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Dumfries and Galloway Council Pension Fund

Annual Report 2012

Year ended 31 March 2012

Prepared for Full Council

November 2012

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The matters raised in this report that flow from the audit are only those which have come to our attention arising from or relevant to our audit that we believe need to be brought to your attention. They are not a comprehensive record of all the matters arising, and in particular we cannot be held responsible for reporting all risks relating to your Fund or all internal control weaknesses.

This report has been prepared for and only for the Full Council in accordance with the terms of our most recent engagement letter dated 23 November 2011 and for no other purpose. We do not accept or assume any liability or duty of care for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

1 Executive summary

The purpose of this report is to provide you with feedback from the work we have performed and to communicate relevant issues which have come to our attention during the audit for the year ended 31 March 2012.

Scope of our work

Our audit was performed under International Standards on Auditing (UK & Ireland) and followed the approach set out in our Audit Plan prepared for the Pension Sub Committee dated 1 August 2012. We have included a summary of our audit approach and specific findings from our audit work for each of the key components within section 2 of this report. There has been no cause for us to vary the planned scope of work.

Our conclusions

- Our audit report on the truth and fairness of the accounts is unqualified.
- No matters have arisen that we have been required to report to the Pensions Regulator in accordance with our whistle-blowing responsibilities under the Pensions Act 2004.

We have not identified any material uncorrected misstatements in the accounts that require representation from the Pension Sub Committee.

Audit issues, findings and internal control recommendations

The main issues and findings from our audit are included in section 2, along with internal control recommendations which are detailed in section 3. The most significant findings from our work completed to date are:

- A difference in membership numbers per the administrative records and those reported in the accounts (page 9).

Independence and objectivity

Our reputation and continued success as a firm depends on our maintaining auditor independence. We are required to communicate with you matters that, in our professional judgement, may reasonably be thought to bear on our independence and objectivity. We have no matters to report to you in this regard.

2 Audit findings

Financial highlights

Fund account

£m	2012
Contributions	27.9
Benefits, leavers and transfers	(25.4)
Administrative expenses	(0.4)
Investment returns	7.4
Net increase	**9.5**
Opening net assets	511.2
Net assets	**520.7**

Net assets statement

£m	2012
Investment assets	526.0
Investment liabilities	(5.4)
Net current assets	0.1
Net assets	**520.7**

Contributions

Key figures

£m	2012	2011
Employer normal	19.4	20.5
Employer additional	2.7	2.8
Member normal	5.7	6.3
Contributions	**27.8**	**29.6**

Commentary

Despite a 0.5% increase in the employer contribution rate and a relatively stable number of active members of the scheme, contributions have decreased since the prior year due to a large reduction in total pensionable salary as the result of high earners leaving active membership and being replaced by new entrants on relatively lower salaries.

Average contribution per active member

£	2012	2011
Normal contributions	4,618	4,866

Total average contributions per member have decreased by 5% on comparison with the prior year as a result of the composition of the active members of the scheme.

Planned approach	Matters arising
We visited selected employer payrolls to gain assurance that pensionable salary is being calculated correctly and the appropriate contribution rates applied. Payroll sites selected for a visit and detailed testing: • Head Office – Dumfries.	No issues noted.
We performed an analytical review of contributions compared with the prior year and review the ratio of member to employer contributions on a month-by-month basis.	No issues noted.
We reviewed the timeliness of the payment of contributions to the Fund in accordance with fund guidance and other documentation.	No issues noted.

Benefits

Key figures

£m	2012	2011
Pensions	17.1	14.9
Lump sums – retirement	7.1	7.6
Lump sums – death	0.4	0.4
Transfers in	(0.4)	(1.5)
Transfers out	1.1	1.1
Total	**25.3**	**22.5**

Commentary

Pension payments have increased in the year due to a 6% increase in the average number of pensioners year-on-year, combined with a pension increase of 2.8%.

Average pension per pensioner member

£	2012	2011
Pension	5,172	4,781

The increase in average pension per pensioner is in line with the pension increase awarded in the year.

Planned approach	Matters arising
We reviewed the principal controls in place over the accuracy of benefit calculations, assessed their effectiveness and carried out procedures to confirm that they had been operating effectively throughout the year. This included a review of the key controls over the IT environment at your Head Office.	No issues noted.
We recalculated high profile and other individually significant benefits paid in the year using actuarial specialists. We performed further substantive tests over benefits and leaver payments using a risk-based approach.	No high profile retirements during the year. No issues noted.
We performed analytical review of the pensioner payroll.	No issues noted.
We placed reliance on the most recent pensioner existence exercise.	The council participates in the National Fraud Initiative. No issues noted.

Investments

Key figures

£m	2012	2011
Fixed interest	111.1	104.3
Index-linked	22.8	17.9
Pooled investment vehicles (PIVs)	376.6	380.7
Derivatives	-	-
Loans and Cash	12.0	10.2
Other	3.5	1.1
Investments	**526.0**	**514.2**

Commentary

The market value of Investments has increased by 2.2% year on year, primarily as the result of investment performance along with the net addition of £2.1m from dealings with members.

Investment returns

£m	2012	2011
Investment income	8.2	7.6
Change in market value (CIMV)	1.0	26.7
Investment management expenses	(1.8)	(2.0)
Investment returns	**7.4**	**32.3**

Investment income has increased in line with the market value of investments held. The reduction in CIMV is expected in light of poor market performance during the year and is reflected in the reduction in total return from 7.1% to 1.9%.

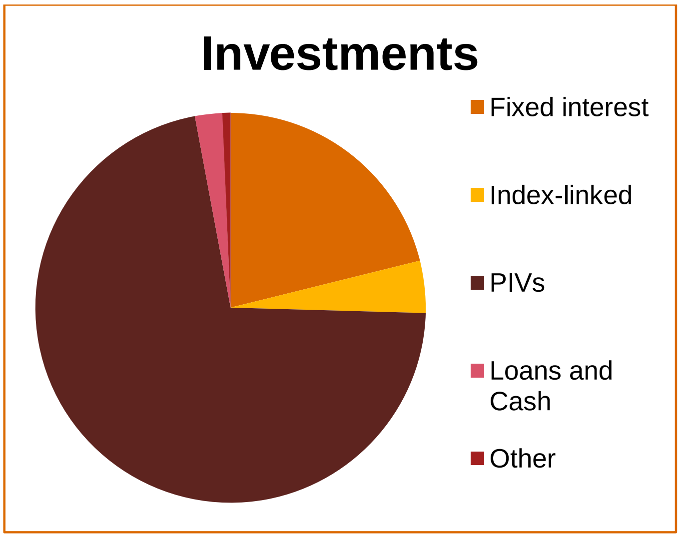
Investment performance

%	2012	2011
Total per investment report	1.9	7.1
Estimated* per accounts	1.5	6.3
Benchmark return	5.5	8.1

**The estimated return based on the financial statements noted above is a simple calculation comparing investment income and change in market value with the average investments held during the year, which we have calculated to assess reasonableness compared with other investment return figures disclosed.*

Planned approach	Matters arising
Obtain third party confirmations and review the investment reconciliations performed between the investment manager and custodian records. Review a reconciliation of cash movements between the Fund bank account and investment managers.	No issues noted.
Perform tests of valuation of listed investments against third party sources, using electronic software to perform a comprehensive check of the year end valuation of quoted investments. Consider whether market conditions may indicate an impairment of the reported values of securities which are no longer actively traded. Confirm the valuation of pooled investment vehicles (PIVs) by reference to unit prices supplied by the manager, and assess the reasonableness of these unit prices.	See below for summary of valuation comfort obtained.
Perform a high level review of reconciliations prepared by your accountants/advisers to demonstrate completeness of transaction recording and appropriateness of disclosure.	None

Summary of investment valuation comfort



Fair value hierarchy: IFRS 7 is not currently a requirement for pension schemes and therefore has not been included within the annual report. IFRS 7 requires disclosure of investment assets in a 3-level hierarchy. The three levels are:

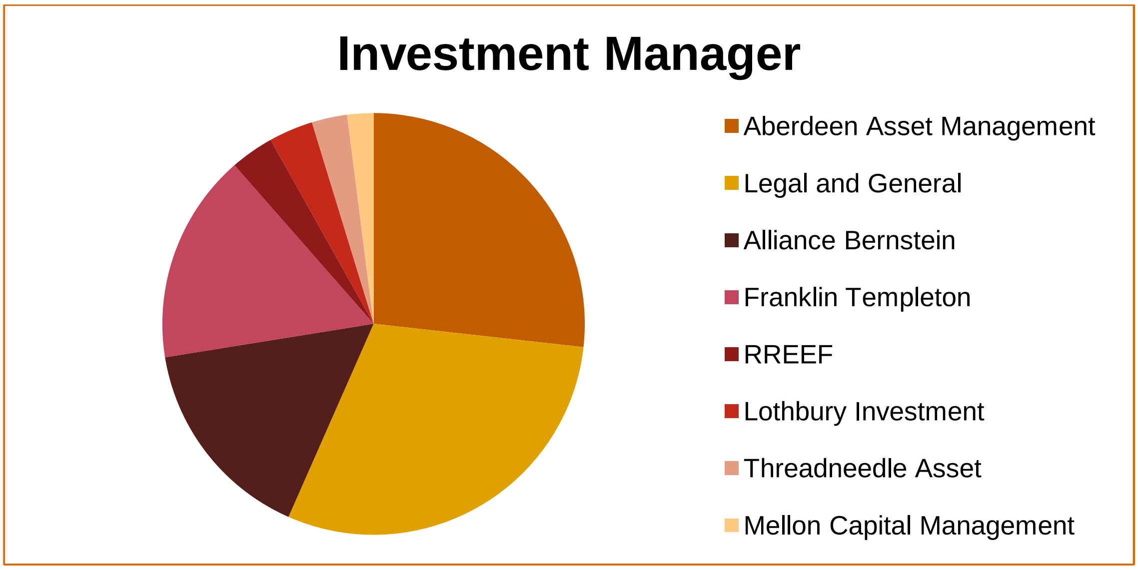
Level 1: Quoted prices (unadjusted) in active markets for identical assets, ie easy to value;

Level 2: Valuation inputs are observable directly (prices) or indirectly (derived from prices), ie moderately difficult to value; and

Level 3: Valuation inputs not based on observable market data, ie difficult to value.

Adoption of this disclosure by UK pension schemes is currently expected from 2015.

Type	Comment
Fixed interest, equities and index-linked (Level 1)	Agreed to external price feeds. No indication of stale prices.
PIVs – equity tracker (Level 2)	Unit price movement is broadly in line with the index tracked.



Date of most recent controls reports	
Dec 2011	Legal and General (1 exception)
	Aberdeen Asset (6 exceptions)
	Alliance Berstein (2 exceptions)
	Franklin Templeton (3 exceptions)
	RREEF (6 exceptions)
	BNY Mellon (6 exceptions)
	Lothbury (16 exceptions)
	Threadneedle (4 exceptions)

Controls reports provide evidence of the existence of controls over selected control objectives at outsourced organisations such as investment managers and custodians. Where these are "type II" reports, they also provide comfort that the controls have been operating effectively over the period covered by the report.

We explained how we use controls reports during the audit in our audit plan.

Significant risks

ISAs recommend that we communicate how we propose to respond to significant risks (those which require special audit consideration) identified during the audit. Because of the potential link to fraud, the risk of management override of controls is always considered a significant risk. We addressed this risk by performing testing of journals, reviewing estimates made by management, and reviewing minutes in connection with significant or unusual transactions. There are no matters to report as a result of this testing.

3 Internal control recommendations

Significant internal control recommendations from this year's audit

We have graded the impact of the matters in this section on the following basis:

HIGH	A significant issue which could result in material financial, regulatory or reputational risk.
MEDIUM	A less significant issue but still relating to an area where we think controls should be improved as a priority.
LOW	Areas where we recommend enhancements be made to existing controls or matters of best practice.

Issue 3.1	**Membership numbers do not agree to underlying records** MEDIUM
Observation and implication	On comparison of active and pensioner membership figures in the accounts to those reported in the supporting administrative data, it was noted that the accounts listed 213 more active members and 13 more pensioners at year end.
Recommendation	In both cases there are fewer members on the administrative records which indicates that there are unlikely to be fictitious payments being made; however, it is recommended that differences between the two sets of data are fully reconciled and reasons for the differences identified.
Management Response	A reconciliation between the Pension records and the Payroll records is currently being undertaken.
Responsible Officer and Implementation Date	**Responsible Officer:** Treasury/ Insurance Officer **Implementation Date:** 31 January 2013