



WALES **AUDIT** OFFICE  

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SWYDDFA **ARCHWILIO** CYMRU

# Audit of Financial Statements Report

## **Clwyd Pension Fund**

**Audit year:** 2011-12

**Issued:** September 2012

**Document reference:** 498A2012

# Status of report

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The team who delivered the work comprised:  
John Herniman, Phil Pugh, Ron Parker and Simon Monkhouse.

# Contents

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The Appointed Auditor intends to issue an unqualified audit report on your financial statements. There are some issues to report to you prior to their approval.

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## Summary report

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Introduction	4
Proposed audit report	4
Significant issues arising from the audit	5

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## Appendices

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Final Letter of Representation	7
Proposed audit report of the Appointed Auditor to Flintshire County Council	10
Summary of corrections made to the draft financial statements which should be drawn to the attention of Flintshire County Council	12

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# Summary report

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## Introduction

1. The Appointed Auditor is responsible for providing an opinion on whether the financial statements give a true and fair view of the financial position of Clwyd Pension Fund at 31 March 2012 and its income and expenditure for the year then ended.
2. We received the draft financial statements for the year ended 31 March 2012 on 30 June 2012, and have now substantially completed the audit work. We are reporting to you the more significant issues arising from the audit, which we believe you must consider prior to approval of the financial statements. The audit team has already discussed these issues with Kerry Feather, Head of Finance.
3. We do not try to obtain absolute assurance that the financial statements are correctly stated, but adopt the concept of materiality. In planning and conducting the audit, we seek to identify material misstatements in your financial statements, namely, those that might result in a reader of the accounts being misled.
4. The quantitative levels at which we judge such misstatements to be material for Clwyd Pension Fund are £817,000 for income and expenditure items and working capital balances, and £10.8 million for other balances. Whether an item is judged to be material can also be affected by certain qualitative issues such as legal and regulatory requirements and political sensitivity.

## Proposed audit report

5. It is the Appointed Auditor's intention to issue an unqualified audit report on the financial statements once you have provided us with a Letter of Representation based on that set out in [Appendix 1](#).
6. However, as part of its investment portfolio, the Pension Fund has substantial holdings in unquoted investment funds (£227.798 million). In the financial statements, these are valued at fair value by fund managers, using an appropriate basis of valuation. The valuations are reliant upon a significant degree of judgement, and due to the subjectivity of these valuations, the fair value of these investments may differ from their realisable values. The difference could be material.
7. In 2010-11 the audit opinion was not modified but it did include an Emphasis of Matter note, to draw to the readers' attention the uncertainties relating to the valuation of unquoted investments. For 2011-12 the audit opinion will not include an Emphasis of Matter note. This change results from our review of the audited accounts of the investment managers, which did not include any Emphasis of Matter this year, compared to previous years where several have declared these. The other reason is that the Authority has disclosed the uncertainty of unquoted investments in Note 6 Fair Value of the Pension Fund accounts.
8. In completing our audit work, we have reviewed the latest available audited financial statements of the various funds, the year-end investment manager valuation reports, and the reports on controls in operation (IASE 3402 Type 11) reports which supersede the reports formerly referred to as SAS70 reports.

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## Significant issues arising from the audit

### Uncorrected misstatements

9. There is one misstatement identified in the financial statements, which remains uncorrected. An explanation of this is set out below and this has been discussed with management but remains uncorrected. We therefore request that you consider whether to correct this item or provide us with the reasons for non-correction in the Letter of Representation. The value of the misstatement is below our materiality level and so if you decide not to correct it we would still be able to provide an unqualified opinion on the statements.
10. There is an understatement in the value of investments in the financial statements of £2,297,087 because, in preparing the draft financial statements at the year-end, the Authority uses the latest investment valuation reports available to it. As part of our audit work we write to all investment managers to obtain final year-end valuation reports. This information is then compared to the investment valuations disclosed in the draft financial statements. As expected, due to more up to date information being available in respect of the valuation of investments at 31 March 2012, the financial statements are understated by £2,297,087.

### Corrected misstatements

11. As a result of the audit there are a number of misstatements identified that have been corrected by management, but which we consider should be drawn to your attention due to their relevance to your responsibilities over the financial reporting process. They are set out with explanations in [Appendix 3](#).

### Other significant issues arising from the audit

12. In the course of the audit we consider a number of matters both qualitative and quantitative relating to the accounts and report any significant issues arising to you. This year:
  - We have no concerns about the qualitative aspects of your accounting practices and financial reporting.
  - We have no major concerns about the qualitative aspects of your accounting practices and financial reporting. We found the information provided to be relevant, reliable, and easy to understand. We concluded that accounting policies and estimates are appropriate and financial statement disclosures unbiased, fair and clear.
  - The Pension Fund's administrators prepare, good quality, year-end closing files, which incorporate all the relevant information needed to produce the year-end statements of account.
  - We did not encounter any significant difficulties during the audit.

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- There were no significant matters discussed and corresponded upon with management which we need to report to you.
  - There are no other matters significant to the oversight of the financial reporting process that we need to report to you.
  - We did not identify any material weaknesses in your internal controls.
- 13.** In 2010-11 we identified issues relating to backlogs of lump sum payments, which resulted in an amendment to the accounts. From the work performed this year we have not identified a similar issue and there has been no requirement to amend the accounts in 2011-12.

# Appendix 1

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## Final Letter of Representation

Appointed Auditor,  
Wales Audit Office,  
24 Cathedral Road,  
Cardiff.  
CF11 9LJ

25 September 2012

## Representations Regarding the 2011-12 Financial Statements

This letter is provided in connection with your audit of the financial statements of Clwyd Pension Fund for the year ended 31 March 2012.

We confirm that to the best of our knowledge and belief, having made enquiries as we consider sufficient, we can make the following representations to you.

## Management Representations

### Responsibilities

We have fulfilled our responsibilities for the preparation of the financial statements in accordance with legislative requirements and the Code of Practice on Local Authority Accounting; in particular the financial statements give a true and fair view in accordance therewith.

We acknowledge our responsibility for the design, implementation, maintenance and review of internal control to prevent and detect fraud and error.

### Information Provided

We have provided you with:

- full access to:
  - all information of which we are aware that is relevant to the preparation of the financial statements such as books of account and supporting documentation, minutes of meetings and other matters;
  - additional information that you have requested from us for the purpose of the audit; and
  - unrestricted access to staff from whom you determined it necessary to obtain audit evidence.

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- the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud;
  - our knowledge of fraud or suspected fraud that we are aware of and that affects Clwyd Pension Fund and involves:
    - management;
    - employees who have significant roles in internal control; or
    - others where the fraud could have a material effect on the financial statements.
  - our knowledge of any allegations of fraud, or suspected fraud, affecting the financial statements communicated by employees, former employees, regulators or others;
  - our knowledge of all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing the financial statements; and
  - the identity of all related parties and all the related party relationships and transactions of which we are aware.

## Financial Statement Representations

All transactions, assets and liabilities have been recorded in the accounting records and are reflected in the financial statements.

Significant assumptions used in making accounting estimates, including those measured at fair value, are reasonable.

Related party relationships and transactions have been appropriately accounted for and disclosed.

All events occurring subsequent to the reporting date which require adjustment or disclosure have been adjusted for or disclosed.

Local Government Investment Regulations require a pension fund, when formulating its investment policy, to consider the full range of investments and give reasons if some asset classes are excluded. The Clwyd Pension Fund fundamentally considers its asset allocation every three years including an optimisation exercise which quantifies the risk and return from a combination of asset classes to provide, at total fund level, both diversification and a return to meet future liabilities. This has led to an allocation to Private Equity due to the assets classes' potential to generate higher returns than other asset classes. The Clwyd Pension Fund has had an allocation to Private Equity since the early 1990s. To manage risk, the Pension Fund has commitments to over 50 direct private equity funds or private equity fund of funds with over 15 different managers.

The life of a typical private equity fund is usually about 10 years. During this period investments are usually made for the first five years and then these assets are realised over the next five years. Typically, the Pension Fund is committed to make draw downs to the fund for about five years and usually receives distributions for the next five years. During the life of the fund it is valued quarterly using the appropriate industry standards but there is inherent uncertainty associated with their valuation, as the only definite points for valuing investments are at the point of investment and realisation. In theory, in the early life of a fund it would usually show a negative return and then returns should increase through the life of



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the fund as underlying investments are developed and sold. This theory is known as the 'J Curve'.

Clearly, there is no liquid market for private equity investments (by definition) and consequently the estimated fair value of private equity investments will always differ from their 'realisable values' at any particular time and, for technical reasons, I understand that the external auditor must refer annually to this difference.

In light of this inherent uncertainty, the value as at 31 March of a number of investments will not be known at the time of the closure of the accounts because valuation processes by third parties will be incomplete. An estimate is reported in the financial statements and actual values disclosed as a note in the accounts (Note 6 – Fair Value of Investments). As reported in Note 6, the Fund has been undervalued by £2.297 million which equates to approximately one per cent of the total value of these types of investments. I understand that the external auditor must refer to this difference as an unadjusted misstatement.

All known actual or possible litigation and claims whose effects should be considered when preparing the financial statements have been disclosed to the auditor and accounted for and disclosed in accordance with the applicable financial reporting framework.

The financial statements are free of material misstatements, including omissions. The effects of uncorrected misstatements identified during the audit are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

### Representations by Flintshire County Council as administering authority for the Clwyd Pension Fund

We acknowledge that the representations made by management, above, have been discussed with us.

We acknowledge our responsibility for the preparation of true and fair financial statements in accordance with the applicable financial reporting framework. The financial statements were approved by Flintshire County Council on 25 September 2012.

Signed by:  
Kerry Feather  
Head of Finance

Date: 25 September 2012

Signed by:

Date: 25 September 2012

# Appendix 2

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## Proposed audit report of the Appointed Auditor to Flintshire County Council

### Independent auditor's report to the Members of Flintshire County Council

I have audited the accounting statements and related notes of:

- Flintshire County Council; and
- Clwyd Pension Fund

for the year ended 31 March 2012 under the Public Audit (Wales) Act 2004.

Flintshire County Council's accounting statements comprise the Movement in Reserves Statement, the Comprehensive Income and Expenditure Statement, the Balance Sheet, the Cash Flow Statement, the Movement on the Housing Revenue Account Statement and the Housing Revenue Account Income and Expenditure Statement.

Clwyd Pension Fund's accounting statements comprise the Fund Account and the Net Assets Statement.

The financial reporting framework that has been applied in their preparation is applicable law and the Code of Practice on Local Authority Accounting in the United Kingdom 2011-12 based on International Financial Reporting Standards (IFRSs).

### Respective responsibilities of the responsible financial officer and the independent auditor

As explained more fully in the Statement of Responsibilities for the Statement of Accounts [set out on pages ... to ...], the responsible financial officer is responsible for the preparation of the statement of accounts, including pension fund accounts, which gives a true and fair view.

My responsibility is to audit the accounting statements and related notes in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me to comply with the Auditing Practices Board's Ethical Standards for Auditors.

### Scope of the audit of the accounting statements

An audit involves obtaining evidence about the amounts and disclosures in the accounting statements and related notes sufficient to give reasonable assurance that the accounting statements and related notes are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to Flintshire County Council and Clwyd Pension Fund's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the responsible financial officer and the overall presentation of the accounting statements and related notes.

In addition, I read all the financial and non-financial information in the Explanatory Foreword to identify material inconsistencies with the audited accounting statements and related notes.

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If I become aware of any apparent material misstatements or inconsistencies, I consider the implications for my report.

#### Opinion on the accounting statements of Flintshire County Council

In my opinion the accounting statements and related notes:

- give a true and fair view of the financial position of Flintshire County Council as at 31 March 2012 and of its income and expenditure for the year then ended; and
- have been properly prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2011-12.

#### Opinion on the accounting statements of Clwyd Pension Fund

In my opinion, the pension fund accounts and related notes:

- give a true and fair view of the financial transactions of Clwyd Pension Fund during the year ended 31 March 2012 and of the amount and disposition of the fund's assets and liabilities as at that date; and
- have been properly prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2011-12.

#### Opinion on other matters

In my opinion, the information contained in the Explanatory Foreword for the financial year for which the accounting statements and related notes are prepared is consistent with the accounting statements and related notes.

#### 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, it does not reflect compliance with 'Delivering Good Governance in Local Government: Framework' published by CIPFA/SOLACE in June 2007, or if the statement is misleading or inconsistent with other information I am aware of from my audit.

#### Certificate of completion of audit

The audit cannot be formally concluded and an audit certificate issued until enquiries arising from a matter raised by a member of the public has been formally completed.

Anthony Barrett  
Appointed Auditor  
Wales Audit Office  
24 Cathedral Road  
Cardiff  
CF11 9LJ

28 September 2012

## Appendix 3

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### Summary of corrections made to the draft financial statements which should be drawn to the attention of Flintshire County Council

During our audit we identified the following misstatements that have been corrected by management, but which we consider should be drawn to your attention due to their relevance to your responsibilities over the financial reporting process.

Value of correction	Nature of correction	Reason for correction
£21.467 million	<p>Note 5 – Market Value of Investments</p> <p>The value of ‘unlisted’ Hedge funds has been reduced by £21.467 million with a corresponding increase in the ‘listed’ hedge fund category.</p>	To ensure the correct disclosure of the value of listed and unlisted Hedge Fund of Funds investments.
£2.563 million	<p>Note 13 – Contingent Liabilities and Contractual Commitments.</p> <p>The value of contractual commitments of invested funds has increased by £2.563 million with a corresponding decrease in the value of outstanding commitments.</p>	To correct the errors identified in respect of the level of investments drawn down for four of the investment funds.



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