

ABERDEEN CITY COUNCIL

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<b>COMMITTEE</b>	Pensions Committee
<b>DATE</b>	14 June 2019
<b>EXEMPT</b>	No
<b>CONFIDENTIAL</b>	No
<b>REPORT TITLE</b>	Internal Audit Report AC1923 – Pension Governance
<b>REPORT NUMBER</b>	IA/AC1923
<b>CHIEF OFFICER</b>	Fraser Bell
<b>REPORT AUTHOR</b>	David Hughes
<b>TERMS OF REFERENCE</b>	2.2

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**1. PURPOSE OF REPORT**

- 1.1 The purpose of this report is to present the planned Internal Audit report on Pension Governance.

**2. RECOMMENDATION**

- 2.1 It is recommended that the Committee review, discuss and comment on the issues raised within this report and the attached appendix.

**3. BACKGROUND / MAIN ISSUES**

- 3.1 Internal Audit has completed the attached report which relates to an audit of Pension Governance.

**4. FINANCIAL IMPLICATIONS**

- 4.1 There are no direct financial implications arising from the recommendations of this report.

**5. LEGAL IMPLICATIONS**

- 5.1 There are no direct legal implications arising from the recommendations of this report.

**6. MANAGEMENT OF RISK**

- 6.1 The Internal Audit process considers risks involved in the areas subject to review. Any risk implications identified through the Internal Audit process are as detailed in the attached appendix.

## 7. OUTCOMES

- 7.1 There are no direct impacts, as a result of this report, in relation to the Local Outcome Improvement Plan Themes of Prosperous Economy, People or Place, or Enabling Technology, or on the Design Principles of the Target Operating Model.
- 7.2 However, Internal Audit plays a key role in providing assurance over, and helping to improve, the Council's framework of governance, risk management and control. These arrangements, put in place by the Council, help ensure that the Council achieves its strategic objectives in a well-managed and controlled environment.

## 8. IMPACT ASSESSMENTS

<b>Assessment</b>	<b>Outcome</b>
<b>Equality &amp; Human Rights Impact Assessment</b>	An assessment is not required because the reason for this report is for Committee to review, discuss and comment on the outcome of an internal audit. As a result, there will be no differential impact, as a result of the proposals in this report, on people with protected characteristics.
<b>Data Protection Impact Assessment</b>	Not required
<b>Duty of Due Regard / Fairer Scotland Duty</b>	Not applicable

## 9. APPENDICES

- 9.1 Internal Audit report AC1923 – Pension Governance.

## 10. REPORT AUTHOR DETAILS

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**Internal Audit Report**

**North East Scotland Pension Fund**

**Pension Governance**

**Issued to:**

Steven Whyte, Director of Resources  
Laura Colliss, Pension Fund Manager  
Jonathan Belford, Chief Officer – Finance  
Fraser Bell, Chief Officer – Governance  
Mairi Suttie, Governance Manager  
Audit Scotland

## **EXECUTIVE SUMMARY**

The North East Scotland Pension Fund (NESPF) and the Aberdeen City Council Transport Fund (ACCTF), jointly known as the Fund, are administered by Aberdeen City Council.

The objective of this audit was to provide assurance over the governance arrangements and procedures in place including risk management and performance management. In general the governance arrangements are appropriate, and aligned with regulatory requirements.

The Council recently adopted a revised Risk Management Framework, which is not currently being applied in full by the Fund. CIPFA has highlighted that it is best practice for local government pension schemes to have their own risk management arrangements. The Service will review and implement procedures to reflect the Fund's requirements.

Whilst Committee and Board members' training is planned and reported on annually, there have been instances where the requirements of the Fund's training policy were not being met. The Service plans to review the policy to ensure appropriate actions can be taken.

Fund managers' performance is subject to regular reporting and review, however there is potential for variation in how this is managed due to varying contractual and monitoring arrangements. The Service has agreed to develop documentation to further promote clarity and assurance of its performance management arrangements, however, has accepted the risk that not all fund managers produce independently assured annual service organisation control reports.

# 1. INTRODUCTION

- 1.1 The North East Scotland Pension Fund (NESPF) and the Aberdeen City Council Transport Fund (ACCTF), jointly known as the Fund, are administered by Aberdeen City Council.
- 1.2 The NESPF provides pension services to 53 bodies and had a net worth of £4.1 billion at the end of the 2017/18 financial year. Members include: all employees of the 11 scheduled bodies, except for those whose employment entitles them to belong to another statutory pension scheme (e.g. Police, Fire, Teachers), 15 transferee bodies and 27 admitted bodies. The employees of the admitted bodies can join the Scheme subject to their individual admission criteria, which are outwith the control of Aberdeen City Council.
- 1.3 The Aberdeen City Council Transport Fund was created in October 1986 for employees of the former passenger Transport Undertaking who transferred to the limited company now known as First Aberdeen, which was created at that time, and has a net worth of £100.1 million at the end of the 2017/18 financial year.
- 1.4 The Funds are built up from contributions from both employees and employing bodies, together with interest, dividends, and rent from investments, out of which pensions and other benefits are paid. Employee contributions are fixed by statute while employer contributions are assessed every three years by an independent Actuary to determine the level of contributions necessary by employing bodies to ensure that the Funds are able to meet future benefits as they fall due.
- 1.5 The objective of this audit was to provide assurance over the governance arrangements procedures in place including risk management and performance management.
- 1.6 The factual accuracy of this report and action to be taken regarding the recommendations made have been agreed with Laura Colliss, Pension Fund Manager, and Mairi Suttie, Governance Manager.

## 2. FINDINGS AND RECOMMENDATIONS

### 2.1 Governance Structure

- 2.1.1 The Governance structure of the Fund is defined within the Governance Policy, which is available to view on the NESPF website and was last updated in April 2018. It covers the roles and responsibilities of all those involved in the governance of both the North East Scotland Pension Fund and the Aberdeen City Council Transport Fund. This is in partial or full compliance with the Public Service Pensions Act 2013, The Local Government Pension Scheme (Scotland) Regulations 2018, and the Pensions Regulator Code of Practice no. 14 “Governance and administration of public service pension schemes”. Out of the 16 guiding principles identified for compliance by the Pension Regulator, compliance is full for 14 and partial for 2. Where compliance is partial explanations of why this is the case are detailed in the Governance Compliance Statement.
- 2.1.2 The governance structure is clearly defined within the Governance Policy at a basic level, including a diagram. However, the associated governance arrangements for external service providers are not included within this. There is a risk that the impact of external services is not fully understood, particularly by members with no financial experience, and therefore decisions are not as transparent as they could be.

#### **Recommendation**

The Service should include external service providers in the Governance Structure Diagram.

#### **Service Response / Action**

Agreed. We will update the diagram to include external service providers.

#### **Implementation Date**

June 2019

#### **Responsible Officer**

Governance Manager

#### **Grading**

Important within audited area

### 2.2 Governance Related Policies

- 2.2.1 Various governance related policies are available to view on the NESPF webpage, ensuring easy access for any member of the scheme as expected by the Pensions Regulator’s Principles of Governance, specifically Principle I – Publicity.
- 2.2.2 The policies are all reviewed annually. The dates of when a policy was last reviewed, and its next review date are contained within the first page of each policy. It is also specified on each policy who the author is and which team is responsible, aiding openness and transparency.
- 2.2.3 A number of policies are specifically required by the Pensions Regulator such as the Internal Dispute Resolution Policy. This must be made readily available to scheme members. The internal dispute resolution procedures are referenced in the guide to the scheme sent to all new members with information on how to obtain these through either contact with the NESPF or by going online.
- 2.2.4 It is also a requirement that the Fund report any breaches of the law that would be deemed as significant to the Pensions Regulator, and / or the Information Commissioners Office depending on the type of breach. The Fund’s policy is thorough and contains examples of breaches that would and would not require reporting. All breaches, significant or otherwise, must be recorded on the Breaches Register and this document is regularly reviewed and updated. On the register the rationale behind whether to report or not report a breach is documented as well as when it occurred, the type of breach, a brief description,

potential consequences, and a risk matrix detailing the impact and likelihood of recurrence. This matrix is used to help assess whether a breach should be reported or not. Procedures are available to staff to enable them to deal with any breaches of the law and report them appropriately.

2.2.5 A conflicts of interest policy is in place and complies with regulatory and legal requirements. Although the Policy only specifically covers the Pensions Board; the Committee is covered by the Councillor Code of Conduct; and the Chief Officer – Finance by the Aberdeen City Council Employee Code of Conduct. The Conflicts Register collates all relevant details in respect of the Fund.

2.2.6 A training policy is in place that applies to Members of the Pensions Committee and the Pensions Board. However, the policy is not always complied with: 6 of 16 members of the Committee and Board had not attended at least 2 days of training as stipulated in the Training Policy. Attendance details were provided to the Committee and Board for discussion at their meeting on 22 June 2018, and future training plans were discussed, but the risks of non-compliance were not highlighted. The policy does not define the action to be taken in the event of training falling short of its requirements. There is, therefore, a risk that members may not have the appropriate knowledge required for their roles, and therefore could be in breach of the Pensions Regulators Code of Practice No. 14 (Governance and administration of Public Service Pension Schemes) in particular regard to the “Knowledge and understanding required by pension board members.”

**Recommendation**

The Service should ensure compliance with the Training Policy

**Service Response / Action**

Agreed. Fund Officers will review and discuss with the Pension Board at the annual meeting in June. The Training Policy will also be reviewed to set out actions that will be taken to address instances where minimum requirements are not being met, and this will also be taken to Committee in June.

**Implementation Date**

June 2019

**Responsible Officer**

Governance Manager

**Grading**

Significant within audited area

**2.3 Risk Management Policies and Procedures**

2.3.1 The Pension Fund follows the Aberdeen City Council Risk Management Framework. According to the Aberdeen City Council Financial Regulations: “*The Risk Management Framework contains the procedures to be adopted to ensure risk is properly identified and appropriate mitigating control actions are put into place.*” The framework delivers thorough and clear explanations of the procedures to follow in regard to risk management.

2.3.2 The Framework identifies a risk aware approach for the Council, and notes that development of a risk appetite statement is being considered. Whilst this is not inconsistent with the Fund’s requirements, it is exposed to different types of risk, and will have a different appetite for different types of risk – e.g. for investments as influenced by its funding strategy. A more tailored approach may be of benefit. Recent guidance from CIPFA, entitled “Managing Risk in the Local Government Pension Scheme (2018)”, recommends that LGPS’ develop their own risk management framework.

**Recommendation**

The Service should develop a Fund specific Risk Management Framework.

**Service Response / Action**

Agreed. Fund Officers will review and implement a Fund specific Risk Management Framework as per CIPFA guidance.

**Implementation Date**

December 2019

**Responsible Officer**

Governance Manager

**Grading**

Important within audited area

2.3.3

A risk register is produced, however it does not follow the format set out in the Framework, which results in a lack of detail surrounding the risks the Fund faces and the controls that are in place for these. In addition, although the risk register is reviewed quarterly by the Pension Fund Management Team, the current format does not provide a record of this review and any changes applied as a result.

**Recommendation**

The Service should update the risk register to follow the format described within the Risk Management Framework.

**Service Response / Action**

Agreed. A Fund specific Risk Management Framework will be implemented in line with recommendation 2.3.2. Going forward the risk register will feature quarterly on the management team meeting agenda and any discussions around review/changes minuted.

**Implementation Date**

December 2019

**Responsible Officer**

Governance Manager

**Grading**

Important within audited area

2.3.4

The risk register is included in quarterly strategy reports presented at Committee, rather than as a separate item. As a result there is limited evidence of discussion regarding risk management, and therefore of compliance with the Council's Risk Management Framework – which requires Committee oversight of registers reflecting risks falling within their terms of reference, as well as receiving an annual report on effectiveness and forward plan scheduling.

**Recommendation**

The Service should ensure the Pensions Committee and Pension Board are provided with the opportunity to discuss risk registers and risk management at least annually.

**Service Response / Action**

Not agreed. Committee members are provided with opportunity to discuss the risk register quarterly. We see no need to take an additional annual report or provide it as a separate item on the agenda. However, further consideration will be given to reporting/escalation of risk as part of the development of the Fund specific Risk Management Framework.

**Internal Audit Comment**

Service response noted.

**Grading**

Important within audited area



## 2.4 Internal Controls

- 2.4.1 All services provided to the Fund by external suppliers are subject to Service Level Agreements contained within the contracts between the Fund and their suppliers. This ensures that the Fund has recourse in the event that a supplier is unable or unwilling to administer the services required.
- 2.4.2 Service providers are asked to supply evidence of an internal controls assessment annually. One supplier has provided a self-certification, with more limited detail, rather than evidence of an independent review. This was raised in Internal Audit report AC1620: Pensions Investment Strategy & Investment Performance Management, and management stated that this was considered adequate given the level of investment with this fund management company at the time, and avoided additional costs.
- 2.4.3 One instance was identified where the last report was dated 27 February 2017, and related to the providers' operations to the year ended 31 December 2016. Another covered a period between October 2015 and January 2017 and is therefore also out of date, and indicates that assurance is not being obtained for each separate year. There is a risk that assurance over internal controls is not being obtained and these may not be as robust as expected.

### **Recommendation**

The Service should ensure statements of Internal Controls are obtained annually.

### **Service Response / Action**

Not agreed. Fund Officers request the latest version of internal control reports on an annual basis, usually in March as part of the year end process. However not all fund managers will update these reports annually and some of the smaller fund managers do not produce them at all. There is a lot of work/cost involved to produce these, so they are not always produced annually (but normally no less than 2 yearly). In addition to the report, Fund Officers take assurance from due diligence at the point of appointment and from our ongoing relationship with the service providers. The Service has considered and accepted the risk of not obtaining these reports.

### **Internal Audit Comment**

Service response noted.

### **Grading**

Significant within audited area

## 2.5 Performance Management

- 2.5.1 There is no policy or procedures relating to reporting the performance of the Fund to the Pensions Committee and the Board, but reports are sent to every meeting. While the Pensions Committee business planner stipulates in advance what will be discussed at any one meeting it would be good practice to set out the specified frequency and content of required reports to ensure continued support in the event of staffing or other changes.

### **Recommendation**

The Service should set the frequency and content of performance reporting for the Pensions Committee.

### **Service Response / Action**

Agreed. The Investment Policy will be amended to include a reference to The Local Government Pension Scheme (Management and Investment of Funds) (Scotland) Regulations 2010, 10 Review of Investment Managers performance. Confirming content and frequency of performance reporting to the Pension Committee.

<u>Implementation Date</u>	<u>Responsible Officer</u>	<u>Grading</u>
June 2019	Governance Manager	Important within audited area

- 2.5.2 There is no specific guidance on how to deal with underperformance of Fund Managers: this is dealt with on a case by case basis. Whilst circumstances will vary, a clear procedure would provide more assurance that these are being treated consistently, fairly and within an appropriate timescale.

<b><u>Recommendation</u></b> The Service should develop guidance on dealing with underperformance of Fund Managers.		
<b><u>Service Response / Action</u></b> Agreed. We will expand on 2.5.1 to include details of how underperformance of managers is managed.		
<u>Implementation Date</u>	<u>Responsible Officer</u>	<u>Grading</u>
June 2019	Pension Fund Manager	Important within audited area

**AUDITORS:** D Hughes  
C Harvey  
C Johnston

## Appendix 1 – Grading of Recommendations

GRADE	DEFINITION
<b>Major at a Corporate Level</b>	The absence of, or failure to comply with, an appropriate internal control which could result in, for example, a material financial loss, or loss of reputation, to the Council.
<b>Major at a Service Level</b>	<p>The absence of, or failure to comply with, an appropriate internal control which could result in, for example, a material financial loss to the Service/area audited.</p> <p>Financial Regulations have been consistently breached.</p>
<b>Significant within audited area</b>	<p>Addressing this issue will enhance internal controls.</p> <p>An element of control is missing or only partial in nature.</p> <p>The existence of the weakness identified has an impact on a system's adequacy and effectiveness.</p> <p>Financial Regulations have been breached.</p>
<b>Important within audited area</b>	Although the element of internal control is satisfactory, a control weakness was identified, the existence of the weakness, taken independently or with other findings does not impair the overall system of internal control.