

Annual governance report

Durham County Council Pension Fund

Audit 2010/11



Contents

- Key messages.....3**
 - Audit opinion and financial statements.....3
- Before I complete my audit.....4**
- Financial statements5**
 - Opinion on the financial statements5
 - Errors in the financial statements5
 - Quality of your financial statements8**
- Appendix 1 – Draft audit report9**
- Appendix 2 - Amendments to the draft financial statements13**
- Appendix 3 - Unadjusted misstatements to the financial statements15**
- Appendix 4 – Draft letter of representation.....17**
- Appendix 5 – Glossary.....20**

Traffic light explanation

Red  Amber  Green 

Key messages

This report summarises the findings from the 2010/11 audit which is substantially complete. It includes the messages arising from my audit of your financial statements.

	My findings
Unqualified audit opinion	●
Weaknesses in internal control	●

Audit opinion and financial statements

- Subject to the completion of my final review and audit closure procedures and completion of our review procedures on the Pension Fund Annual Report my audit is substantially complete.
- We will provide a verbal update to members of the Audit Committee with regard to these matters at the meeting on 29 September.
- Subject to the satisfactory resolution of these matters, and any matters raised by the Committee, I propose to give an unqualified audit opinion on the financial statements. I cannot issue my opinion

until the audit of the Council's main financial statements has been completed. This is because the pension fund statements form part of the Council's financial statements.

- The draft financial statements were submitted for audit by the due date, were substantially complete and were supported by good working papers in line with my expectations. They were free from material error except for the need for a £40m adjustment in Note 6 to both the purchase and sales of investments as noted in the table of adjustments in Appendix 2. There is no impact on either the Net Asset Statement or Fund Account.
- In addition, during the course of my audit I identified some missing or incomplete disclosures which officers have adjusted.
- Overall I have not identified any significant weaknesses in the pension fund's internal controls.

Before I complete my audit

I confirm to you

My report includes only matters of governance interest that have come to my attention in performing my audit. My audit is not designed to identify all matters that might be relevant to you.

Independence

I can confirm that I have complied with the Auditing Practices Board's ethical standards for auditors, including ES 1 (revised) - Integrity, Objectivity and Independence. I can also confirm there were no relationships resulting in a threat to independence, objectivity and integrity.

The Audit Commission's Audit Practice has not undertaken any non-audit work for the Fund during 2010/11.

I ask you to confirm to me

I ask the Audit Committee to:

- take note of the matters which are set out in this report; and
 - approve the letter of representation, provided alongside this report, on behalf of the Council and Fund before I issue my opinion.
-

Audit fees

I have completed my work on the pension fund audit within the planned fee of £42,500 reported in my opinion audit plan.

Financial statements

Subject to completion of my final review and audit closure procedures, I propose to give an unqualified opinion on the pension fund financial statements. The financial statements submitted for audit were free from material error. During the course of my audit I identified the need for one material amendment to Note 6 and also some disclosure matters that have now been adjusted.

Opinion on the financial statements

Subject to completion of my final review and audit closure procedures, I plan to issue an audit report including an unqualified opinion on the financial statements. Appendix 1 contains a copy of my draft report.

Errors in the financial statements

During the course of my audit I identified various amendments to the disclosures within the financial statements (further details are set out in the table on page 7). The Council has amended the pension fund financial statements for these errors.

Financial statements

The Pension Fund's financial statements are important means by which the Fund accounts for its stewardship of public funds. The Council has final responsibility for these statements. It is important that you consider my findings before you adopt the financial statements and the annual governance statement.

In planning my audit I identified risks and areas of judgement that I have considered as part of my audit.

Key audit risk and our findings

Key audit risk	Finding
<p>1. Transition to International Financial Reporting Standards</p> <p>The Council is required to prepare the 2010/11 pension fund financial statements according to International Financial Reporting Standards (IFRS), including a re-statement of 2009/10 balances where applicable.</p> <p>This poses a risk of material misstatement to the pension fund financial statements.</p>	<p>I have:</p> <ul style="list-style-type: none">■ reviewed the Council's approach to the implementation of IFRS; and■ tested the accounting entries and disclosures relating to IFRS. <p>The draft financial statements did include an opening net asset statement as at 1/4/2009 as required under IFRS, but some adjustments were needed and the Council has amended the pension fund financial statements for these.</p> <p>There were no other material differences to the pension fund's financial statements on transition to IFRS. I am satisfied that the pension fund financial statements have been properly compiled according to IFRS.</p>
<p>2. Disclosures in the financial statement</p> <p>In the previous year's draft pension fund financial statements, some of the disclosures required by the Statement of Recommended Practice (SoRP) were missing or incomplete.</p> <p>This poses a risk of incomplete disclosures in the 2010/11</p>	<p>I have reviewed the disclosures in the pension fund financial statements.</p> <p>The draft financial statements were submitted for audit were substantially complete, however disclosures were missing or incomplete in the following areas:</p> <ul style="list-style-type: none">■ accounting policies for Transfers In and Out, the valuation basis for Index Linked securities and unquoted pooled investment vehicles;

Key audit risk

pension fund financial statements.

Finding

- the notes to the accounts are unclear as to which investments are valued at bid, as required by IFRS, and which are valued at mid-market; and
- the note on estimates under accounting policies (note 2) was a little vague and made no reference to any specific estimates and judgments e.g. Fair Value of financial instruments, particularly private equity/unquoted investments if material and retirement benefits.

The Council has amended the pension fund financial statements for these items. I am now satisfied that the disclosures within the pension fund financial statements comply with requirements.

3. Working papers

In the previous year some working papers were not easy to follow and delays occurred in obtaining responses to some audit queries raised.

There is a risk that this could impact on the timely delivery and quality of the financial statements and a timely audit opinion.

I have reviewed the quality of the draft financial statements and associated working papers.

The draft financial statements were submitted for audit by the due date, were substantially complete and were supported by good working papers in line with my expectations and which were much improved from last year.

4. Actuarial revaluation

The pension fund is required to obtain an actuarial valuation of the whole of the fund as at 31 March 2010.

There is a risk that the details of the actuarial valuation are not fully disclosed in the pension fund financial statements.

I have reviewed the actuarial revaluation disclosures in the financial statements.

I am satisfied that the disclosures within the pension fund financial statements are consistent with the information set out in the actuarial revaluation reports.

Financial statements

Significant weaknesses in internal control

Overall I have not identified any significant weaknesses in internal control.

I am not expressing an opinion on the overall effectiveness of internal control. I have not provided a comprehensive statement of all weaknesses which may exist in internal control, or of all improvements which may be made. I have reported only those matters which have come to my attention because of the audit procedures I have performed.

Quality of your financial statements

I consider aspects of your accounting practices, accounting policies, accounting estimates and financial statements disclosures. Except for the matters regarding disclosures in the financial statements, as set out on page 7, there are no other issues I want to raise with you.

Letter of representation

Before I issue my opinion, auditing standards require me to ask you and management for written representations about your financial statements and governance arrangements. Appendix 4 contains the draft letter of representation.

Appendix 1 – Draft audit report

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF DURHAM COUNTY COUNCIL [DRAFT]

Opinion on the Authority and Group accounting statements

I have audited the Authority and Group accounting statements of Durham County Council for the year ended 31 March 2011 under the Audit Commission Act 1998. The Authority and Group accounting statements comprise the Authority and Group Movement in Reserves Statement, the Authority and Group Comprehensive Income and Expenditure Statement, the Authority and Group Balance Sheet, the Authority and Group Cash Flow, the Housing Revenue Account, the Movement on the Housing Revenue Account Statement and Collection Fund and the related notes. These accounting statements have been prepared under the accounting policies set out in the Statement of Accounting Policies.

This report is made solely to the members of Durham County Council in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 48 of the Statement of Responsibilities of Auditors and Audited Bodies published by the Audit Commission in March 2010.

Respective responsibilities of the Corporate Director Resources and auditor

As explained more fully in the Statement of the Corporate Director Resources' Responsibilities, the Corporate Director Resources is responsible for the preparation of the Authority and Group's Statement of Accounts in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom. My responsibility is to audit the accounting statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me to comply with the Auditing Practice's Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the accounting statements sufficient to give reasonable assurance that the accounting statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Authority and Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Authority and Group; and the overall presentation of the accounting statements. I read all the information in the explanatory foreword and the annual report to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

Opinion on accounting statements

In my opinion the accounting statements:

- give a true and fair view of the state of Durham County Council's affairs as at 31 March 2011 and of its income and expenditure for the year then ended;
- give a true and fair view of the state of the Group's affairs as at 31 March 2011 and of its income and expenditure for the year then ended; and
- have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom.

Opinion on other matters

In my opinion, the information given in the explanatory foreword and the content of the Annual Report for the financial year for which the accounting statements are prepared is consistent with the accounting statements.

Matters on which I report by exception

I have nothing to report in respect of the governance statement on which I report to you if, in my opinion the governance statement does not reflect compliance with 'Delivering Good Governance in Local Government: a Framework' published by CIPFA/SOLACE in June 2007.

Opinion on the pension fund accounting statements

I have audited the pension fund accounting statements for the year ended 31 March 2011 under the Audit Commission Act 1998. The pension fund accounting statements comprise the Fund Account, the Net Assets Statement and the related notes. These accounting statements have been prepared under the accounting policies set out in the Statement of Accounting Policies.

This report is made solely to the members of Durham County Council in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 48 of the Statement of Responsibilities of Auditors and Audited Bodies published by the Audit Commission in March 2010.

Respective responsibilities of the Corporate Director Resources and auditor

As explained more fully in the Statement of the Corporate Director Resources' Responsibilities, the Corporate Director Resources is responsible for the preparation of the pension fund's Statement of Accounts in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom. My responsibility is to audit the accounting statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me to comply with the Auditing Practice's Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the accounting statements sufficient to give reasonable assurance that the accounting statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the fund's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the fund; and the overall presentation of the accounting statements. I read all the information in the explanatory foreword and the annual report to identify material inconsistencies with the audited accounting statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

Opinion on accounting statements

In my opinion the pension fund's accounting statements:

- give a true and fair view of the financial transactions of the pension fund during the year ended 31 March 2011 and the amount and disposition of the fund's assets and liabilities as at 31 March 2011, other than liabilities to pay pensions and other benefits after the end of the scheme year; and
- have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom.

Opinion on other matters

In my opinion, the information given in the explanatory foreword and the content of the Annual Report for the financial year for which the accounting statements are prepared is consistent with the accounting statements.

Conclusion on Authority's arrangements for securing economy, efficiency and effectiveness in the use of resources

Authority's responsibilities

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

Auditor's responsibilities

I am required under Section 5 of the Audit Commission Act 1998 to satisfy myself that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Audit Commission requires me to report to you my conclusion relating to proper arrangements, having regard to relevant criteria specified by the Audit Commission.

I report if significant matters have come to my attention which prevent me from concluding that the Authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. I am not required to consider, nor have I considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

Basis of conclusion

I have undertaken my audit in accordance with the Code of Audit Practice, having regard to the guidance on the specified criteria, published by the Audit Commission in October 2010, as to whether the Authority has proper arrangements for:

- securing financial resilience; and
- challenging how it secures economy, efficiency and effectiveness.

The Audit Commission has determined these two criteria as those necessary for me to consider under the Code of Audit Practice in satisfying myself whether the Authority put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2011.

I planned my work in accordance with the Code of Audit Practice. Based on my risk assessment, I undertook such work as I considered necessary to form a view on whether, in all significant respects, the Authority had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Conclusion

On the basis of my work, having regard to the guidance on the specified criteria published by the Audit Commission in October 2010, I am satisfied that, in all significant respects, Durham County Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2011.

Certificate

I certify that I have completed the audit of the Authority and Group accounts of Durham County Council and Durham County Council Pension Fund in accordance with the requirements of the Audit Commission Act 1998 and the Code of Audit Practice issued by the Audit Commission.

Cameron Waddell
District Auditor
Audit Commission

[Date]

Appendix 2 - Amendments to the draft financial statements

I identified the following misstatements during my audit and management have adjusted the financial statements. I bring them to your attention to aid you in fulfilling your governance responsibilities.

Adjusted misstatement	Nature of adjustment	Fund account		Net assets statement	
		Dr £000s	Cr £000s	Dr £000s	Cr £000s
Dr Dividend accruals	Dividend accruals for Barings and Royal London incorrectly included in investment assets.			2,240	
Cr Fixed Interest (overseas public sector)					211
Cr Equities (UK)					351
Cr Equities (overseas)					156
Cr Index Linked (overseas)					133
CR Index linked (UK)					1,389
Dr Index Linked (UK)	Misallocated Royal London stock			3,585	
Cr Fixed Interest (UK other)					3,585
Dr Change in market value	Overstatement of cash with fund managers	2,573			
Cr other cash deposits					2,573

		Fund account	Net assets statement
Dr Pooled inv vehicles (managed funds - non property - unquoted)	Misallocated forward currency and hedging AllianceBernstein		270
Cr Derivative contracts - assets			270
Dr Derivative contracts (assets)	Royal London derivatives based on incorrect valuation method		6,177
Cr Derivative contracts (liabilities)			6,177
Dr Change in market value	CBRE cash overstated as accruals	82	
Cr Fund Manager Cash	included in cash and accruals		82
Dr Note 6 - cash and short term inv - loans long term Las	Long term investment incorrectly included as short term		441
Cr Note 6 Long term investments			441
Dr Note 6 – Managed Funds (non property -UK –quoted)	Unquoted investment incorrectly included as quoted		25,339
Cr Note 6 – Managed Funds (non property -UK –unquoted)			25,339
Dr Note 6 – Purchases & Sales table - Purchases (Managed & Unitised Funds)	2009-10 purchases and sales included in 2010-11		40,183
Purchases & Sales table - Sales (Managed & Unitised Funds)		40,183	

Appendix 3 - Unadjusted misstatements to the financial statements

I identified the following misstatements during my audit, but management has not adjusted the financial statements. I bring them to your attention to help you in fulfilling your governance responsibilities and ask you to correct these misstatements.

If you decide not to amend, please tell me why in the representation letter. If you believe the effect of the uncorrected errors, individually and collectively, is immaterial, please reflect this in the representation letter. Please attach a schedule of the uncorrected errors to the representation letter.

		Fund account		Net assets	
Unadjusted misstatement	Nature of required adjustment	Dr £000s	Cr £000s	Dr £000s	Cr £000s
Dr Equities (UK unquoted)	Omission of part of investment with nel			30	
Cr Change in market value			30		
Dr Other current liabilities	Transfer values incorrectly accrued (not in accordance with accounting policies)			282	
Cr Benefits payable		282			
Dr Note 14 - Commutations and lump sums	Incorrect posting of commutations and lump sums	547			
Cr note 14 – pensions payable			547		

		Fund account	Net assets
Dr Contribution income	Difference between general ledger and Adelphi	361	
Cr Change in market value			361
Cr Note 6 –Purchases (Index linked)	Unknown difference allocated to purchases		381
Dr Note 6 –Purchases (Index linked)		381	
Dr Tax accrual	Incorrect fund manager balances		118
Cr Dividend accrual			
Cr Change in market value			96
Dr Fund manager cash	Understatement of fund manger cash		131
Cr Change in market value			131
Dr Change in market value	Understatement of investment income	257	
Cr Investment income			257
Dr Note 6 – Change in market value (index linked)	Overstatement of Index linked purchases	381	
Cr Note 6 –Purchases (index linked)			381
Dr Note 6 – Purchases (Equities)	Inconsistent treatment of currency fluctuations	683	
Cr Note 6 –Sales (Equities)		123	
Cr Note 6 – Change in market value (Equities)			786
Dr Note 6 –Sales (Managed and unitised funds)		718	
Cr Note 6 –Change in market value (Managed & unitised fds)			718

Appendix 4 – Draft letter of representation

To: Cameron Waddell

District Auditor
Audit Commission
Nickalls House

Gateshead NE8 1HH

Durham County Council Pension Fund – Audit for the year ended 31 March 2011

We confirm to the best of our knowledge and belief, having made appropriate enquiries of other officers of Durham County Council, the following representations given to you in connection with your audit of the Council's financial statements for the year ended 31 March 2011 and the associated financial statements of its pension fund.

We acknowledge our responsibility under the relevant statutory authorities for preparing the financial statements which give a true and fair view of the financial position and financial performance of the Durham County Council pension fund and for making accurate representations to you.

The Council has no plans or intentions that may materially alter the carrying value or classification of assets and liabilities reflected in the financial statements.

Supporting records

All the accounting records have been made available to you for the purpose of your audit and all the transactions undertaken by the Council have been properly reflected and recorded in the accounting records. All other records and relevant information, including minutes of all Members meetings, have been made available to you.

Related party transactions

We confirm the completeness of the information provided regarding the identification of related parties. The identity of, and balances and transactions with, related parties have been properly recorded and where appropriate, adequately disclosed in the financial statements.

Contingent assets and contingent liabilities

There are no other contingent assets or contingent liabilities, other than those that have been properly recorded and disclosed in the financial statements. In particular:

- there is no significant pending or threatened litigation, other than those already disclosed in the financial statements; and
- there are no material commitments or contractual issues, other than those already disclosed in the financial statements; and
- no financial guarantees have been given to third parties.

Law, regulations, contractual arrangements and codes of practice

There are no instances of non-compliance with laws, regulations and codes of practice, likely to have a significant effect on the finances or operations of the Durham County Council pension fund.

The Council has complied with all aspects of contractual arrangements that could have a material effect on the financial statements in the event of non-compliance. There has been no non-compliance with requirements of regulatory authorities that could have a material effect on the financial statements in the event of non-compliance.

Irregularities

We acknowledge our responsibility for the design and implementation of internal control systems to prevent and detect fraud or error.

There have been no:

- irregularities involving management or employees who have significant roles in the system of internal accounting control;
- irregularities involving other employees that could have a material effect on the financial statements; or
- communications from regulatory agencies concerning non-compliance with, or
- deficiencies on, financial reporting practices which could have a material effect on the financial statements.

We also confirm that we have disclosed:

- our knowledge of fraud, or suspected fraud, involving either management, employees who have significant roles in internal control or others where fraud could have a material effect on the financial statements; and
- our knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

Post balance sheet events

Since the date of approval of the financial statements by Members of the Council, no additional significant post balance sheet events have occurred which would require additional adjustment or disclosure in the financial statements.

Compensating arrangements

There are no formal or informal compensating balancing arrangements with any of our cash and investment accounts.

We confirm that this letter has been discussed and agreed by the Audit Committee on [] September 2011

Signed

Name: Don McLure

Position: Director of Finance and

Signed

Name: Eddie Bell

Position: Chair of the Audit Committee
Corporate Resources

Date

Appendix 5 – Glossary

Annual governance statement

A statement of internal control prepared by an audited body and published with the financial statements.

Audit closure certificate

A certificate that I have completed the audit following statutory requirements. This marks the point when I have completed my responsibilities for the audit of the period covered by the financial statements.

Audit opinion

On completion of the audit of the financial statements, I must give my opinion on the financial statements, including:

- whether they give a true and fair view of the financial position of the audited body and its spending and income for the year in question; and
- whether they have been prepared properly, following the relevant accounting rules.

Opinion

If I agree that the financial statements give a true and fair view, I issue an unqualified opinion. I issue a qualified opinion if:

- I find the statements do not give a true and fair view; or
- I cannot confirm that the statements give a true and fair view.

Materiality and significance

The Auditing Practices Board (APB) defines this concept as ‘an expression of the relative significance or importance of a particular matter for the financial statements as a whole. A matter is material if its omission would reasonably influence users of the financial statements, such as the addressees of the auditor’s report; also a misstatement is material if it would have a similar influence. Materiality may also be considered for any individual primary statement within the financial statements or of individual items included in them. We cannot define materiality mathematically, as it has both numerical and non-numerical aspects’.

The term ‘materiality’ applies only to the financial statements. Auditors appointed by the Commission have responsibilities and duties under statute, as well as their responsibility to give an opinion on the financial statements, which do not necessarily affect their opinion on the financial statements.

‘Significance’ applies to these wider responsibilities and auditors adopt a level of significance that may differ from the materiality level applied to their audit in relation to the financial statements. Significance has both qualitative and quantitative aspects.

Weaknesses in internal control

A weakness in internal control exists when:

- a control is designed, set up or used in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements quickly; or
- a control necessary to prevent, or detect and correct, misstatements in the financial statements quickly is missing.

An important weakness in internal control is a weakness, or a combination of weaknesses that, in my professional judgement, are important enough that I should report them to you.

Value for money conclusion

The auditor's conclusion on whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources based on criteria specified by the Audit Commission.

The Code of Audit Practice defines proper arrangements as corporate performance management and financial management arrangements that form a key part of the system of internal control. These comprise the arrangements for:

- planning finances effectively to deliver strategic priorities and secure sound financial health;
- having a sound understanding of costs and performance and achieving efficiencies in activities;
- reliable and timely financial reporting that meets the needs of internal users, stakeholders and local people;
- commissioning and buying quality services and supplies that are tailored to local needs and deliver sustainable outcomes and value for money;
- producing relevant and reliable data and information to support decision making and manage performance;
- promoting and displaying the principles and values of good governance;
- managing risks and maintaining a sound system of internal control;
- making effective use of natural resources;
- managing assets effectively to help deliver strategic priorities and service needs; and
- planning, organising and developing the workforce effectively to support the achievement of strategic priorities.

If I find that the audited body had adequate arrangements, I issue an unqualified conclusion. If I find that it did not, I issue a qualified conclusion.

If you require a copy of this document in an alternative format or in a language other than English, please call:
0844 798 7070

© Audit Commission 2011.

Design and production by the Audit Commission Publishing Team.

Image copyright © Audit Commission.

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors, members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
- any third party.

