the information in the financial statements.

We consider materiality whilst planning and performing our audit based on quantitative and qualitative factors.

Whilst planning, we make judgements about the size of misstatements which we consider to be material and which provides a basis for determining the nature, timing and extent of risk assessment procedures, identifying and assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures.

The materiality determined at the planning stage does not necessarily establish an amount below which uncorrected misstatements, either individually or in aggregate, will be considered as immaterial.

We revise materiality for the financial statements as our audit progresses should we become aware of information that would have caused us to determine a different amount had we been aware of that information at the planning stage.

Our provisional materiality is set based on a benchmark of net assets. We will identify a figure for materiality but identify separate levels for procedures design to detect individual errors, and also a level above which all identified errors will be reported to the Audit Committee.

We consider that net assets remains the key focus of users of the financial statements and, as such, we base our materiality levels around this benchmark.

We expect to set a materiality threshold at 1% of net assets.

8. MATERIALITY AND MISSTATEMENTS (CONTINUED)

Based on investments reported to the Pension Fund Committee as at 30 September 2017, we anticipate the overall materiality for the year ending 31 March 2018 to be in the region of £27.69m. The materiality for the year ended 31 March 2017 was £11,415m, as a result of the application of a different materiality methodology as detailed below.

After setting initial materiality, we continue to monitor materiality throughout the audit to ensure that it is set at an appropriate level.

Misstatements

We aggregate misstatements identified during the audit that are other than clearly trivial. We set a level of triviality for individual errors identified (a reporting threshold) for reporting to the Audit Committee that is consistent with the level of triviality that we consider would not need to be accumulated because we expect that the accumulation of such amounts would not have a material effect on the financial statements. Based on our preliminary assessment of overall materiality, our proposed triviality threshold is £831,000 based on 3% of overall materiality. If you have any queries about this please do not hesitate to raise these with Mark Kirkham.

Change in materiality methodology

During 2017-18 we have reviewed and revised the materiality methodology for public sector pension funds. In prior years we applied one materiality figure to the financial statements which considered net assets, contributions receivable and benefits payable. The revised methodology calculates a financial statement materiality, but calculates a specific materiality for the fund accounts.

The impact of the revision is that the materiality applied to the net assets statement will be higher than in previous years. This is considered to be an appropriate level to give a reasonable assurance opinion that the financial statements are materially fairly stated. The table below compares the initial materiality for 2017-18 calculated using the revised methodology and what it would have been using then methodology applied in 2016-17.

Threshold	Revised 2018 methodology £'000s	2017 methodology £'000s
Net assets statement materiality	27,690	15,750
Fund account materiality	15,750	15,750
Trivial threshold for errors to be reported to the Audit Committee	831	473

APPENDIX A – KEY COMMUNICATION POINTS

ISA (UK) 260 'Communication with Those Charged with Governance', ISA (UK) 265 'Communicating Deficiencies In Internal Control To Those Charged With Governance And Management' and other ISAs (UK) specifically require us to communicate the following:

Required communication	Audit Strategy Memorandum	Audit Completion Report
Our responsibilities in relation to the audit of the financial statements and our wider responsibilities	✓	
Planned scope and timing of the audit	✓	
Significant audit risks and areas of management judgement	✓	
Our commitment to independence	✓	✓
Responsibilities for preventing and detecting errors	✓	
Materiality and misstatements	✓	✓
Fees for audit and other services	✓	
Significant deficiencies in internal control		✓
Significant findings from the audit		✓
Significant matters discussed with management		✓
Our conclusions on the significant audit risks and areas of management judgement		✓
Summary of misstatements		✓
Management representation letter		✓
Our proposed draft audit report		✓

APPENDIX B – FORTHCOMING ACCOUNTING AND OTHER ISSUES

Changes relevant to 2017/18

There are no significant changes to the Code of Practice on Local Authority Accounting (the Code) for 2017/18 in relation to pension funds. Minor changes to the Code include the requirement for a disclosure note on investment management transaction costs and clarification on the investment concentration disclosure.

Changes in future years

Accounting standard	Year of application	Implications
IFRS 9 – Financial Instruments	2018/19	The standard will replace IAS 39 and will introduce significant changes to the recognition and measurement of the Fund's financial instruments, particularly its financial assets. Although the accounting changes are complex and may require the reclassification of some instruments, it is likely that the Fund will continue to measure the majority of its financial assets at fair value.

The 2018/19 Code will apply the requirements of IFRS16 Leases and IFRS 15 Revenue from Contracts with Customers, but it is unlikely that this will have significant implications for most local government pension schemes.

Other issues - Pooling

As members are aware, pooling arrangements are required to be in place by 1 April 2018. Pooling will have a significant impact on the way that investments are managed and monitored. It is imperative that the Fund maintains strong governance arrangements both during and after the transition of investments.

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