

Aberdeen City Council

Pension Fund Financial Controls and Pension Payroll

Internal Audit Report –
Final

2014/2015 for Aberdeen
City Council

May 2015

Internal Audit KPI Targets	Target dates	Actual dates	Red/Amber/ Green	Commentary where applicable
Terms or reference agreed 4 weeks prior to fieldwork			Green	
Planned fieldwork start date	16 December 2014	16 December 2014	Green	
Fieldwork completion date	16 January 2015	3 April 2015	Red	Significant delays in completing CAATs testing
Issuing draft reports for management comments	17 April 2015	17 April 2015	Green	
Receiving management comments	1 May 2015	3 May 2015	Green	
Issuing finalised reports	8 May 2015	8 May 2015	Green	
Final reports presented to the Pensions Committee	15 June 2015	15 June 2015	Green	

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This report has been prepared solely for Aberdeen City Council in accordance with the terms and conditions set out in our engagement letter 4th October 2010. We do not accept or assume any liability or duty of care for any other purpose or to any other party. This report should not be disclosed to any third party, quoted or referred to without our prior written consent.

Internal audit work will be performed in accordance with Public Sector Internal Audit Standards (PSIAS). As a result, our work and deliverables are not designed or intended to comply with the International Auditing and Assurance Standards Board (IAASB), International Framework for Assurance Engagements (IFAE) and International Standard on Assurance Engagements (ISAE) 3000.

1. Executive Summary

Report classification	Total number of findings					
	Critical	High	Medium	Low	Advisory	
Medium	← Section 3 →					
	Control design	-	-	-	-	-
	Operating effectiveness	-	-	2	2	-
	Total	-	-	2	2	-

Summary of findings

- 1.01 The scope of our review was to consider the design and operating effectiveness of the key controls in relation to the pension payroll, as well as the operating effectiveness of the key financial controls in relation to the pension fund, at the North East of Scotland Pension Fund and Transport Fund. Our testing covered each of the key sub-processes, and involved an assessment of the design and operating effectiveness of the key controls that help achieve the control objectives as set out in the agreed terms of reference.
- 1.02 In general our review identified a sound system of control; however, there were areas for improvement identified in how some key controls operated, particularly around ensuring evidence of proper authorisation and review by senior pension officers. From our review of the controls implemented by the North East of Scotland Pension Fund and Transport Fund we have identified the following two medium risk findings:
- In one instance, from a sample of 45 tested, no evidence was retained of a senior pension officer authorisation for payment of the balance of pension for a deceased member. We also found that in two out of four months tested, no evidence was retained to verify that a senior pension officer had reviewed the payment checklist and completed the payment reconciliations. In all cases a senior pension officer should be authorising and reviewing payments to mitigate against the risk of fraud or error; and
 - From a sample of 45 tested, we identified one case where no evidence had been retained to verify a request for a change in a member's bank details. We also found one instance where a member's change of address had not been properly evidenced. Ensuring proper control over changes in member's details is important to preventing fraud or error.

Management comment

Policies and Procedure will continued to be reviewed throughout 2015 to ensure proper controls are in place.

2. Background and scope

Background

- 2.01 The North East of Scotland Pension Fund (NESPF) and the Transport Fund are administered by Aberdeen City Council within the Local Government Pension Scheme regulations. There are 13 Scheduled bodies including Aberdeen City Council, Scottish Water, Aberdeenshire Council and The Moray Council and 41 admitted bodies.
- 2.02 Aberdeen City Council has delegated responsibility for the administration of the Pension Funds to the Pensions Committee, which is responsible for benefits administration and investment management. The Committee consists of nine City Council elected members. All members have equal voting rights. There is also a Joint Investment Advisory Committee (JIAC), which has responsibility for monitoring the investment management of the Pension Fund and making recommendations to the Pensions Committee on the appointment, retention and termination of investment management contracts.

Compliance with Regulations

- 2.03 We assessed the key procedures in place at the NESPF for ensuring compliance with the terms of all relevant regulations, including The Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations. Our review identified the key controls operated by NESPF including: quarterly compliance monitoring; and that compliance with all relevant laws and regulations is required to be reported as part of the pension fund's annual report. The pension manager is required to report to the JIAC and Pension Committee on any compliance failures that are identified in these quarterly reviews.
- 2.04 The NESPF has an investment strategy and this strategy has been approved by the JIAC and Pensions Committee. The funds invested in by the NESPF are also approved by the JIAC and Pensions Committee. The pensions manager is responsible for collating reports from the fund managers to monitor their adherence to the investment strategy. On a quarterly basis the pensions manager reports to the JIAC and Pensions Committee on the current status of each fund manager, and how they are performing against the investment strategy.

Amendments to Standing Data

- 2.05 We reviewed the design of the key controls in place for amending standing data: this included the controls for new starts, leavers, retirees, death of members or pensioners, and changing bank and address details.
- 2.06 New members of the pension scheme are notified to the NESPF by their employer through submission of the relevant form; white sheets or PEN1 forms are received from the employer for all new members other than employers using iConnect or Employer Services. No new member can be enrolled in the pension scheme without the NESPF having received this form or PEN1 enrolment form except when an employer uses iConnect/ES in which new members are uploaded online.

- 2.07 When a member leaves the pension scheme the employer will submit a cessation notice to the NESPF. No member is removed from the scheme without receipt of this notification. Any calculations required to determine the extent of any refunds due to the leaver or to determine the leavers deferred pension benefits must be approved by two separate pensions or senior pension officers.
- 2.08 The pension system is configured to identify when a member has reached retirement age. No pension payments are made until the NESPF has received a PEN6 cessation notice from the employer confirming that the employee has retired and is eligible to receive their pension. When a member is eligible for early retirement further information must be gathered before making any pension payments; this can depend on the nature of the reason for early retirement. For example, if the early retirement is for ill health a doctor's letter must be obtained.
- 2.09 When notice is received that a pensioner has passed away they are automatically 'closed' in the system to prevent any further pension payments through the pension payroll. On receipt of notification of a pensioner's death the NESPF will look to obtain a death certificate to verify the death.
- 2.10 Changes and amendments to bank details and addresses are only made by the NESPF through a signed letter that includes their pension reference number/NI number, or online through MyPension, which notifies the Pension Department via email of the change, or via a report from the Bank informing of the change made by a member. Once any changes are made the NESPF will send a letter to the member confirming the change to verify that the details have been changed correctly.
- 2.11 Requests for a change to an address for both pensioners, widowers and non-pensioners must be made by either a signed letter, email or call quoting a pension reference number, National Insurance number, or previous address if sent by member, or when an employer changes address details via Employer Services or iConnect. No changes should be made where the member or employer does not provide some form of evidence.
- 2.12 New members must opt to transfer in their existing pension to the NESPF within 12 months of joining. The exception to this rule is members who are transferring in from another NESPF administered scheme, for example a member who moved employment from Aberdeenshire Council to Aberdeen City Council. Only members who were previously a member of another Public Sector Transfer Club pension scheme may transfer in their pension to the NESPF.
- 2.13 When a member opts to transfer out of the NESPF scheme to a new pension scheme they must provide a signed transfer out request detailing the new scheme they wish to join. The pension officers will perform a check of the new scheme and confirm that it is HMRC registered but there is no obligation on the NESPF to prevent members joining non-HMRC registered schemes, although they will as a courtesy notify members if they have concerns regarding the validity of the new scheme.

Annual Benefits Notices and Calculations

- 2.14 With the use of Computer Assisted Audit Techniques we re-performed the monthly pension calculations and lump sums which are automatically calculated by the pension system. Using this method we were able to test the full population of 21,597 calculations since 1 October 2013. The results of this test are shown overleaf:

	Count	Percentage
Calculations agreed as accurate through use of CAATs	20,236	93.7%
Items not following standard calculation due to additional instructions for sharing arrangements or overpayments	23	0.1%
Items where the person has an early redemption date against their pension and so does not follow the standard calculation	1,338	6.2%
Total	21,597	100%

2.15 As can be seen from the table above we were able to agree the accuracy of 99.9% of pension calculations through the use of CAATs. We sample tested calculations from the remaining 0.1% and found no exceptions.

Pension Payments

2.16 NESPF has had to develop new processes and controls in the context of the available staffing resources. There are no dedicated pension payroll staff and the processing of pension payroll has been brought within the scope of the senior pension officers. Management are aware of the risk this creates around a lack of segregation of duties, and therefore controls have been developed in order to mitigate this risk, with the requirement for double review and sign-off of pension payroll processing and payment.

2.17 Immediate Payments (IMM) is now used for all other payments related to pensions not covered by the monthly payroll run, which includes transfers out, lump sums, balance of pensions and refunds. Senior Pensions Officers run a report from the system which generates all payments needing to be paid for the specified period, these reports are run bi-weekly. Segregation of duties exists between the senior pensions officer generating the report and the senior pensions officer authorising the payment.

2.18 The NESPF policy, in line with pension regulations, is for contributions to be received from members by the 19th of the month. We reviewed documentation to ensure that processes were in place to monitor the receipt of contributions and to follow-up when contributions are consistently not received in line with policy and regulations.

2.19 Monthly analytical checks are performed by the pension accounting team that involves comparing data on the pension contributions and pension payroll. The pension accounting team will analyse the contributions received from each employer on a monthly basis. Where variances are identified between the actual amount received and the amount expected to be received, these are logged and assessed for reasonableness and if material investigated by the pension accounting team with the relevant employer.

Use of Third Parties

- 2.20 The NESPF utilises third parties for managing the assets of the pension fund. These third parties are required to provide annual SAS 70 or ISAE 3402 reports to provide assurance concerning the effectiveness of their control environment. The pensions manager will receive and review these reports and will communicate any findings to the JIAC at the appropriate quarterly meeting. In the event that a serious issue is ever identified the pensions manager can call for an emergency meeting of the JIAC to present the findings.

Scope and limitations of scope

- 2.21 The detailed scope of this review is set out in the Terms of Reference (within Appendix 2).

3. Detailed findings and recommendations

3.01 Payment and reconciliations – Control operation

Finding

For Cessation Notices, any calculations required for deferred leavers or refunds are made by the system and checked by a senior pension officer. As per the Pension Administration Strategy 2013, the target to process, refund and issue payment is 10 days. However, in one instance from a sample of 45 tested, we identified a refund calculation and authorisation of payment that had not been processed and was still outstanding, with the cessation notice being received from the member over three months prior to the date of our testing.

Our review further identified one case, from a sample of 45 tested, where authorisation by a senior pension officer for payment of the balance of pension for a deceased member could not be evidenced. All such payments should be authorised by a senior pension officer prior to payment. We also identified missing documentation for two months out of four selected for testing where reconciliations between the BACS payment, the amount per the payroll report and the amount per the system, could not be evidenced as the documents had not been scanned on to the system. As a result we could not find evidence that a senior pension officer authorisation and check had been performed for those months.

Risks

There is a risk that payments could be incorrect or that fraud or error may occur in the process without proper checks due.

Action plan

Finding rating	Agreed action	Responsible person / title
Medium	<ul style="list-style-type: none">• Management will reiterate to senior pension officers the importance of following procedure and ensuring that appropriate checks have been performed for all payments. Management will also ensure that reconciliations are performed and that the monthly pension checklists are completed.• Management will aim to process refunds in line with PAS2013 performance targets and communicate targets to employees.• Management will ensure better control is held around the provision of documentation.	<p>Pensions Manager</p> <hr/> <p>Target date:</p> <p>Immediate implementation of actions agreed while all policies and procedures will continue to be reviewed.</p>

3.02 Changes in member details – Control operation

Finding		
<p>In one instance, from a sample of 45 tested, we found no evidence of any correspondence received from either the employer, or member, notifying of a need for a change in bank details. Changes to bank details must be made by a member either through a signed letter or email that includes their pension reference number or National Insurance number, online through MyPension, or following a report from the bank informing of the change made by the member. No changes should be made other than through the processes above.</p> <p>We also identified one instance, from a sample of 45 tested, where a member’s request for a change of address was made through a telephone call. Changes to address should follow a similar process to a change in bank details; however, in this instance there was no further evidence to support the member’s request other than a log of the date and time of the call.</p>		
Risks		
<p>Improper procedures around changes in member details, such as bank details and addresses, increase the risk of members becoming the victims of fraud.</p>		
Action plan		
Finding rating	Agreed action	Responsible person / title
Medium	<ul style="list-style-type: none"> • Management will ensure better control around holding sufficient documentation for evidence will be carried out, especially around areas of the system containing sensitive information such as bank details. • Management agreed when a member sends a request to change their address via a telephone call, that the member will be required to provide further evidence to verify the veracity of their request. 	<p>Pensions Manager</p> <hr/> <p>Target date:</p> <p>Immediate implementation of actions agreed while all policies and procedures will continue to be reviewed.</p>

3.03 Statutory notices for new members – control operation

Finding

White sheets or PEN1 forms are received from the employer for all new members other than employers using iConnect or Employer Services. From a sample of 45 tested we found four cases where there was no evidence of a statutory notice being sent to members. Regardless of the method chosen to enrol members into the pension scheme, a statutory notice should be automatically generated and sent to the member.

Risks

There is a risk that member data may be incomplete or inaccurate, and that proper policies and procedures may not have been followed.

Action plan

<u>Finding rating</u>	<u>Agreed action</u>	<u>Responsible person / title</u>
Low	Management will ensure evidence of statutory notices being sent to all members is retained for each member and adequate documentation is held for audit purposes.	Pensions Manager
		<u>Target date:</u> Immediate implementation of actions agreed while all policies and procedures will continue to be reviewed.

3.04 Third party controls report review - control operation

Finding		
<p>On an annual basis the Pensions Manager is required to review the controls reports issued by third party fund managers and custodians of the pension fund. The Pensions Manager must then report to the Pensions Committee on any issues identified in those reports. In our review, for the 10 reports received in 2014, we found one instance where the controls report received from the third party had not been reviewed and reported on to the Pensions Committee.</p>		
Risks		
<p>There is a risk that any issues identified in the third party reports would not be identified on a timely basis. Control failures at third parties (i.e. fund managers or pension custodians) could result in losses of data or financial loss for the pension fund in turn resulting in regulatory non-compliance issues.</p>		
Action plan		
Finding rating	Agreed action	Responsible person / title
Low	The Pensions Manager will ensure that review and sign off of all third party reports is performed annually and any issues reported to the Pensions Committee on a timely basis.	Pensions Manager
		Target date: Immediate implementation of actions agreed while all policies and procedures will continue to be reviewed.

Appendix 1 – Basis of our classifications

Individual finding ratings

Finding rating	Assessment rationale
Critical	A finding that could have a: <ul style="list-style-type: none"> • Critical impact on operational performance; or • Critical monetary or financial statement impact; or • Critical breach in laws and regulations that could result in material fines or consequences; <i>or</i> • Critical impact on the reputation or brand of the organisation which could threaten its future viability.
High	A finding that could have a: <ul style="list-style-type: none"> • Significant impact on operational performance; or • Significant monetary or financial statement impact ; or • Significant breach in laws and regulations resulting in significant fines and consequences ; <i>or</i> • Significant impact on the reputation or brand of the organisation.
Medium	A finding that could have a: <ul style="list-style-type: none"> • Moderate impact on operational performance; or • Moderate monetary or financial statement impact; or • Moderate breach in laws and regulations resulting in fines and consequences; or • Moderate impact on the reputation or brand of the organisation.
Low	A finding that could have a: <ul style="list-style-type: none"> • Minor impact on the organisation’s operational performance; or • Minor monetary or financial statement impact; or • Minor breach in laws and regulations with limited consequences; or • Minor impact on the reputation of the organisation.
Advisory	A finding that does not have a risk impact but has been raised to highlight areas of inefficiencies or good practice.

Report classifications

Findings rating	Points
Critical	40 points per finding
High	10 points per finding
Medium	3 points per finding
Low	1 point per finding

Report classification	Points
Low risk	6 points or less
Medium risk	7– 15 points
High risk	16– 39 points
Critical risk	40 points and over

Appendix 2 – Terms of reference

Aberdeen City Council

Terms of Reference – Pension Fund Financial Controls and Pension Payroll

This review is being undertaken as part of the 2014/2015 internal audit plan approved by the Audit & Risk Committee approved in April 2014.

Background

The North East of Scotland Pension Fund and the Transport Fund are administered by Aberdeen City Council within the Local Government Pension Scheme regulations. There are 13 scheduled bodies including ACC, Scottish Water, Aberdeenshire Council and The Moray Council.

Aberdeen City Council has delegated strategic responsibility for the administration of the Pension Funds to the Pensions Committee, who are responsible for benefits administration and investment management. The Committee consists of 9 City Council elected members, including at least one from each of the major political parties. All members have equal voting rights. There is also a Joint Investment Advisory Committee (JIAC). The JIAC have responsibility for monitoring the investment management of the Pension Fund and making recommendations to the Pensions Committee on the appointment, retention and termination of investment management contracts.

Scope

The overall scope of this review will be to consider the design and operating effectiveness of the key controls in relation to the pension payroll as well as the operating effectiveness of the key controls in relation to the pension fund. The sub-processes and related control objectives included in this review are:

Compliance with Regulations	<ul style="list-style-type: none"> • Procedures are in place for complying with the terms of all relevant regulations, including The Local Government Pension Scheme (Benefits, Membership and Contributions) (Scotland) Regulations. • An investment strategy exists at a fund level and only assets in line with this strategy are invested in.
Amendments to Standing Data	<ul style="list-style-type: none"> • Appropriate procedures are implemented in order that amendments to standing data, such as new starts, leavers, retirees and death of pensioners are recorded timeously and accurately. This includes leaver notifications, death certificates and pension enrolment forms. • All transfers in have a valid transfer pack to ensure all relevant information has been obtained. • Procedures exist to ensure transfers out are to valid schemes. • Appropriate procedures are implemented in order that amendments such as bank details and addresses are appropriately authorised as complete and accurate.
Annual Benefit Notices and Calculations	<ul style="list-style-type: none"> • Monthly pension calculations and lump sums are calculated accurately (this will be tested through the use of Computer Assisted Audit Techniques). • Annual benefit notices are accurate and are distributed to existing active members on a timely basis.
Pension Payments	<ul style="list-style-type: none"> • Pension payments are only made to those members of the pension scheme entitled to receive such benefits and that payments made at point of retirement. • Appropriate controls are in place so that pension payments are complete and accurate. • Appropriate checks are in place to ensure contributions are paid to the scheme by 19th of the following calendar month in line with pension regulations. • Monthly analytical checks are performed to identify any unusual trends and these are acted upon.
Use of third parties	<ul style="list-style-type: none"> • The Council has assurance over the control environment operating at third parties such as pension custodians through obtaining and reviewing SAS 70 and ISAE 3402 controls reports.

Audit approach

Our audit approach is as follows:

- Obtain an understanding of the key controls in place through discussions with key personnel, and review of supporting governance documentation
- Identify the key risks of the pension fund financial controls and payroll
- Evaluate the design of the controls in place to address the key risks
- Test the operating effectiveness of the key controls on a sample basis
- Use computer assisted audit techniques (CAATs) to test the accuracy of pension calculations.

Limitations of scope

The scope of our work is outlined above. Our review will be conducted on a sample basis. We will not assess the governance arrangements in place around the pension funds.

Internal control, no matter how well designed and operated, can provide only reasonable and not absolute assurance regarding achievement of an organisation's objectives. The likelihood of achievement is affected by limitations inherent in all internal control systems. These include the possibility of poor judgment in decision-making, human error, control processes being deliberately circumvented by employees and others, management overriding controls and the occurrence of unforeseeable circumstances.

Appendix 3 – Limitations and responsibilities

Limitations inherent to the internal auditor's work

We have undertaken a review of the Pension Fund Financial Controls and Pension Payroll.

Internal control

Internal control, no matter how well designed and operated, can provide only reasonable and not absolute assurance regarding achievement of an organisation's objectives. The likelihood of achievement is affected by limitations inherent in all internal control systems. These include the possibility of poor judgment in decision-making, human error, control processes being deliberately circumvented by employees and others, management overriding controls and the occurrence of unforeseeable circumstances.

Future periods

Our assessment of controls relating to the Pension Fund Financial Controls and Pension Payroll is at April 2015. Historic evaluation of effectiveness is not relevant to future periods due to the risk that:

- the design of controls may become inadequate because of changes in operating environment, law, regulation or other; or
- the degree of compliance with policies and procedures may deteriorate.

Responsibilities of management and internal auditors

It is management's responsibility to develop and maintain sound systems of risk management, internal control and governance and for the prevention and detection of irregularities and fraud. Internal audit work should not be seen as a substitute for management's responsibilities for the design and operation of these systems.

We endeavour to plan our work so that we have a reasonable expectation of detecting significant control weaknesses and, if detected, we shall carry out additional work directed towards identification of consequent fraud or other irregularities. However, internal audit procedures alone, even when carried out with due professional care, do not guarantee that fraud will be detected.

Accordingly, our examinations as internal auditors should not be relied upon solely to disclose fraud, defalcations or other irregularities which may exist.

In the event that, pursuant to a request which Aberdeen City Council has received under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004 (as the same may be amended or re-enacted from time to time) or any subordinate legislation made thereunder (collectively, the "Legislation"), Aberdeen City Council is required to disclose any information contained in this document, it will notify PwC promptly and will consult with PwC prior to disclosing such document. Aberdeen City Council agrees to pay due regard to any representations which PwC may make in connection with such disclosure and to apply any relevant exemptions which may exist under the Legislation. If, following consultation with PwC, Aberdeen City Council discloses any this document or any part thereof, it shall ensure that any disclaimer which PwC has included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.

This document has been prepared only for Aberdeen City Council and solely for the purpose and on the terms agreed with Aberdeen City Council in our agreement dated 4 October 2010. We accept no liability (including for negligence) to anyone else in connection with this document, and it may not be provided to anyone else.

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