REPORT TO: **PENSION SUB-COMMITTEE OF THE POLICY & RESOURCES COMMITTEE & PENSION BOARD – 20 MARCH 2023**

REPORT ON: **TAYSIDE PENSION FUND INTERNAL AUDIT REPORT –CONTRIBUTION MONITORING REVIEW**

REPORT BY: **EXECUTIVE DIRECTOR OF CORPORATE SERVICES**

REPORT NO: **92-2023**

1 PURPOSE OF REPORT

To submit to the Sub-Committee the Audit Report prepared by the Fund's Internal Auditor, PricewaterhouseCoopers (PwC).

2 RECOMMENDATIONS

The Sub-Committee is asked to note the content of the report on the audit exercise undertaken, and to approve the management response.

3 FINANCIAL IMPLICATIONS

None.

4 MAIN TEXT

4.1 Internal Audit Report – Contribution Monitoring Review (Appendix A)

The report details the review of the design and operating effectiveness of the contribution monitoring processes and procedures in place at Tayside Pension Fund (TPF). We reviewed the aspects of the risk management framework that allow the Pension Board and Sub-Committee to identify, evaluate and record risks and monitor the internal controls that have been established to monitor employer contributions into Tayside Pension Fund

4.2 PwC have rated the control environment as satisfactory with exceptions, and medium risk. Further details are included in Appendix A of their report. PwC classify medium risk as that a finding could have moderate impact on operational performance, reputation, financial impact, or regulatory breach.

4.3 The findings and recommendations of the audit have been discussed with management and their responses are contained within the reports. The implementation of the agreed management actions will be monitored, with progress being reported to the Sub-Committee in due course.

5 POLICY IMPLICATIONS

This report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management. There are no major issues.

6 CONSULTATIONS

The Chief Executive and Head of Democratic and Legal Services has been consulted on the content of this report and agree with the contents.

7 BACKGROUND PAPERS

None

ROBERT EMMOTT
EXECUTIVE DIRECTOR OF CORPORATE SERVICES **10 APRIL 2023**

Internal audit report 2022/2023

Contribution Monitoring

Tayside Pension Fund
Final
March 2023

Contents

Distribution list

For action:
Stuart Norrie (Senior Banking and Investment Officer)

For information:
Pension Board & Pension Sub-Committee
Executive Director Corporate Services
Head of Corporate Finance

Executive summary

Report classification

Satisfactory with Exceptions (8 points)

Total number of findings

	Critical	High	Medium	Low	Advisory
Control design	-	-	2	2	-
Operating effectiveness	-	-	-	-	-
Total	**-**	**-**	**2**	**2**	**-**

Impact of our findings on opinion areas

Area	Impact
Risk Management	No findings have been identified that impact Risk Management.
Corporate Governance	No findings have been identified that impacts Corporate Governance.
Internal Control	Findings have been identified that impacts Internal Controls.

Summary of findings

Our review considered the design and operating effectiveness of the contribution monitoring processes and procedures in place at Tayside Pension Fund (TPF). We reviewed the aspects of the risk management framework that allow the Pension Board and Sub-Committee to identify, evaluate and record risks and monitor the internal controls that have been established to monitor employer contributions into TPF. The detailed scope of this review can be found in Appendix B.

A summary of our findings noted during our review are as follows:

- **Insufficient documentation of breaches (Medium):** Records of breaches should be kept in the breach log regardless of materiality. However, the breach log only records material breaches and records of internal discussion are not kept in an easily accessible format.
- **Limited policies and procedures in place (Medium):** TPF does not have documented policies and procedures in place to ensure the contributions process is conducted consistently.
- **Differences between expected and actual contributions are not consistently investigated (Low):** Differences between expected and actual contributions are only investigated for variances over £10. Either all variances should be investigated, or a documented rationale should be in place to justify the £10 threshold.
- **Reminder emails to employers cannot be evidenced (Low):** Employers are reminded to send contributions on time, but TPF's system to send reminders cannot show an audit trail of these being sent.

Current year findings

1 Insufficient documentation of breaches

Control design

Finding rating

Rating	Medium

Finding and root cause

Pension funds should report all breaches of pension regulations that are considered likely to be of material significance to the Pensions Regulator. Guidance on which breaches are material is provided in Code 1 of the Pension Regulator's Code of Practice.

To assist decision-making in this respect, funds should have a breach log in place, which records all breaches of pension regulations, such as the requirement for employers to submit contributions on time. As noted in Code 1, a satisfactory procedure is likely to include 'a system to record breaches even if they are not reported to the Pensions Regulator (the principal reason for this is that the record of past breaches may be relevant in deciding whether to report future breaches)'. The breach log should also contain details of the breach and the rationale behind reporting (or not reporting) breaches to the Pensions Regulator, as these may inform reporting of future breaches.

TPF has a breach log in which breaches recorded are assigned a rating of red, amber or green, in line with Code 1 guidance. However, current policy is to only record breaches that are considered material by TPF. In addition, discussion with TPF's Section 95 Officer (who makes the decision on whether or not to report the breach to the Pension Regulator) is not detailed in the breach log. Although these discussions are documented, they often form part of wider discussions on whether an employer can afford to remain in the Fund, meaning that it is not possible to easily retrieve discussions relating to breach reporting. This means that it is not possible to use past reporting decisions to inform whether or not future breaches should be reported.

Potential implications

If immaterial breaches are not recorded in the breach log, there is a risk that TPF fails to report a breach to the Pension Regulator when it would be considered to be of material significance on the basis of previous immaterial breaches. This could expose TPF to regulatory consequences from the Pensions Regulator.

If details of decisions on whether or not to report breaches are not easily accessible, there is a risk that the decisions cannot be used to inform future reporting decisions, increasing the likelihood of materially significant breaches not being reported. There is also a risk that TPF cannot evidence its monitoring processes and demonstrate that they have met the legal requirement to establish and operate adequate internal controls.

Management action plan

1. Record all identified breaches in the breach log, regardless of materiality.
2. Record all discussions with the Section 95 Officer on whether breaches should be reported to the Pensions Regulator in the breach log.

Responsible person/title:

Senior Manager – Financial Services

Target date: 31 March 2023

Current year findings

2 Limited policies and procedures in place

Control design

Finding rating

Rating	Medium

Finding and root cause

Policies and procedures should be in place to ensure processes relating to contributions monitoring are conducted consistently. These include:

- A Pension Administration Strategy, detailing employers' obligations to pay contributions, and any potential penalties for late contributions;
- Internal policies on the contributions monitoring process, including reconciling expected contributions to actual contributions, reconciling the TPF91 return to contribution payment and roles and responsibilities in these sub-processes; and
- A breach policy, detailing the definition of a breach and events to be taken in the event of a breach.

TPF has a Pension Administration Strategy in place but does not have these other policy documents.

Potential implications

If documented policies and procedures are not in place, there is a risk that the contributions process is not conducted consistently and in line with good practice. This may result in damaged employer relationships if penalties from the Pension Administration Strategy are not applied consistently. Documented procedures also provide a source of knowledge and direction for individuals in the event of key staff members (who are familiar with the operation of these processes) not being available for a period of time.

Management action plan

1. Document internal processes relating to the contributions monitoring process and the breach log. These policies and procedures should be approved by the Section 95 Officer.	Responsible person/title: Senior Banking and Investment Officer Target date: 30 April 2023

Current year findings

3 Differences between expected and actual contributions are not consistently investigated

Control design

Finding rating

Rating	Low

Finding and root cause

Expected employer contributions based on pensionable pay and the contribution rate should be reconciled with actual employer contributions. The LGPS Regulations 2013 state, “A Scheme employer must contribute to the appropriate fund in each year covered by a rates and adjustment certificate… the amount appropriate for that authority.” Other Local Government Pension Schemes we have worked with ensure this obligation is fulfilled by investigating any differences between actual and expected contributions. If a threshold is be used for the purposes of investigation (i.e. investigating a difference higher than a given amount), we see this clearly defined with rationale provided as to why the fund is comfortable with this threshold.

For TPF, most employers submit monthly returns detailing the contributions due to be paid. For these contributions, only discrepancies above £10 are investigated. A number of employers instead submit annual returns after the end of their financial year, which are reconciled to the employer’s actual contributions paid during the year. We note that all employers are expected to submit monthly returns from March 2023. Of a sample of 25 employers, one such employer had a discrepancy of 22p that was not investigated, as it was considered immaterial. Acknowledging the low value of this discrepancy, we would expect TPF to clearly define and document its rationale as to why the fund is comfortable with a threshold of £10.

Potential implications

If discrepancies are not investigated, there is a risk that inaccurate contributions are not detected. This means that employers may not pay contributions in line with the R&A certificate and thereby be non-compliant with the LGPS Regulations 2013 (Regulation 67).

Management action plan

Action	Responsibility
1. If a threshold is to be used, this should be supported with documented and approved rationale which explains why differences will not be investigated.	Responsible person/title: IT Systems and Process Analyst Target date: 30 April 2023

Current year findings

4 Reminder emails to employers cannot be evidenced

Control design

Finding rating

Rating	Low

Finding and root cause

On a monthly basis, employers have a responsibility to submit returns detailing their contributions by the 19th of the following month, and payment of pension contributions by the 22nd of the following month. Between April and September 2022, there were 32 instances of late payment or pension return submission. To improve the likelihood of payments and returns being sent on time, TPF sends reminder emails to employers when the contribution deadline is approaching, via i-Connect, the system employers use to submit contribution returns. However, the system does not allow visibility of its audit log, meaning that it is not possible to evidence that an employer has been reminded to submit contributions on time, or to verify that the employer has been reminded.

Potential implications

If reminder emails cannot be evidenced, there is a risk that TPF cannot use these emails to document where they have communicated with an employer paying its contributions late. There is also a risk that should reminder emails not be sent, this would not be detected by TPF.

Management action plan

1. Employer emails will in future be sent via Outlook so that there is an audit trail for reminder emails.	Responsible person/title:
	N/A - Action now implemented
	N/A - Action now implemented

Appendices

Appendix A: Basis of our classifications

Individual finding ratings

Critical	A finding that could have a: • **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; or • **Critical** impact on the reputation or brand of the organisation which could threaten its future viability.
High	A finding that could have a: • **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; or • **Significant** impact on the reputation or brand of the organisation.
Medium	A finding that could have a: • **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.

Appendix A: Basis of our classifications

Individual finding ratings

Low	A finding that could have a: • **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

The report classification is determined by allocating points to each of the findings included in the report.

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
Satisfactory	6 points or less
Satisfactory with exceptions	7 – 15 points
Needs improvement	16 – 39 points
Unsatisfactory	40 points and over

Appendix B: Terms of reference

Background and audit objectives

Tayside Pension Fund has been administered by Dundee City Council since 1st April 1996. It is part of the Local Government Pension Scheme (LGPS), which is a statutory scheme established under the primary legislations of the Superannuation act 1972 and Public Service Pensions Act 2013. As at 31st March 2022, Tayside Pension Fund had investment assets of £5.1 billion, and a membership of over 53,000 across 43 participating employers. These participating employers include 3 local authorities, as well as their subsidiary companies and contractors; a number of universities and colleges; and a range of organisations with funding or service links to local government.

The rules by which the LGPS scheme operates by are set out in the Local Government Pension Scheme (Scotland) Regulations which are Scottish Statutory Instruments (SSIs). Separate regulations set out scheme benefits, investment and governance requirements

TPF is responsible for monitoring contributions from the employers to the pension scheme. According to The Pensions regulator, TPF needs to ensure that it:

- takes responsibility for monitoring contributions
- takes steps to recover and remedy missed or late payments quickly and efficiently
- reports any materially significant payment failures to the regulator in good time
- informs its members if such a payment failure occurs.

Employers need to calculate contributions and make the correct deductions from staff pay. Legislation requires that when the employers deduct contributions from their staff's pay, they must pay these and their own contributions to the pension scheme on time and accurately i.e. no later than the 19th day of the next month.

This audit will review the contributions monitoring process performed by TPF. On the next page we have outlined in detail the specific objectives and risks for each of the sub-processes.

Appendix B: Terms of reference

Scope

We will review the design and operating effectiveness of key monitoring controls in place relating to the monitoring of contributions for the coverage period of 1 April 2022 to 31 October 2022.

The sub-processes, risks and related control objectives included in this review are:

Sub-process	Objectives	Risks
Policies and procedures	• Policies and procedural guidance for the contributions process have been established. • There is clear ownership and accountability for managing key policies, procedures, and processes. • Employers are provided with guidance to ensure their submissions are made in the required format; are complete and accurate and are submitted on time.	• Policies and procedures are inconsistently applied. • Employers do not submit complete, accurate and timely contributions.
Employer contributions	• The Administering Authority monitors the actual employer contributions received to ensure they are in line with expectations. • The Administering Authority confirms that employer contributions received are in line with statutory timelines. • Any employers with overdue contributions are identified and issues are followed up with the employer or escalated (as appropriate) on a timely basis.	• Contributions are not received/inaccurate/not timely.
Employer contribution receipts	• Contribution receipts into the bank account are reconciled to the contribution files received from the employers. Any discrepancies are identified, followed up and resolved in a timely manner. • Contribution receipts into the bank account are received in line with statutory deadlines. • Payments have been accurately allocated into the General Ledger.	• Late or incorrect contribution receipts from employers leading to incorrect valuation of liabilities/benefit payments.
Governance and Board reporting	• Monitoring and reporting arrangements are in place to ensure appropriate oversight over the employer contributions process is provided to the Pension Sub-Committee. • Significantly late payments are included in reporting to the Pension Sub-Committee and if materially significant, to the regulator.	• The Trustee/board does not receive adequate reporting in order to make informed decisions.

Appendix B: Terms of reference

Limitations of scope

Our audit of contributions will not cover the re-calculation of the contributions.

Our assessment will include those matters that we consider relevant based on our understanding of the key risks to the organisation. The assessment will be restricted to evaluating and testing the design and operating effectiveness of key control objectives as set out on page 4.

Any observations we may report are limited to those identified through the course of our work and are not intended to represent an exhaustive list of all potential issues or considerations. Our work is not designed to ensure compliance with all laws and regulations. Fraud, error, or non compliance with laws and regulations may occur and not be detected. Furthermore, the scope of our work does not constitute assurance over compliance with any laws and regulations.

Audit approach

Our audit approach is as follows:

- Obtain an understanding of the contribution process through discussions with key personnel, review of systems documentation and a walkthrough of the process.
- Identify the key risks of the contribution process.
- Evaluate the design of the controls in place to address the key risks.
- Test the operating effectiveness of the key controls.

Appendix C: Limitations and responsibilities

Limitations inherent to the internal auditor's work

We have undertaken this review subject to the limitations outlined below:

Internal control

Internal control systems, no matter how well designed and operated, are affected by inherent limitations. 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 is for the period specified only. 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 changes; 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 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.

Thank you

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