



INFRASTRUCTURE,  
GOVERNMENT AND HEALTHCARE

**Report to those  
charged with  
governance  
2008/09**

**Oxfordshire County  
Council Pension  
Fund**

**September 2009**

AUDIT

The contacts at KPMG in connection with this report are:

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This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission has issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document.

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact June Awty, who is the engagement partner to the Authority, telephone 0207 311 1769, email [june.awty@kpmg.co.uk](mailto:june.awty@kpmg.co.uk) who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on 0161 236 4000, email [trevor.rees@kpmg.co.uk](mailto:trevor.rees@kpmg.co.uk), who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Investigation Officer, Westward House, Lime Kiln Close, Stoke Gifford, Bristol, BS34 8SR or by e mail to: [complaints@audit-commission.gov.uk](mailto:complaints@audit-commission.gov.uk). Their telephone number is 0844 798 3131, textphone (minicom) 020 7630 0421

## Executive summary

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### Scope of this report

The Audit Commission's Code of Audit Practice (the Code) requires us to summarise the work we have carried out to discharge our statutory audit responsibilities together with any governance issues identified and we report to those charged with governance (in this case the Oxfordshire County Council Audit Committee) at the time they are considering the financial statements. We are also required to comply with International Standard on Auditing (ISA) 260 which sets out our responsibilities for communicating with those charged with governance.

This report meets both these requirements. It summarises the key issues identified during our audit of the Oxfordshire County Council Pension Fund's ('the Fund's') financial statements for the year ended 31 March 2009.

This report does not repeat matters we have previously communicated to you.

### Summary of findings

#### *Financial statements*

The Fund is responsible for having in place effective systems of internal control which ensure the regularity and lawfulness of transactions, to maintain proper accounting records and to prepare financial statements that present fairly its financial position and its expenditure and income. It is also responsible for preparing and publishing a Governance Compliance Statement with its financial statements.

Our findings are detailed in section two and our proposed opinion on the accounts is presented in Appendix 1.

#### *Status of the audit*

At the date of this report our audit of the financial statements is substantially complete subject to completion of the following areas:

- Receipt and review of certain direct investment manager confirmations; and
- Audit work on valuation of some investments held from FundRADAR.

## Executive summary (continued)

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### *Declaration of independence and objectivity*

In relation to the audit of the Oxfordshire County Council Pension Fund for the year ended 31 March 2009, we confirm that there were no relationships between KPMG LLP and the Oxfordshire County Council Pension Fund, its officers and senior management and its affiliates that may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Audit Commission's requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix 5 in accordance with ISA 260.

### *Exercise of other powers*

We have a duty under section 8 of the Audit Commission Act 1998 to consider whether, in the public interest, to report on any matter that comes to our attention in order for it brought to the attention of the public. In addition we have a range of other powers under the 1988 Act. We did not exercise these powers or issue a report in the public interest in 2008/09.

### *Certificate*

We are required to certify that we have completed the audit in accordance with the requirements of the Audit Commission Act 1998 and the Code of Audit Practice. If there are any circumstances under which we cannot issue a certificate, then we are required to report them to you and to issue a draft opinion on the financial statements.

### *Fees*

Our fee for the audit is £50,000. This has been contained within the fee proposed in our audit plan. We have not performed any non-audit work.

### **Acknowledgements**

We would like to take this opportunity to thank officers and members for their continuing help and co-operation throughout our audit work.

## Financial statements

**The Fund is responsible for having effective systems of internal control to ensure the regularity and lawfulness of transactions, to maintain proper accounting records and to prepare financial statements that present fairly its financial position and its expenditure and income. It is also responsible for preparing and publishing an Annual Statement of Governance with its financial statements.**

**We have substantially completed our work on the 2008/09 financial statements.**

**We also review your Governance Compliance Statement and report if we have any concerns.**

### Introduction

Our financial statements work can be split into four phases, detailed below.

Stage	Tasks	Timing	Completed
Planning	<ul style="list-style-type: none"> <li>Updating our business understanding and risk assessment</li> <li>Assessing the organisational control environment</li> <li>Issuing our accounts audit protocol</li> </ul>	December 2008 to February 2009	✓
Control evaluation	<ul style="list-style-type: none"> <li>Reviewing the accounts production process</li> <li>Evaluating and testing controls over key financial systems</li> <li>Review of internal audit</li> <li>Evaluating and testing controls over authority management and control</li> </ul>	March to June 2009	✓
Substantive testing	<ul style="list-style-type: none"> <li>Planning and performing substantive work</li> <li>Evaluating the accounts production process</li> <li>Concluding on critical accounting matters</li> <li>Identifying audit adjustments</li> <li>Reviewing the Annual Governance Statement</li> </ul>	June to July 2009	✓
Completion	<ul style="list-style-type: none"> <li>Declaring our independence and objectivity</li> <li>Reporting matters of governance interest</li> <li>Forming our audit opinion</li> </ul>	August to September 2009	-

This report focuses on the control evaluation, substantive testing and completion stages.

## Financial statements (continued)

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### Substantive testing – critical accounting matters

The key accounting issues for 2008/09 financial statement are summarised in Appendix 2. We have now completed our testing of these areas and the outcome of our work is summarised in the Appendix.

We have completed detailed audit procedures over the investment valuation. Our FundRADAR team assisted us to evaluate the pricing of equities, hedge funds and pooled investment vehicles. The results of this work are set out in Appendix 3.

### Substantive testing – adjustments to the accounts

In accordance with ISA 260 we are required to report uncorrected audit differences to you. We also report any material misstatements which have been corrected and which we believe should be communicated to you to help you meet your governance responsibilities.

We did not identify any material misstatements in the fund's financial statements.

### Substantive testing – Governance Compliance Statement

We have reviewed the Governance Compliance Statement and confirmed that

- it complies with *Delivering Good Governance in Local Government: A Framework* published by CIPFA/SOLACE in June 2007; and
- it is not misleading or inconsistent with other information we are aware of from our audit of the financial statements.

### Completion – other matters

ISA 260 requires us to communicate to you “audit matters of governance interest that arise from the audit of the financial statements” which includes:

- material weaknesses in internal control identified during the audit;
- matters specifically required by other auditing standards to be communicated to those charged with governance (e.g. issues relating to fraud, compliance with laws and regulations, subsequent events etc); and
- other audit matters of governance interest.

There are no matters which we wish to draw to your attention.

### Completion – opinion

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion.

Our proposed opinion on the financial statements is presented in Appendix 1.

## Appendix 1: Proposed audit report within Authority's accounts – pension fund

### Opinion on the pension fund accounts

We have audited the pension fund accounts for the year ended 31 March 2009 under the Audit Commission Act 1998. The pension fund accounts comprise the Fund Account, the Net Assets Statement and the related notes. The pension fund accounts have been prepared under the accounting policies set out in the Statement of Accounting Policies.

This report is made solely to Oxfordshire County Council, as a body, in accordance with Part II of the Audit Commission Act 1998. Our audit work has been undertaken so that we might state to Oxfordshire County Council, as a body, those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than Oxfordshire County Council, as a body, for our audit work, for this report, or for the opinions we have formed.

### Respective responsibilities of the Responsible Financial Officer and auditors

The Responsible Financial Officer's responsibilities for preparing the pension fund accounts in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2008 are set out in the Statement of Responsibilities for the Statement of Accounts.

Our responsibility is to audit the pension fund accounts and related notes in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the pension fund accounts present fairly, in accordance with relevant legal and regulatory requirements and the Code of Practice on Local Authority Accounting in the United Kingdom 2008, the financial transactions of the pension fund during the year and the amount and disposition of the fund's assets and liabilities, other than liabilities to pay pensions and other benefits after the end of the scheme year. We also report to you whether, in our opinion, the information which comprises the commentary on the financial performance included within the Pension Fund Annual Report, is consistent with the pension fund accounts.

We review whether the governance compliance statement published in the Pension Fund Annual Report reflects compliance with the requirements of Regulation 34(1)(e) of the Local Government Pension Scheme (Administration) Regulations 2008 and related guidance. We report if it does not meet the requirements specified by the Department of Communities and Local Government or if the statement is misleading or inconsistent with other information we are aware of from our audit of the financial statements. We are not required to consider, nor have we considered, whether the governance statement covers all risks and controls. Neither are we required to form an opinion on the effectiveness of the Authority's corporate governance procedures or its risk and control procedures.

We read other information published with the pension fund accounts and related notes and consider whether it is consistent with the audited pension fund accounts. This other information comprises the Explanatory Foreword published in the financial statements and [the remaining elements of the Pension Fund Annual Report]. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the pension fund accounts and related notes. Our responsibilities do not extend to any other information.

### Basis of audit opinion

We conducted our audit in accordance with the Audit Commission Act 1998, the Code of Audit Practice issued by the Audit Commission and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the pension fund accounts and related notes. It also includes an assessment of the significant estimates and judgments made by the Authority in the preparation of the pension fund accounts and related notes, and of whether the accounting policies are appropriate to the Authority's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the pension fund accounts and related notes are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the pension fund accounts and related notes.

## Appendix 1: Proposed audit report within Authority's accounts– pension fund (continued)

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### Opinion

In our opinion the pension fund accounts and related notes present fairly, in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2008, the financial transactions of the Pension Fund during the year ended 31 March 2009, and the amount and disposition of the fund's assets and liabilities as at 31 March 2009, other than liabilities to pay pensions and other benefits after the end of the scheme year.

June Awty

**for and on behalf of KPMG LLP**

Chartered Accountants

London



## Appendix 2: Accounts risk areas

This appendix summarises the key accounting issues for the 2008/09 financial statements and our final findings following our substantive work.

Issue	Risk and implications	Findings during final audit
<p><b>Changes to accounting requirements</b></p> <p>The 2008 <i>Statement of Recommended Practice on Local Authority Accounting in the UK</i> (SORP) includes a number of changes, including aligning the disclosure of the Pension Fund accounts with the Statement of Recommended Practice (SORP): Financial Report of Pension Schemes (revised May 2007).</p>	<p>There is a risk that the financial statements prepared by the Council will not appropriately comply with the updated SORP. This would result in additional time required by both local management and KPMG to address any non-compliance with the SORP and could delay the finalisation of the financial statements.</p>	<p>Finance staff have familiarised themselves with the changes required under the SORP 2008. The Council have used the SORP disclosure checklist when preparing the draft financial statements to help ensure compliance with the SORP.</p>
<p><b>Other investments with uncertain recoverability</b></p> <p>During an economic downturn the valuation of some investments become more uncertain especially where markets are illiquid or investments are in markets such as property.</p>	<p>There is a risk some investments will not be recoverable and therefore consideration of the recoverability of these will need to be addressed by the Council in the financial statements.</p>	<p>The Council has considered the recoverability of their investment portfolio and made adjustments where necessary.</p>
<p><b>Accounting estimates and valuations</b></p> <p>The current economic environment introduces a number of risks for the financial statements, in particular for estimates and valuations. This includes the valuation of investments which are carried at market value.</p>	<p>There is a risk that estimates or valuations within the financial statements are not appropriately considered on a regular basis and therefore are not representative of the current economic environment.</p>	<p>A review has been undertaken for the 2008/09 financial statements to ensure the carrying values of investments are reflective of the current economic environment at the balance sheet date. The Council has considered the valuation of investments as part of the closedown process.</p>

## Appendix 3: Results of FundRADAR valuation

As noted in section two of this report the investment portfolio of the Fund has been priced independently by our FundRADAR team.

### Our FundRADAR team

The team is based in Frankfurt and is an interdisciplinary team of specialists including mathematicians, economists, computer specialists. The software has been specifically developed by KPMG to enable portfolio analysis.

### Overview of methodology and approach

The FundRADAR pricing procedure is focused on providing a coverage as high as possible and it is based on transparent reference prices. The pricing procedure is carried out in three steps as described below.



- |   |  |  |
|---|--|--|
| <ul style="list-style-type: none"> <li>• Equities &amp; listed derivatives: last / bid prices from primary exchange</li> <li>• Bonds: Bloomberg-Generic Price &amp; selected broker quotes</li> </ul> | <ul style="list-style-type: none"> <li>• Manual research of reliable pricing sources (price-history, stale prices, verification with other pricing sources or mark-to-model calculations)</li> </ul> | <ul style="list-style-type: none"> <li>• Manual price verification by mark-to-model calculation (bonds &amp; OTC derivatives)</li> </ul> |
|---|--|--|



Step 1: Bloomberg Generic Price (BGN) is an average price calculated by Bloomberg (BB) based on different broker quotations (5 for corporate and government bonds, 3 for asset backed securities). These quotes have to be within a certain range and outliers will be eliminated. Provided it is within this range the price will be assessed as being reliable. Where the BGN price is not seen to be reliable we research in BB for single quotations of this specific instrument. Stale prices or an implausible price development within a period of at least 3 business days lead to a rejection of the quote.



Step 2: We perform a manual research for reliable prices. The prices will be tested against each other, on quantitative criteria (jumps, stale prices) and on qualitative criteria (e.g. whether they reflect the Credit Default Swaps (CDS) spreads quoted for this issuer). When a reliable pricing source could be identified this will then be set as the new pricing reference for that bond as long as it fulfils the quality checks as outlined in Step 1.



Step 3: Manual fair value calculations are performed when neither step 1 nor step 2 provides a reliable external price. For corporate bonds these are mainly based on a discounted cash flow model incorporating the actual CDS spreads for this issuer or spread that could be observed from comparable bonds of the same issue for which there are reliable quotes observable. For Asset Backed Securities (ABS) the calculation is based on the assessment of the weighted average life (which is performed by using a cash flow model considering the historic prepayment rates of the collateral) and the spreads used in the DCF model (derived from specific spread matrices according to type of ABS, rating and expected time to maturity).

## Appendix 3: Results of FundRADAR valuation (continued)

We have set out below the pricing methodology used by our FundRADAR service and also their findings for the work they have completed.

### Pricing Methodology

The tables below set out the different pricing methodologies adopted by FundRADAR in valuing the securities. For the asset classes listed below we were able to compare the price used by the investment managers to external sources.

Value (£m)	Asset Class	Deviation (£m)	Pricing method
461m	Other (inc. pooled funds, property funds etc)	1.45m	External Price/Mark to Market
307m	Equities	-	External Price/Mark to Market

For derivative investments we validated the pricing assumptions used in the pricing by the investment manager.

Value (£m)	Derivatives	Pricing method
(0.29)m	Forward FX	Recalculation of gain/loss

### Findings

A mark to market approach was used to compare the prices provided by the investment managers with ones from external price sources.

Out of securities tested using FundRADAR, whilst differences were found in some securities, the total deviation noted was £1.45m which is 0.19% of the total value of the securities. [This is not uncommon due to different pricing feeds and exchange rates being used by investment managers.]

Within the portfolio we identified 14 securities where no reliable market data was available. These are included in the Fund's portfolio at a total value of £22m. These have been confirmed to other appropriate confirmations.

### Derivatives

We achieved 100% coverage of the forward foreign exchange contracts.

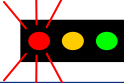


Using the information provided by the custodian we recalculated the gain or loss for each forward foreign exchange contract and verified the futures contract prices to external sources.

### Private equity

We also commissioned one of our private equity team to review the private equity investments and associated accounting policies. Our review focussed on the Partners Group Secondary investments and we verified the valuations and associated accounting policies.

## Appendix 4: Recommendations

We have given each recommendation a risk rating (as explained below) and agreed what action management will need to take.

Priority rating for recommendation		
<p><b>Priority one:</b> issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.</p> 	<p><b>Priority two:</b> issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.</p> 	<p><b>Priority three:</b> issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.</p> 

No.	Priority Rating	Issue and recommendation	Management response	Officer and due date
1	● (two)	<p>The Fund uses the Authority's bank account and as a result the Authority can use the monies within the bank account.</p> <p>There is currently no written agreement between the Authority and the Pension Fund in respect of this arrangement. We recommend that the arrangement is formalised in an agreement which demonstrates that the Fund receives full benefit from its investment.</p>	<p>There is a common understanding on how the pension fund is recompensed by the Council for using any surplus cash. We will ensure this understanding is formally written down and agreed by the Council and the Pension Fund Committee.</p>	<p>Principal Financial Manager – Treasury and Pension Fund Investments 31 March 2010</p>

## Appendix 5: Declaration of independence and objectivity

### Declaration of Independence and Objectivity 2008/09

Auditors appointed by the Audit Commission must comply with the *Code of Audit Practice* (the Code) which states that:

*“Auditors and their staff should exercise their professional judgement and act independently of both the Audit Commission and the audited body. Auditors, or any firm with which an auditor is associated, should not carry out work for an audited body, which does not relate directly to the discharge of auditors’ functions, if it would impair the auditors’ independence or might give rise to a reasonable perception that their independence could be impaired”*

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code, the detailed provisions of the Statement of Independence included within the Audit Commission’s *Annual Letter of Guidance and Standing Guidance* (Audit Commission Guidance) and the requirements of APB Ethical Standard 1 *Integrity, Objectivity and Independence* (‘Ethical Standards’).

The Code states that, in carrying out their audit of the financial statements, auditors should comply with auditing standards currently in force, and as may be amended from time to time. Audit Commission Guidance requires appointed auditors to follow the provisions of ISA (UK & I) 260 *Communication of Audit Matters with Those Charged with Governance* that are applicable to the audit of listed companies. This means that the appointed auditor must disclose in writing:

- Details of all relationships between the auditor and the client, its directors and senior management and its affiliates, including all services provided by the audit firm and its network to the client, its directors and senior management and its affiliates, that the auditor considers may reasonably be thought to bear on the auditor’s objectivity and independence.
- The related safeguards that are in place.
- The total amount of fees that the auditor and the auditor’s network firms have charged to the client and its affiliates for the provision of services during the reporting period, analysed into appropriate categories, for example, statutory audit services, further audit services, tax advisory services and other non-audit services. For each category, the amounts of any future services which have been contracted or where a written proposal has been submitted are separately disclosed.

Appointed auditors are also required to confirm in writing that they have complied with Ethical Standards and that, in the auditor’s professional judgement, the auditor is independent and the auditor’s objectivity is not compromised, or otherwise declare that the auditor has concerns that the auditor’s objectivity and independence may be compromised and explaining the actions which necessarily follow from this. These matters should be discussed with the Oxfordshire County Council Audit Committee.

Ethical Standards require us to communicate to those charged with governance in writing at least annually all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place that, in our professional judgement, may reasonably be thought to bear on our independence and the objectivity of the Audit Partner and the audit team.

### General procedures to safeguard independence and objectivity

KPMG’s reputation is built, in great part, upon the conduct of our professionals and their ability to deliver objective and independent advice and opinions. That integrity and objectivity underpins the work that KPMG performs and is important to the regulatory environments in which we operate. All partners and staff have an obligation to maintain the relevant level of required independence and to identify and evaluate circumstances and relationships that may impair that independence.

Acting as an auditor places specific obligations on the firm, partners and staff in order to demonstrate the firm’s required independence. KPMG’s policies and procedures regarding independence matters are detailed in the Ethics and Independence Manual (‘the Manual’). The Manual sets out the overriding principles and summarises the policies and regulations which all partners and staff must adhere to in the area of professional conduct and in dealings with clients and others.

## Appendix 5: Declaration of independence and objectivity (cont'd)

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KPMG is committed to ensuring that all partners and staff are aware of these principles. To facilitate this, a hard copy of the Manual is provided to everyone annually. The Manual is divided into two parts. Part 1 sets out KPMG's ethics and independence policies which partners and staff must observe both in relation to their personal dealings and in relation to the professional services they provide. Part 2 of the Manual summarises the key risk management policies which partners and staff are required to follow when providing such services.

All partners and staff must understand the personal responsibilities they have towards complying with the policies outlined in the Manual and follow them at all times. To acknowledge understanding of and adherence to the policies set out in the Manual, all partners and staff are required to submit an annual Ethics and Independence Confirmation. Failure to follow these policies can result in disciplinary action.

### **Auditor Declaration**

In relation to the audit of the financial statements of the Oxfordshire County Council Pension Fund for the financial year ended 31 March 2009, we confirm that there were no relationships between KPMG LLP and the Oxfordshire County Council Pension Fund, its officers and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Audit Commission's requirements in relation to independence and objectivity.