

ORGANISATION EUROPÉENNE POUR LA RECHERCHE NUCLÉAIRE
CERN EUROPEAN ORGANIZATION FOR NUCLEAR RESEARCH

<i>Action to be taken</i>		<i>Voting Procedure</i>
TAKE NOTE	FINANCE COMMITTEE 336 th Meeting 22 June 2011	-
TAKE NOTE	COUNCIL 159 th Session 23 and 24 June 2011	-

PENSION FUND

**REPORT BY THE EXTERNAL AUDITORS ON THE ACCOUNTS OF THE
CERN PENSION FUND FOR THE FINANCIAL YEAR 2010**

COMMENTS BY THE PENSION FUND MANAGEMENT UNIT

The report on the audit of the accounts of the Pension Fund for the 2010 financial year is given in document CERN/FC/5532-CERN/2968. This document contains the comments of the Pension Fund Management Unit.

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INTRODUCTION

The Pension Fund Management Unit (PFMU) has examined the Auditors' Report on the accounts of the CERN Pension Fund for the 2010 financial year.

The comments of the PFMU are limited to the clarifications given below. The other elements of the report requiring no comment to be made have been duly noted.

The format of the Fund's financial statements was approved by the Pension Fund Governing Board (PFGB) at its meeting of the 18 February 2010. The Statement of Financial Position includes a Technical Balance Sheet indicating the actuarial present value of promised retirement benefits. International Accounting Standard 26 (IAS 26) – Accounting and Reporting by Retirement Plans, permits that the financial statements are accompanied by the Actuary's Report or that this document is presented separately from the financial statements. There is no requirement in the Standard for disclosure of the Funding Ratio. However, the Fund takes good note of the Auditors' remarks and will review its presentation of this information.

SECTION 2 – CERTIFICATE OF THE EXTERNAL AUDITORS

2.2 Opinion

The Auditor's comments quote the Actuary's Report which states that "if the PF had had to be liquidated at this date, it would have cost Member States 3,185 MCHF.....". In fact this is a liquidation scenario only under IAS 26 principles, which are based on projected salaries to indicate the magnitude of the potential obligations of the Fund and not the obligations payable in the event of a discontinuance of the plan. The Fund will discuss with the Actuary to establish more accurate terminology.

SECTION 3 - NO COMMENT

SECTION 4 - LEGAL STATUS OF THE PENSION FUND WITHIN THE ORGANIZATION

4.1. Amendments to the Rules and Regulations of the Pension Fund

With regard to the recommendation of the External Auditors concerning Financial Regulations and Procurement Rules in respect of the Fund's activities, the Fund will establish, as a priority, a timetable for the drafting and implementation of these procedures.

SECTION 5 - THE CONTROL ENVIRONMENT IN CERN PENSION FUND

5.1. Internal Control Environment

We take note of your recommendation regarding the non-compliance with the Strategic Asset Allocation (SAA) approved by Council in 2008.

We bring to your attention the fact that this SAA was approved prior to the financial crisis, and that conditions in the financial markets have changed dramatically since 2008. We recall also that non-compliance with the SAA dates back to 2009 at which point the PFGB had already decided to suspend normal implementation in view of turbulence in the markets.

Furthermore, the new Rules approved by Council in 2010 replace the prior process to establish the SAA. Since the beginning of 2011, the Fund already operates according to the spirit of the new rules, although the process has not yet been fully formalized.

For instance, in February 2011, the PFIC agreed an updated "Natural Strategic Asset Allocation" for 2011, which the PFMU has since started to implement, providing regular updates to the PFIC and the PFGB.

In addition, the PFMU has already held several discussions of a draft statement of investment principles (SIP). We confirm that we target presenting a formal draft to the PFGB before the end of this year.

5.1.1. Signature of former Administrator of the Fund on bank establishments

All banks with whom the Fund carries out business were informed in writing of this change to the signatory list and the failure to cancel this signature is an omission on the part of the banks in question.

The Fund will write again to these banks to ensure full compliance with the current signatory regime at the Fund. Furthermore, the Fund's internal control system ensured that no payment orders were presented to the former administrator for signature. We also recall that we have a double signature process in place which prevents any unauthorized movement of cash by a single person.

5.1.2. Verification of data used by real estate experts and figures as audited by local auditors

The Fund will establish a reconciliation process to ensure the use of audited data as part of the investment property revaluation exercise.

5.1.3. Sensitivity analysis to be disclosed from January 2013

The provisions of IPSAS 30 will be studied before its entry into effect, in order to ensure that the Fund has the necessary means to ensure full conformity with the Standard.

5.2. Audit

5.2.1. External Audit

Regarding the selection of PWC, we bring to your attention that the initial selection was made after a competitive tender process involving three bids. Repeating the process annually is not consistent with best practice given the time required by the auditor to develop the knowledge and expertise of the Fund. Industry best practice is to keep the same provider for five years. Furthermore, we have initiated the process to formalize a contract with PWC.

Regarding the timely delivery of PWC's report, we note that the timescale for delivery of PWC's report was contained in the 2010 audit plan and endorsed by the PFGB. Within that plan, provision was made and a date set aside for comments by the External Auditors. The opportunity to influence both the content and timeline of the audit plan by the External Auditors is therefore encompassed in the audit planning process.

Finally, regarding your recommendation that "PFGB seek a high level of assurance on the basis of the risks that the PFGB itself would like to specifically monitor..", we consider that the PFGB, being responsible for the financial statements, is not in a position to instruct an independent auditor with regard to the parameters of his mandate.

5.2.2. Internal Audit

Regarding the Internal Audit Function, this topic was extensively discussed in Working Group 1 and at the PFGB in preparation of the update to the Fund's Rules. The recommendation of the PFGB, fully supported by its expert members appointed by Council, was that the internal audit function is best organized through the implementation of a fully functioning Internal Control System (ICS). Review of the effectiveness of the ICS in the course of the annual audit would give reassurance of the compliance of operations with best practice.

6. Financial Results for the Year

Regarding the decline in Funded Status in 2010 and 2011, we bring to your attention the fact that this is also due to the change in the discount rate from 4.5% in 2008 to 2.55% in 2010, and 2.1% in 2011.

We take good note of your recommendation to bring the actuarial review to Council's attention. It is worth noting that the new Rules require the presentation of a full actuarial review to the Council every three years. An annual process is not practical due to the amount of effort and the cost of such a full detailed analysis of the Fund's actuarial situation. The PFGB, of course, is not precluded from performing the full actuarial review more often than every three years, if it deems it necessary.

6.1. Financial Risks versus Performance

The Fund takes note of the Auditors' statement that "We simply bring to the attention of the Council the fact that the underfunding would have been far less significant, if a *"minimum risk policy"* would have been implemented. For example, if in the past 15 years, the Fund's Assets had been invested in long-term governmental Bonds - generally agreed as reference for sound and safe investments, such as, for instance Swiss or German Treasury Bonds - the Fund could have achieved a return on investment without having incurred in a loss in the Financial Assets, and, moreover, also without incurring in the external Portfolios' managers fees".

We are surprised by this conclusion and have strong reservations that such an investment approach would have delivered Council's actuarial return objective of 5% while at the same time respecting a "minimum risk policy". Nevertheless, the Fund will instruct an independent investment

risk consultant to carry out a retrospective study of the risks and returns of such an investment strategy and report the findings to the Pension Fund Investment Committee (PFIC) and the PFGB.

Disclosure of the Risks

Investment Policy

We take good note of your remark that the Fund does not have a policy regarding the choice of principles of ethics in the selection of investments. We will consider your advice to implement such ethical investing guidelines where possible.

7. Audit results

7.2. Procurement Rules

As mentioned above under 4.1 Amendments to the Rules and Regulations of the Pension Fund, the Fund will establish, as a priority, a timetable for the drafting and implementation of these procedures

Regarding the selection of the IT consulting contract, we would like to emphasise the fact that three bids were obtained, and that the award of the mandate was made by the PFGB, on the recommendation of the PFMU, from among the three candidates.

The fact that the successful firm has a link with the external auditor PWC is a coincidence.

It is worth noting that, although the Fund does not have the CERN infrastructure for the adjudication of tender offers, the CERN rules were, as far as possible, applied in spirit.

7.3. Lack of formal authorization

We bring to your attention the fact that the Fund has a travel authorization policy in place for travel by the CEO. The Fund also has a travel authorization process in place for the PFMU staff by which the Fund's management oversees travel. We will study your recommendation to make that procedure more formal.

We note that the issue of travel expenses concerns only the former Administrator. It is important to understand that there was a transition period during which the former administrator, while no longer in office, was actively engaged in transferring his knowledge of 20 years at the Fund,

and managing various aspects of the Fund in coordination with and on request of the CEO.

7.4. Investment properties sales and guarantees

We will instruct the local investment property auditors to incorporate into their audit plan periodic checks of the existence, validity and amounts concerning deposit guarantees.

7.5. Code of Conduct and declaration

The Fund's Code of Conduct was approved by CERN Council as part of the new Rules in December 2010 (CERN/2013/Rev.3). The Code is explicit concerning:

- Persons and bodies subject to the Code
- General responsibilities under the Code
- Rules and procedures governing conflicts of interest (including actions to be taken in cases of conflicts of interest)
- Certification of compliance

Signed Certificates of Compliance have been obtained from the staff of the Management Unit and members and participants in the meetings of the Fund management bodies and their working groups. External service providers have also been advised of their requirement to comply with the Code and the exercise to obtain their certificates of compliance is well advanced.

Given that the Code has been only recently enshrined in the Rules of the Fund, we are very satisfied with its application to date. The Fund, however, is not complacent with regard to this issue and will continue to monitor the effect of the Code in practice and in particular will take good note of developments at the CERN level.

The Management of the Fund would like to warmly thank the Auditors for their examination of the accounts and financial statements of the Fund and their recommendations regarding its operations.