

Internal Audit Report

Pension Fund Finance and Investment

July 2019

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From: Caroline Glitre, Head of Internal Audit

We would like to thank management and staff in the Council's Finance team and Capita Employee Benefits for their time and co-operation during the course of the internal audit.

Executive Summary

Assurance level	Number of recommendations by risk category				
LIMITED ASSURANCE	Critical	High	Medium	Low	Advisory
	-	2	1	1	-
Scope					
<p>This report sets out the findings of our work undertaken in March to June 2019 to review the design and operating effectiveness of controls in place in relation to the London Borough of Barnet's pension fund's finance and investment, in line with our terms of reference agreed on 11 March 2019. The scope of work and controls identified are summarised in Appendix 3.</p>					
Summary of findings					
<p>The administration of London Borough of Barnet's Pension Fund ("the Fund" or "the Scheme") is outsourced to Customer Support Group ("CSG"), which is part of Capita. CSG are responsible for administering records and scheme finances in relation to contributions and benefits paid. The Fund's general ledger is maintained by the Council's Treasury team, who were part of CSG until 31 March 2019. The Treasury team also manage the investment portfolio, which comprises a large number of pooled investment funds. Investment decisions are made by the Pension Fund Committee.</p> <p>We found that the Fund has a well-defined process for reviewing investment performance and recording transactions. However, we noted that there were weaknesses in monitoring the contributions due to the scheme. We also noted that the scheme has a number of outstanding agreements with admitted bodies, including 13 admission agreements, five cessation agreements and the renewal of 10 admission bonds.</p> <p>This audit has identified two high, one medium and one low risk findings.</p> <p>We identified the following high risk-rated issues as part of the audit:</p> <ul style="list-style-type: none"> • Monitoring of contributions (finding one) – When the audit fieldwork commenced, we found that the CSG Pensions Finance team could not check whether contributions had been deducted in line with the Rates and Adjustments Certificate, as it did not obtain information that would allow it to do so, and did not track whether lump sum contributions required under the Rates and Adjustments Certificate have been paid, leading to an annual, manual exercise being required to review this. This may lead to contributions due not being received, leading to a loss to the Fund. At the date of this report work to rectify this was underway but was not yet complete. • Admission agreements, bonds and cessation agreements (finding two) – We noted in our review of Pension Fund Committee minutes that there is a backlog of admission agreements, bonds and cessation agreements. This means that the Fund may be exposed to financial risk as a result of not entering agreements with new or former employers. <p>We identified the following medium risk-rated issue as part of the audit:</p> <ul style="list-style-type: none"> • Collection of strain contributions (finding three) – We found that there was no clear process for ensuring that strain contributions, being those payable by employers where a member retires early with no reduction to pension, are received. This may lead to contributions due not being received, leading to a loss to the Fund. 					

We identified the following low risk-rated issue as part of the audit:

- **Budgets and management information (finding four)** – We found that management information provided to the Pension Fund Committee does not cover contributions received, benefits paid, level of debt outstanding in relation to strain contributions and whether contributions are received on time from scheme employers. There is a risk that the Fund does not manage its costs without a budget and the Pension Fund Committee may not be aware of issues which require resolving.

2. Findings, Recommendations and Action Plan

Ref	Finding	Risks	Risk category	Agreed action
1.	<p><u>Monitoring receipt of contributions</u></p> <p><i>Control design</i></p> <p>Employers are required to deduct both employee and employer contributions in accordance with the scheme regulations and the Fund's Rates and Adjustment Certificate. These are required to be paid over monthly. The CSG Pensions Finance team are responsible for monitoring the receipt of contributions, including whether all contributions were received, whether contributions were deducted and paid to the Fund at the correct rate and whether contributions were received on time. They maintain a tracker to record contributions received which are then also recorded in Acclink, a system used by CSG Pensions Finance to record financial transactions relating to contributions and benefits. CSG Pensions Finance are responsible for Acclink.</p> <p>During the audit, we identified:</p> <ul style="list-style-type: none"> • CSG's process for receiving information from employers did not allow it to check whether contributions were deducted or paid at the correct rate. • CSG's tracker did not allow it to monitor whether additional lump sum contributions were received. This means that a manual exercise has to be undertaken to review whether all contributions so due were received. <p>In March 2018, Internal Audit identified that CSG Pensions Finance did not monitor contributions received to ensure they were being deducted at the correct rate and agreed to implement additional monitoring by 30 June 2018. This action had not been implemented at the time fieldwork for this review was undertaken. During fieldwork, we noted that CSG were implementing a new process to allow them to monitor</p>	<p>Contributions may not be deducted or paid to the Fund at the correct rate which may lead to the Fund suffering a loss and being underfunded.</p> <p>Omissions of contributions may not be detected leading to underfunding of the scheme.</p>	<p>HIGH</p>	<p>Agreed action:</p> <ol style="list-style-type: none"> a) CSG Pensions Finance will implement the new process for collecting data from employers on the amounts paid over to the Fund to enable them to check if contributions are deducted at the correct rate and all contributions due under the Rates and Adjustments Certificate, including additional lump sum contributions, are collected. b) CSG will provide monthly reports to the Council on the collection of contributions which will include reporting on whether contributions were received on time, at the correct rate and details of any significant issues noted when reviewing contributions received, such as failure to provide starter and leavers forms for member changes or unexplained movement in contributions received. c) Late or underpayment of contributions will be reported

Ref	Finding	Risks	Risk category	Agreed action
	<p>the contributions received, so as to allow them to check that contributions are deducted at the correct rate and that all contributions due, including lump sum payments, are received on time.</p>			<p>to each meeting of the Pension Fund Committee and Local Pension Board</p> <p>Responsible officer:</p> <p>a) and b) Keith Barker, Head of Scheme Finance and Payroll, CSG Pensions Finance</p> <p>c) George Bruce, Head of Treasury</p> <p>Target date:</p> <p>a) and b) 31 July 2019</p> <p>c) 30 September 2019</p>
2.	<p>Admission agreements, bonds and cessation agreements</p> <p><i>Operating effectiveness</i></p> <p>When a new employer joins the Fund's pool, usually through the transfer of staff to a new employer under TUPE arrangements, an admission agreement should be signed with employers. Typically, these require the employer to provide a bond to the Fund to reduce the risk regarding non-payment of contributions. A cessation agreement should also be agreed once an employer leaves the Fund's pool as a result of it employing no members of the Fund.</p> <p>We noted that there are a number of employers for whom admission agreements or cessation agreements are required or bonds have expired. The following statistics were reported to the 30 May 2019 Pension Fund Committee meeting:</p>	<p>The Council may be in breach of the Local Government Pension Scheme Regulations 2013 if it does not have admission agreements in place.</p> <p>The Fund may be exposed to risk of employers not fulfilling their obligations to the scheme if a bond is not entered into.</p> <p>The Fund may not recover amounts due from former employers if cessation</p>	HIGH	<p>Agreed action:</p> <p>a) We will promptly complete admission agreements, cessation agreements and renewals of admission bonds for all employers identified in the report to the Pension Fund Committee on 30 May 2019 to minimise risk to the Fund.</p> <p>b) We will agree Service Level Agreements (SLAs) with CSG, our actuary and legal team to establish</p>

Ref	Finding	Risks	Risk category	Agreed action
	<ul style="list-style-type: none"> 13 employers did not have admission agreements, the oldest dating back to 1 September 2014. 5 employers have left the Fund and did not have a cessation agreement, the oldest dating back to 30 September 2015. Admission bonds relating to 10 employers had expired, with the oldest bond expiring on 28 February 2016. 	calculations are not carried out promptly.		<p>potential timelines for future admission agreements, cessation agreements and the renewal of admission bonds.</p> <p>Responsible officer: George Bruce, Head of Treasury</p> <p>Target date: 30 September 2019</p>
3.	<p><u>Collection of strain contributions</u></p> <p><i>Control design</i></p> <p>When a member of the Fund retires early, without an actuarial reduction in their pension, additional contributions, known as strain contributions, are charged to employers to cover the cost of providing the additional benefits to the member. Strain contributions are calculated by the CSG Pensions Administration team. The CSG Pensions Finance team raise an invoice and record strain contributions due from employers within Acclink. This summarised information is passed to the Council and input to the Fund's general ledger.</p> <p>We noted that:</p> <ul style="list-style-type: none"> The CSG Pensions Finance team ordinarily send invoices to employers' registered addresses, however some employers dispute receiving these invoices. It is not clear who is responsible for ensuring that invoices raised to employers for strain contributions are collected and there is no clearly defined process for chasing debts due. 	Strain contributions may not be received leading to the Fund being underfunded.	MEDIUM	<p>Agreed action:</p> <p>a) The CSG Pensions Administration team will agree where and to whom invoices relating to strain costs will be sent as part of the retirement process and notify the employer of the final calculated strain cost once the retirement has been agreed.</p> <p>b) The Council will agree when and how often CSG will pursue outstanding amounts and at what stage the Council will be informed and take action against the employer.</p> <p>c) CSG Pensions Finance will implement the process agreed with the Council for collecting strain contributions.</p>

Ref	Finding	Risks	Risk category	Agreed action
				<p>d) CSG will provide monthly reports to the Council on the collection of strain contributions including an analysis of ageing of outstanding debt and current status of aged debts.</p> <p>e) An age analysis of strain cost debtors will be included in quarterly reports to the Pension Fund Committee</p> <p>Responsible officer:</p> <p>a) Mark Richardson, Service Delivery Manager, CSG Pensions Administration</p> <p>b) George Bruce, Head of Treasury,</p> <p>c) and d) Keith Barker, Head of Scheme Finance and Payroll, CSG Pensions Finance</p> <p>(e) George Bruce, Head of Treasury</p> <p>Target date:</p> <p>a) 31 July 2019</p> <p>b) n/a – implemented as agreed in June 2019</p> <p>c) and d) 31 July 2019</p> <p>e) 31 December 2019</p>

Ref	Finding	Risks	Risk category	Agreed action
4.	<p><u>Budgets and management information</u></p> <p><i>Control design</i></p> <p>The Fund manages over £1bn of assets and incurs management expenses of £8m per annum. Management expenses include administrative costs, investment management expenses and oversight costs.</p> <p>Over the last 12 months, the level of reporting to the Pension Fund Committee has increased, giving the committee an overview of costs incurred by the Fund in addition to ongoing reporting on asset performance.</p> <p>We found that:</p> <ul style="list-style-type: none"> • Management information reported on the Fund's finances is restricted to investment performance and expenses. It does not include reporting on contributions received, benefits paid, the level and ageing of strain contributions outstanding or timeliness of the receipt of contributions. 	<p>The Fund may hold insufficient or excess funds in cash or similar liquid investments leading to it forgoing future investment gains.</p>	<p>LOW</p>	<p>Agreed action:</p> <p>Six monthly reporting of fund costs to the Pension Fund Committee will be expanded to include reporting on contributions received and, benefits paid.</p> <p>Responsible officer:</p> <p>George Bruce, Head of Treasury</p> <p>Target date:</p> <p>30 September 2019</p>

Appendix 1: Definition of risk categories and assurance levels in the Executive Summary

Note: the criteria should be treated as examples, not an exhaustive list. There may be other considerations based on context and auditor judgement.

Risk rating	
Critical 	<p>Immediate and significant action required. A finding that could cause:</p> <ul style="list-style-type: none"> • Life threatening or multiple serious injuries or prolonged work place stress. Severe impact on morale & service performance (e.g. mass strike actions); or • Critical impact on the reputation or brand of the organisation which could threaten its future viability. Intense political and media scrutiny (i.e. front-page headlines, TV). Possible criminal or high profile civil action against the Council, members or officers; or • Cessation of core activities, strategies not consistent with government's agenda, trends show service is degraded. Failure of major projects, elected Members & Senior Directors are required to intervene; or • Major financial loss, significant, material increase on project budget/cost. Statutory intervention triggered. Impact the whole Council. Critical breach in laws and regulations that could result in material fines or consequences.
High 	<p>Action required promptly and to commence as soon as practicable where significant changes are necessary. A finding that could cause:</p> <ul style="list-style-type: none"> • Serious injuries or stressful experience requiring medical many workdays lost. Major impact on morale & performance of staff; or • Significant impact on the reputation or brand of the organisation. Scrutiny required by external agencies, inspectorates, regulators etc. Unfavourable external media coverage. Noticeable impact on public opinion; or • Significant disruption of core activities. Key targets missed, some services compromised. Management action required to overcome medium-term difficulties; or • High financial loss, significant increase on project budget/cost. Service budgets exceeded. Significant breach in laws and regulations resulting in significant fines and consequences.
Medium 	<p>A finding that could cause:</p> <ul style="list-style-type: none"> • Injuries or stress level requiring some medical treatment, potentially some workdays lost. Some impact on morale & performance of staff; or • Moderate impact on the reputation or brand of the organisation. Scrutiny required by internal committees or internal audit to prevent escalation. Probable limited unfavourable media coverage; or • Significant short-term disruption of non-core activities. Standing orders occasionally not complied with, or services do not fully meet needs. Service action will be required; or • Medium financial loss, small increase on project budget/cost. Handled within the team. Moderate breach in laws and regulations resulting in fines and consequences.
Low 	<p>A finding that could cause:</p> <ul style="list-style-type: none"> • Minor injuries or stress with no workdays lost or minimal medical treatment, no impact on staff morale; or • Minor impact on the reputation of the organisation; or • Minor errors in systems/operations or processes requiring action or minor delay without impact on overall schedule; or • Handled within normal day to day routines; or • Minimal financial loss, minimal effect on project budget/cost.
Level of assurance	
Substantial 	<p>There is a sound control environment with risks to key service objectives being reasonably managed. Any deficiencies identified are not cause for major concern. Recommendations will normally only be Advice and Best Practice.</p>
Reasonable 	<p>An adequate control framework is in place but there are weaknesses which may put some service objectives at risk. There are Medium priority recommendations indicating weaknesses but these do not undermine the system's overall integrity. Any Critical recommendation will prevent this assessment, and any High recommendations would need to be mitigated by significant strengths elsewhere.</p>
Limited 	<p>There are a number of significant control weaknesses which could put the achievement of key service objectives at risk and result in error, fraud, loss or reputational damage. There are High recommendations indicating significant failings. Any Critical recommendations would need to be mitigated by significant strengths elsewhere.</p>
No 	<p>There are fundamental weaknesses in the control environment which jeopardise the achievement of key service objectives and could lead to significant risk of error, fraud, loss or reputational damage being suffered.</p>

Appendix 2 – Analysis of findings

Area	Critical		High		Medium		Low		Total
	D	OE	D	OE	D	OE	D	OE	
Governance	-	-	1	-	-	-	1	-	2
Contributions income	-	-	1	-	-	-	-	-	1
Contributions income – change in member status	-	-	-	-	1	-	-	-	1
Benefits paid	-	-	-	-	-	-	-	-	-
Fund expenditure	-	-	-	-	-	-	-	-	-
Investments – strategy	-	-	-	-	-	-	-	-	-
Investments – transactions	-	-	-	-	-	-	-	-	-
Investments - management	-	-	-	-	-	-	-	-	-
Total	-	-	2	-	1	-	1	-	4

Key:

- Control Design Issue (D) – There is no control in place or the design of the control in place is not sufficient to mitigate the potential risks in this area.
- Operating Effectiveness Issue (OE) – Control design is adequate, however the control is not operating as intended resulting in potential risks arising in this area.

Timetable					
Terms of reference agreed: 11 March 2019	Fieldwork commenced: 19 March 2019	Fieldwork completed: 13 June 2019	Draft report issued: 17 June 2019	Management comments received: 24 June 2019	Final report issued: 9 July 2019

Appendix 3 – Identified controls

Area	Objective	Risks	Identified Controls
<p>Governance</p>	<p>There are defined arrangements for the management and oversight of the Fund’s investment and finances.</p>	<p>Governance arrangements may not support the Council effectively fulfilling its responsibilities if:</p> <ul style="list-style-type: none"> • Governance responsibilities, including key accountabilities, are not clearly defined; • Compliance with internal Service Level Agreements (for example between the pensions administration team and treasury team) is not monitored to mitigate operational issues arising due to dependencies; • Management information is not accurate or is not produced to facilitate oversight and scrutiny; or • Action plans to address issues identified are not formulated and implemented leading to underlying issues continuing. 	<ul style="list-style-type: none"> • The Pension Fund Committee is responsible, as scheme manager, for oversight of the Fund’s investment and finances. • Day to day management of the Fund’s investments and finances is delegated to the Council’s Treasury team who manage the Fund’s general ledger. • CSG’s pensions finance team is responsible for maintaining a subledger, Acclink, for recording transactions relating to contributions received and receivable and benefits paid. This data is communicated to the Treasury team monthly and uploaded to the general ledger. • There is a monthly call between CSG pensions administration and the Treasury team. An actions log is maintained to record these calls • Management information presented to the Pension Fund Committee comprises: <ul style="list-style-type: none"> ○ Quarterly investment performance reports ○ Pension fund costs every six months <p>(See finding 3: budgets and management information) (See finding 4: Admission agreements, bonds and cessation agreements)</p>

Area	Objective	Risks	Identified Controls
Contributions income	Contributions are received promptly and in accordance with the Rates and Adjustments Certificates and LGPS Regulations 2013.	Contributions may not be received promptly and in accordance with the Rates and Adjustments Certificates if: <ul style="list-style-type: none"> • Employers do not deduct contributions at the correct rate; • Late contributions are not identified and followed up; or • Responsibility is not assigned for ensuring that all contributions required by the Rates and Adjustments certificate are collected. 	<ul style="list-style-type: none"> • CSG record contributions received by month in Acclink and a spreadsheet maintained to monitor contribution receipt by month. (see finding 1: monitoring contribution receipts) • CSG are responsible for ensuring all contributions due are received.
Contributions income – change in member status	Contributions required due to change in member status are identified and additional contributions received.	Contributions required due to a change in member status may not be identified and additional contributions may not be received if: <ul style="list-style-type: none"> • Changes in member status which require additional contributions are not identified; • Additional contributions required are not calculated and notified to employers; or • The receipt of additional contributions is not monitored. 	<ul style="list-style-type: none"> • When members retire, a requirement for strain contributions is identified from the members record by the pensions administration team. • Additional contributions are calculated using a strain calculator and approved by a member of the pensions administrations team. • The amount calculated to be paid is communicated to the CSG pensions finance team. • Invoices are raised to employers for amounts due. • Invoices are raised based on data from the pensions payroll where strain contributions are due on a pay as you go basis. <p>(See finding 2: Collection of strain contributions)</p>

Area	Objective	Risks	Identified Controls
Benefits paid	Benefits paid are recorded completely and accurately.	Benefits paid may not be recorded completely and accurately if: <ul style="list-style-type: none"> • Benefits paid are not recorded on the fund's general ledger. 	<ul style="list-style-type: none"> • All benefits are paid from the bank account managed by CSG and this is reconciled monthly to ensure that all benefit payments are recorded.
Fund expenditure	Fund expenditure is reported completely and accurately.	Fund expenditure may not be complete and accurate if: <ul style="list-style-type: none"> • The Fund is not aware of all expenditure which it incurs; or • Fund expenditure is not recorded on an accruals basis. 	<ul style="list-style-type: none"> • The Fund produces an analysis of scheme costs every six months. (See finding 3: budgets and management information)
Investments – strategy	The Fund has an approved investment strategy statement and this statement is complied with by the Fund.	The Fund's investments may not be appropriately invested if: <ul style="list-style-type: none"> • An investment strategy statement does not exist or has not been approved; or • Investing activities outside of the Fund's investment strategy statement are not identified. 	<ul style="list-style-type: none"> • The Fund has an investment strategy which is approved by the Pension Fund Committee • The Fund invests in pooled investment vehicles which invest as set out in their factsheets. • The Pension Fund receives quarterly investment manager performance reports and this includes a comparison between the investment strategy and assets held by the Fund.
Investments transactions	Investment transactions are recorded accurately and completely.	The Fund's records of investments held and investment transactions may be inaccurate if: <ul style="list-style-type: none"> • Investment activities are not recorded correctly on the general ledger. 	<ul style="list-style-type: none"> • Monthly or quarterly reports are received from investment managers. These are recorded on the general ledger using journals which are approved prior to posting to the Fund's general ledger.

Area	Objective	Risks	Identified Controls
Investments management	- Investments are managed in accordance with the Fund's investment strategy statement and investment performance issues are identified and mitigating actions implemented.	<p>The Fund's investments may not be managed appropriately or performance issues not identified if:</p> <ul style="list-style-type: none"> • Those managing investments make investments outside of those permitted by the Fund; • Investment performance monitoring does not allow poor performance to be identified promptly; or • Actions agreed may not be implemented. 	<ul style="list-style-type: none"> • All changes to asset holdings, including decisions to invest and divest, are made by the Pension Fund Committee. • Performance reports are received quarterly from the Fund's Investment Advisers and reported to the Pension Fund Committee. Performance reports include: <ul style="list-style-type: none"> ○ A rating ○ Comparisons against benchmarks • Updates are provided at each meeting in respect of implementation of agreed changes to investment strategy.

Appendix 4 – Internal Audit roles and responsibilities

Limitations inherent to the internal auditor's work

We have undertaken the review of Pensions Fund Finance and Investment, 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.

Specifically, we have not:

- Provided assurance over the maintenance of member records;
- Provided assurance over the calculation of benefits paid to members of the scheme; or
- Provided assurance over the management of the contract between CSG and the Council.

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; 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.