

Pensions Audit Sub Committee

2.00 p.m., Tuesday, 29 September 2015

Lothian Pension Fund – Internal Audit Update 2015/16

Item number	5.5
Report number	
Executive/routine	
Wards	All

Executive summary

The purpose of this report is to provide a summary of Internal Audit Activity during the period 1 April 2015 to 31 August 2015.

The activity planned for the financial year 2015/16 was based on the allocation of internal audit resource across the City of Edinburgh Council's (CEC) services and was approved by the CEC's Governance and Best Value Committee on 25 March 2015.

Three internal audit reviews are planned for the 2015/16 year:

- A review of the new payment system (Immediate Payments to Pensioners);
- A review of the procedures surrounding Externally Managed Investments; and
- A review of 'Compliance' arrangements

The review of Immediate Payments to Pensioners has been completed and the matters arising are considered in this report. The other two reviews are currently in progress.

Links

Coalition pledges

Council outcomes [CO26](#)

Single Outcome Agreement

Lothian Pension Fund – Internal Audit Update 2015/16

Recommendations

- 1.1 Committee is requested to:
- Note the Internal Audit activity during the period 1 April to 30 August 2015
 - Note the matters arising from the Internal Audit review undertaken in this period.

Background

Internal Audit plan 2015/16

- 2.1 The internal audit plan for the Lothian Pension Fund (LPF) was set out in the Internal Audit report to Pensions Audit Sub-Committee on 5 March 2015
- 2.2 The internal Audit plan is risk based, with a focus on governance, risk and controls. The areas identified for inclusion in the plan are determined following discussions with LPF management and examination of risk registers.
- 2.3 The plan for 2014/15 included three planned Internal Audit reviews:
- A review of the new payment system (Immediate Payments to Pensioners);
 - A review of the procedures surrounding Externally Managed Investments; and
 - A review of 'Compliance' arrangements
- 2.4 The review of Immediate Payments to Pensioners has been completed and the matters arising are considered in this report. The other two reviews are currently in progress.

Main report

Review of Immediate Payments

- 3.1 In order to assess the procedures & controls in place surrounding the Immediate Payments module, Internal Audit conducted the following:
- Walked through the Immediate Payment process and identified the key controls within the process for each type of Immediate Payment;
 - Considered the design of the controls in place, their validity and whether there were any omissions; and

- Tested on a sample basis that the key controls identified were operating correctly.
- 3.2 As part of our procedures we reviewed a sample of 45 immediate payments selected on a hap-hazard basis.
- 3.3 This review identified five findings of which two were graded as 'Medium' and three as 'Low'.

Summary of finding	Grading
The Immediate Payments module has not been updated for changes to the Local Government Pension Scheme concerning transfers out. As a consequence, all transfers out have to be manually calculated, resulting in increased risk of error and delay occurring.	Medium
Monthly bank (payroll No.2 account) and pay suspense accounts were not reconciled for April & May 2015 as a consequence of staffing pressures. Failure to complete these reconciliations increases the risk of errors not being detected and resolved timeously. [These reconciliations are currently fully up to date].	Medium
The Fund is failing to meet its service standards for payment timescales. For a sample of 38 payments we identified 8 payments that did not meet, what are ambitious service standards. This is a poorer performance than the Fund's 90% target. It should be noted that the fund has not breached any statutory standards in these 8 cases.	Low
Members approaching retirement are sent an estimate of their annual pension and any entitlement to a lump sum. These estimates are manually calculated and are not checked by a second administrator before being issued. These calculations are re-performed prior to any funds being paid out once the entitlement crystallises so an incorrect calculation will not lead to a loss to the Fund but could result in members making decisions based on erroneous information.	Low
We identified two payments which were not correctly authorised in line with the scheme of delegation. Both payments were valid and had been accurately calculated.	Low

For greater detail on these findings, please see the full report which is in Appendix 1.

- 3.4 Management have accepted these findings and successfully implemented the agreed management actions with the exception of the finding in connection with transfers out, which is beyond their control. Management continue to work with

their IT supplier to address the system limitations in connection with transfers out.

Measures of success

- 4.1 Alignment of Internal Audit activity to the key risks faced by the LPF to ensure that governance is improved, managers take responsibility for corrective action and confidence in the management of risk is increased.

Financial impact

- 5.1 There are no direct financial implications.

Risk, policy, compliance and governance impact

- 6.1 There are no adverse impacts arising from this report.

Equalities impact

- 7.1 There are no adverse equalities impacts arising from this report.

Sustainability impact

- 8.1 There are no adverse sustainability impacts arising from this report.

Consultation and engagement

- 9.1 None.

Background reading / external references

Magnus Aitken

Chief Internal Auditor

Magnus Aitken, Chief Internal Auditor

E-mail: magnus.aitken@edinburgh.gov.uk | Tel: 0131 469 3143

Links

Coalition pledges

Council outcomes CO26 – The Council engages with stakeholders and works in partnerships to improve services and deliver agreed objectives.

Single Outcome Agreement

Appendices Lothian Pension Fund – Immediate Payments Internal Audit Report

The City of Edinburgh Council **Internal Audit**

Lothian Pension Fund – Immediate Payments

Corporate Governance

Final Report

August 2015

CG1504

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Although there are a number of specific recommendations included in this report to strengthen internal control, it is management's responsibility to design, implement and maintain an effective control framework, and for the prevention and detection of irregularities and fraud. This is an essential part of the efficient management of the Council. Communication of the issues and weaknesses arising from this audit does not absolve management of this responsibility. High and Critical risk findings will be raised with senior management and elected members as appropriate.

Executive summary

Total number of findings

Critical	0
High	0
Medium	2
Low	3
Advisory	0
Total	5

Summary of findings

From the review the following areas of good practice were identified:

- Entitlement to funds is calculated automatically by the Altair pension administration system. The accuracy of calculations, input data and bank details is verified before a payment is authorised;
- Payments are not made without authorisation from the member and appropriate identity checks; and
- There is a defined scheme of delegation in place which sets out the approval required for all expenditure.

The following areas for improvement were identified:

- In common with all other administering authorities of the Local Government Pension Scheme (LGPS) in Scotland, Lothian Pension Fund (LPF) is currently unable to calculate the value of transfers out of the fund because the Altair pension administration system has not been updated for changes to the Local Government Pension Scheme. This means that LPF is currently, not consistently meeting statutory timescales for processing transfers nor its own standards of customer care;
- Monthly bank and pay suspense account reconciliations were not prepared in April and May 2015;
- The calculation of the retirement lump sum and annual pension is not checked before quotes are sent to members approaching retirement;
- Eight of 38 immediate payments direct to members (21%) were not paid within the timescales set out in the LPF customer care standards; and
- Two of 45 immediate payments tested were not authorized in line with the scheme of delegation, although it is noted that both such payments were correct in both sum and payee.

Our detailed findings and recommendations are laid out within Section 2: *Detailed findings*.

1. Background

Background


The immediate payments module was added to the Altair integrated pension administration and payment system in March 2015. The module allows Lothian Pension Fund (LPF) to process one-off payments including:

- Retiral lump sums;
- Refunds of contributions;
- Transfers out;
- Death-in-service lump sums;
- Death grants; and
- Balance of payments.

All immediate payments must be authorised as required by the scheme of delegation, and should be paid within the Lothian Pension Fund's standards of customer care.

2. Detailed findings

1. Transfers out

Finding	
<p>The Altair pension administration software has not yet been updated for changes to the Local Government Pension Schemes (LGPS) concerning transfers out of the scheme.</p> <p>Transfer values cannot be calculated automatically, resulting in delays in processing the payment. The number of cases outstanding at 10 July 2015 was 53. The value cannot be specified because the pension software used requires program changes.</p> <p>The pension administration software is used by LGPS schemes nationally. Program changes must be developed by the Altair system provider, Heywood Limited.</p>	
Business Implication	Finding Rating
<ul style="list-style-type: none"> Lothian Pension Fund may not meet statutory timescales for the payment of transfers out of the scheme. There would be an increased risk of error should the value of funds for transfer be calculated manually. For this reason, and also because of the impact on other workflows, no manual calculations are currently being done, pending suitable amendment to the automated system. 	 <p>Medium</p>
Action plans	
Recommendation	Responsible Officer
<p>LPF should continue to work with the system provider and the LGPS network to update the Altair pension administration software so that the value of funds for transfer can be calculated automatically.</p>	<p>Pensions & Accounting Manager</p>
Agreed Management Action	Estimated Implementation Date
<p>This issue has been raised with the supplier by the Scottish Pensions Liaison Group on behalf of all the LGPS administering authorities in Scotland in order to expedite resolution. The supplier initially advised that the expected date for rectification would be October 2015, but it is hoped that efforts to bring this forward may soon prove fruitful.</p> <p>Should such delay persist then LPF will consider additional staff resourcing and manual processing to clear these outstanding tasks.</p>	<p>October 2015, although it is hoped to be sooner.</p>

2. Bank and pay account reconciliations

Finding	
<p>Monthly bank (Payroll No.2 account) and pay suspense account reconciliations were not completed in April and May 2015.</p>	
Business Implication	Finding Rating
<p>Errors in payments or ledger postings in that period may not have been identified and resolved in a timely manner.</p>	<div style="background-color: yellow; padding: 10px; display: inline-block;">Medium</div>

Action plans	
Recommendation	Responsible Officer
<p>Bank and pay account reconciliations should be completed each month. Reconciling items should be investigated and resolved in a timely manner.</p>	<p>Pensions & Accounting Manager</p>
Agreed Management Action	Estimated Implementation Date
<p>Reconciliation of the bank and suspense accounts is done on a cumulative basis and, as at 15 July 2015, all transactions to 30 June 2015 have been completed.</p> <p>In April and May 2015, the accounting staff resources were focused on concurrent workstreams of the final accounts and Annual Report 2015 of Lothian Pension Fund, Lothian Buses Pension Fund and Scottish Homes Pension Fund and the establishment of LPFE Limited and LPFI Limited.</p> <p>As a consequence of this, and because the risk of short delay in post payment reconciliation was considered to be relatively minor and therefore manageable, greater priority was accorded to completion of the year-end and the financial arrangements for the new company vehicles that the monthly reconciliation procedures. That said, LPF fully recognises the importance of such reconciliation as good practice and shall commit to completing every month, whilst noting the caveat that there may be specific resource pressures at the annual close-down.</p>	<p>Completed.</p>

3. Customer service standards

Finding

LPF has set published customer service standards, committing to pay amounts due to members within certain timescales:

- Retirement lump sums within 5 working days of receipt of all necessary documents;
- Refunds within 10 working days of request;

Dependents should also be notified of any entitlement to benefits within 5 working days when LPF is notified of the death of a member.

We tested a sample of 38 immediate payments and noted:

- 1 refund not paid within 10 working days of request;
- 5 retirement lump sums not paid within 5 working days of receipt of all necessary documents, or retirement if later; and
- 2 death grants not calculated within 10 working days of request

There was no evidence that statutory service standards were not met.

Business Implication

Lothian Pension Fund may not meet its own published customer service standards.

Finding Rating

Low

Action plans

Recommendation

Immediate payments should be processed within the timescales published in the customer service standards. Compliance with customer service standards should be monitored.

Management may wish to consider whether their internal customer service standard are achievable and in line with industry practice.

Responsible Officer

Pensions & Accounting Manager

Agreed Management Action

The context of the customer care standards should also be emphasised. LPF sets very challenging targets in establishing these customer care standards for pension administration services. Its key performance indicator, published in the annual LPF Service Plan, is set at attaining the customer care standards in 90% of cases, a performance level deemed sufficient to attain the UK Government's "Customer Service Excellence (CSE)" accreditation. Although desired, it is not expected, therefore, that the target of customer care standards shall be met in every instance.

In two of the test cases, where the target was not met was because the member had In-House Additional Voluntary Contributions (AVCs). LPF

Estimated Implementation Date

Performance monitoring is ongoing.

does not know the final value of the AVC fund until after the retirement date, therefore there is a delay in calculating and paying final benefits. Affected members are advised that there will be a delay.


Monitoring of pension administration performance is undertaken and reported to LPF management team on a monthly basis, and indeed more frequently by line managers. Progress against the key performance indicator is also reported to Pensions Committee through the regular Service Plan updates.

During the monthly pensioner payroll run, it is necessary to close any processing activity on immediate payments. As payment control processes become more embedded, it is anticipated that the essential pension administration processing system down-time should be minimised. One of the reasons for the introduction of the new stand-alone LPF payments system was to improve on the performance of the previous arrangement, whereby payments were made through the Council's payments service. It is considered that, without doubt, speed and reliability have been enhanced. That said, it is recognised that demand pressures on the pension administration service are increasing, together with complexities inherent in new LGPS2015 Regulations.

LPF shall however continue to target excellence in its customer service. A "customer journey mapping" exercise will shortly be undertaken to provide feedback on retirement payments and inform a review of administration procedures,

CIPFA benchmarking service, to which LPF subscribes, also provides one source of comparison with other LGPS administering authorities.

4. Retirement lump sums

Finding	
<p>Members approaching retirement are sent a calculation of their annual pension and any entitlement to a lump sum.</p> <p>The quote is not checked by a second administrator before it is sent to the member.</p> <p>All calculations are checked by a second administrator once the member has requested payment of the lump sum. Any errors in the calculation should therefore be detected before the lump sum is paid.</p>	
Business Implication	Finding Rating
Members may plan for retirement on an inaccurate estimate of their annual pension and lump sum entitlement.	

Action plans	
Recommendation	Responsible Officer
Quotes for annual pensions and lump sums should be checked by a second administrator before they are sent to the member.	Pensions & Accounting Manager
Agreed Management Action	Estimated Implementation Date
<p>At present, with current staffing resources, it is considered impractical to provide a second check on quotations unless they are undertaken by a trainee pension administrator.</p> <p>This position, that is the absence of a check on quotation, will be reviewed in 2016 once the LGPS2015 has been operational for a more prolonged period and the current backlog of transfers (per Finding 1) has been cleared. Data cleansing (of member records) through monthly contribution reconciliations, is prioritised in order to fulfil TPR obligations and focus will also be directed towards higher attainment of customer service standards (per Finding 3).</p> <p>A comment is also made that it does not appear that the audit has identified any particular instance of a retirement quotation being incorrect. With calculation formulae embedded in the software, input fields are the only variables, which should serve to minimise the risk of error.</p>	Review by 30/09/2016

5. Authorisation of payments

Finding

All immediate payments must be authorised in line with the scheme of delegations. There was no evidence that two of 45 immediate payments tested had been authorised appropriately.

- 1 payment of £80,433 which had not been authorised by a senior member of staff. In terms of the scheme of delegation, any sum over £60,000, requires to be approved by two authorised signatories. In this instance, only a single authorisation has been effected;
- 1 payment of £40 which had not been authorised by a pension administration team leader.

In both cases, the member's entitlement to funds was calculated accurately and subject to appropriate review by the administration team.

Business Implication

There is an increased risk of error where payments are not authorised appropriately.

Finding Rating

Low

Action plans

Recommendation

All payments must be authorised in line with the letters of sub-delegation from City of Edinburgh Council.

A report of all payments over £60,000 should be generated and reviewed before each BACS run to confirm that the payments have been authorised by a senior member of staff as required by the scheme of delegation.

Responsible Officer

Pensions & Accounting Manager

Agreed Management Action

There is an inherent weakness in the supplier's pension administration payment system, which from the outset, has required LPF to introduce bespoke manual authorisation procedures. Specifically, the weakness is that authorisation is completed by "check boxes" but absence of such does not automatically place the payment on hold. To clarify, this stage is subsequent to the calculation of benefit entitlement, which is peer checked by a Pensions Administrator.

In both the cases highlighted, the amount of pension was correctly checked by the pension administrator and then passed to operational management for payment approval. Unfortunately, in one case the "check box" was not completed and in the other instance the requirement for a second authorisation for an over £60,000 payment was overlooked.

Within the constraint of the supplier's system, a review of procedures has been undertaken with the objective of mitigating the risk of future

Estimated Implementation Date

15 July 2015, with revised procedures to be documented by 31 July 2015.

occurrence of the instances evidenced by this audit. To that end, the Authorisation screen has been improved to include multiple payment approvals. Also, at each payment date, the Pay Control (Accounting) team will now scrutinise the date order payment list (DOPL) report to identify any over £60,000 payments and ensure that suitable duplicate authorisation has been recorded, prior to payment being released.

Further improvements have now been completed (as at 15 July 2015) to restrict input to the initial authorisation screen to the immediate line managers (Pensions Operations & Development managers and Deputy), with view only access to senior management. For approvals of over £60,000, input access to this screen has been restricted to senior management. Also, for payments following the death of a pensioner member, a new "balance of pension" (BOP) screen has been developed (BOP). Input to this screen has been restricted to the Payroll Processing team.

Refresher training on these payment procedures, incorporating the latest revisions, will be provided to all relevant staff as soon as possible.

Appendix 1 - Basis of our classifications

Finding rating	Assessment rationale
Critical	<p>A finding that could have a:</p> <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; or • Critical impact on the reputation or brand of the organisation which could threaten its future viability.
High	<p>A finding that could have a:</p> <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; or • Significant impact on the reputation or brand of the organisation.
Medium	<p>A finding that could have a:</p> <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	<p>A finding that could have a:</p> <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	<p>A finding that does not have a risk impact but has been raised to highlight areas of inefficiencies or good practice.</p>

Appendix 2 – Terms of Reference

Lothian Pension Fund

Terms of Reference – Immediate Pensions Payments

To: Alastair Maclean

From: Magnus Aitken
Chief Internal Auditor

Date: 8 June 2015

This review is being undertaken as part of the 2015/16 internal audit plan approved by the Pensions Committee in March 2015.

Background

The immediate payments module was added to the Altair integrated pension administration and payment system in March 2015. The module allows Lothian Pension Fund to process one-off payments to members and nominated third parties including:

- Retiral lump sums
- Refunds of contributions
- Transfers out
- Death-in-service lump sums
- Death grants
- Balance of pension

Scope

The scope of this review will be to assess the design and operating effectiveness of the Council's controls relating to immediate pension payments.

The sub-processes and related control objectives included in the review are:

Sub-process	Control Objectives
Immediate payments	<ul style="list-style-type: none">• Payments to members and nominated third parties are accurate and reflect their entitlement to funds.• Payments are made to authorised recipients only.• Payments are authorised in line with the scheme of delegation.• Payments are completed within the timescales set out in the service standards.• Payments are recorded accurately on the ledger.

Limitations of Scope

The scope of our review is outlined above. Testing will be undertaken on a sample basis for the period 01 April 2015 to 31 May 2015 where applicable.

Approach

Our audit approach is as follow:

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

Internal Audit Team

Name	Role	Contact Details
Magnus Aitken	Chief Internal Auditor	0131 469 3176
Gemma Dalton	Internal Auditor	0131 260 4057

Key Contacts

Name	Title	Role	Contact Details
Alastair Maclean	Director of Corporate Governance	Review Sponsor	0131 529 4136
Clare Scott	Investment & Pensions Service Manager	Key Contact	0131 469 3865
John Burns	Pensions & Accounting Manger	Key Contact	0131 469 3711

Timetable

Fieldwork Start	Wednesday 17 June 2015
Fieldwork Completed	Friday 26 June 2015
Draft report to Auditee	Friday 3 July 2015
Response from Auditee	Friday 10 July 2015
Final Report to Auditee	Wednesday 15 July 2015
Final report available for presentation to the Pensions Committee	Wednesday 15 July 2015

Note: Actual progress against the dates set out above will be recorded on the face of the final report, along with commentary explaining any discrepancies.

Appendix 1: Information Request

It would be helpful to have the following available prior to our audit or at the latest our first day of field work:

- Copy of policies and procedures relating to the immediate payments process; and
- Transactional listing of immediate payments to members and third parties in the period 01 April 2015 to 31 May 2015.

This list is not intended to be exhaustive; we may require additional information during the audit which we will bring to your attention at the earliest opportunity.