



Pensions Contributions

CS05-2016

INTERNAL AUDIT REPORT

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Report Author: Hazel Strudwick

Audit Manager: Sarah Bubb

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| Head of Financial Services, Strategic and Corporate Services | Nick Vickers |
| Treasury and Investments Manager, Strategic and Corporate Services | Alison Mings |

| AUTHORS | |
|----------------|-----------------|
| Report Author | Hazel Strudwick |
| QA | Sarah Bubb |



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1 EXECUTIVE SUMMARY

1.1 Introduction

- a) As part of the approved 2015-2016 Audit Plan it was agreed that Internal Audit would undertake a review of the controls over Pensions Contributions to the Kent Local Government Pension Scheme. The overall objective of the audit is to provide assurance that pension contributions are being correctly calculated and paid into the Kent Pension Fund. This is an annual review; last year's audit report was issued in January 2015 with a Substantial audit opinion.
- b) Kent County Council is the administering authority for the Kent County Council Superannuation Fund (also known as Kent Pension Fund).
- c) For the year to 31 March 2015 employer contributions were £168.363m with KCC being the largest contributor at £89.453m. Employee contributions for the year to 31 March 2015 were £49.351m.
- d) The function is overseen by the Head of Financial Services and the Treasury and Investments Manager. As at 30 September 2015 there were 635 employers in the Scheme of which 424 are active and pay contributions.

| | |
|--|---|
| AUDIT OPINION & PROSPECTS FOR IMPROVEMENTS | |
| Opinion (See Appendix A for Definitions) | Substantial  |
| Prospects for improvement (See Appendix C for Definitions) |  |

1.2 Summary

The overall opinion is based on sample testing, review of documentation and interviews with key officers, which identified that controls are operating adequately and effectively. Based on the sample of transactions tested we are satisfied that there is an adequate system of control in place to ensure contributions are being correctly calculated (based on pensionable pay) and paid into the Pension Fund.

Strengths:

- Detailed and up to date policies and procedures are in place.

- Contributions are calculated based on employers' pensionable pay and at the correct percentage rate.
- Controls within the pension contribution monitoring workbooks identify any differences between the expected employer contributions and the payments received.
- Reconciliations with Oracle are performed monthly.

Areas for development

- Recognise multi-academy trusts as employers in the Fund and ensure the system can manage the establishment of new academies and their movement between trusts.
- Keep the current Excel spreadsheet based system under review to ensure it can continue to support the increasing number of employers in the Fund.
- Explore other options for recording employer contributions including greater use of the Pension Fund website.

Prospects for improvement have been assessed as Good due to the following factors:

- Appropriate action plans have been developed in response to the issues identified from our audits.
- Management are preparing for the upcoming valuation as at 31 March 2016 and implementation of new employer rates from 1 April 2017.
- The systems in place have been developed in-house based on Excel spreadsheets which may not be appropriate if the number of employers in the scheme increases significantly. Management are fully aware of this and are making appropriate plans.
- Pension contributions are processed, monitored and reconciled by a small team who have a good understanding of their role and processes. However, succession planning is required.

Summary of management responses

| | Number of issues raised | Management Action Plan developed | Risk accepted and no action proposed |
|--------------------|--------------------------------|---|---|
| High Risk | 0 | 0 | 0 |
| Medium Risk | 0 | 0 | 0 |
| Low Risk | 2 | 2 | 0 |

2 FINDINGS

A. Background

- 1) The Local Government Pension Scheme (LGPS) is a nationwide pension scheme for people working in local government or for other specified employers.
- 2) Both employees and employers contribute to the LGPS. Employees' contributions are set by the Government whilst employers' contributions vary in order to ensure that benefits under the scheme are properly funded. The Fund Actuary undertakes an actuarial valuation of the Kent Fund's liabilities every three years and it is from this valuation that the employers' contributions are set. The last actuarial valuation was carried out at 31 March 2013 and the employer contribution rate then certified was payable from 1 April 2014.
- 3) It is KCC's responsibility to collect and account for employer and employee contributions. The system for recording and monitoring these contributions remains the same as last year. The Excel workbooks have been improved following our recommendations from the 2014/15 audit. Additional workbooks have been developed to ensure anomalies in employers' contributions are flagged for investigation every month.
- 4) KCC monitors the timing of receipt of contributions compared to a KPI of 95%. To 31 December the KPI had been exceeded each month with an average 98% of all contributions being received on or before the due date.
- 5) Management recognises that the Excel based system includes inherent risks in particular related to the use of macro based spreadsheets. The risk is mitigated by the monthly monitoring and explanation of differences. A process is in place for evidencing of this review.
- 6) The Pension Fund risk register includes the following key risks:
 - Failure to collect pension contributions in line with regulatory guidelines,
 - Increased number of employers in the fund.
 - Implementation of actuarial valuation results
 - Employer outsourcing
 - Financial failure of an employer

B. Detailed Findings

Procedure Notes

- 7) Procedure notes documenting the process are in place, and have been updated during the year. These notes are sufficient to provide guidance on the receipt, recording and reconciliation of contributions.

- 8) Procedure notes for employers are available on the Kent Pension Fund website and are up to date.

Employer Contributions

- 9) Each employer in the Pension Scheme is required to pay their contributions and those of their employees to the Fund in arrears, by the 19th of the following month. The employer will complete a PEN 4/1 form by selecting their name via the drop down list on the Kent Pension Fund website. The PEN 4/1 is pre-populated with the contribution rate for that employer and this creates the expected employers' contribution based on pensionable pay. Employers' secondary contributions (deficit contributions) are also pre-populated from the actuarial report. The completed form is submitted to the KCC Treasury and Investments team by email each month and the details are uploaded automatically into individual contribution sheets for each employer, using Excel macros.
- 10) Testing of a random sample of 20 employers (including KCC) for the months June, July and October 2015 confirmed that they had all provided a PEN 4/1 form and the recording of the data on the contribution monitoring worksheet was correct. The contribution rates used were agreed to the actuarial report.
- 11) Individual employer data feeds into a summary Excel worksheet which highlights where the employer contribution differs from the expected contribution by 0.5% or more. The PEN 4/1 form is not accepted and processed if a difference has occurred without any explanation. If the difference is not corrected the following month it is investigated with the employer. Reasons for differences are documented and corrections made where necessary to ensure the accuracy of the employer contributions received throughout the year.
- 12) Contributions are paid directly by BACS, CHAPS or cheque into the KCC Pension Fund bank account. A cash receipts journal is created from a download of the daily Bankline report and manually coded. Once uploaded and posted, this updates Oracle and also updates the contributions monitoring workbook. A key control is the matching of the pension contributions due as per the PEN 4/1 and the payment received. Any difference is highlighted and followed up with an explanation. This ensures the correct expected payment is received and has been coded to the right employer and to the correct income code.
- 13) A debtor journal is created and posted to Oracle for the expected contributions. At the month end Pension Fund participating employer transactions are downloaded from Oracle and matched to the debtor amounts. The reason for any outstanding debtors is identified and followed up for recovery as necessary. This process is manual and will be completed for each employer every month in order to identify where a receipt does not match the expected contribution.
- 14) Monthly reconciliations with Oracle are performed for all income codes.

Employee Contributions

- 15) Examination of the Oracle Payroll system confirmed that the pension contribution bands for 2015-16 had been input correctly for the payrolls run by KCC on Oracle. For non-KCC payrolls, the individual employers are responsible for deducting and passing over the correct pension contributions for their employees.

Year End Reconciliations

- 16) At the year-end employers are required to submit an Annual Employers Return (PEN 4/B). This is used to confirm that the annual pensionable pay and contributions match the total of the monthly pay and contributions. Exceptions that are greater than 0.5% are investigated with the employer. The onus is on the employer to pay the correct contributions.
- 17) Contributions are reconciled with Oracle at the year end to confirm that the actual contributions received have been accounted for correctly against each income code and employer. This reconciliation for 31 March 2015 was checked and had been appropriately authorised by the Treasury and Investments Manager.

Risk Management

- 18) There is a Pension Fund risk register that is approved at the Superannuation Fund Committee. The risks identified in respect of employers are being appropriately managed and mitigated.

System and Resources

- 19) The current system is adequate but continued changes with KCC recognising academies as part of a multi-academy trust rather than as a single academy trust and the increasing number of employers may result in the need to update and develop the system. **See Issue 1**
- 20) The day to day processes and monitoring are performed by a few individuals who have the necessary skills and knowledge. However, KCC should consider the risk of losing key members of staff in the future. **See Issue 2**

Back Up and Recovery

- 21) The Excel workbooks developed to manage and monitor pension contributions are all saved to the KCC shared drive and backed up centrally each night.






3 ISSUES IDENTIFIED & MANAGEMENT ACTION PLAN

| 1. Pension Contribution System | |
|--|--|
| <p><u>Issue and Potential Root Cause</u> The current Excel system is adequate for the current number of employers and how the contributions are paid. The increase in the number of employers in the Kent Pension Fund may result in the need to update and develop the system further. This should include exploring other options for how employers submit their contributions.</p> <p>Risk The current system may not be effective for identifying errors and anomalies in contributions.</p> <p>Root Cause The system being based on Excel spreadsheets was developed in-house. The current system may be less effective with an increase in employers.</p> | <p>Risk Rating</p> <p style="text-align: center;">Low</p> |
| <p><u>Management Action Plan</u></p> <p>We will continue to maintain strong controls on the contributions process and continuously monitor employer returns to ensure they are accurate and the correct cash is received. As more Kent and Medway schools convert to academies we will support the establishment of the multi-academy trusts as single employers in the Fund.</p> <p>We will work with the Pensions Admin team to make greater use of Employer self service and the Pension Fund website for the submission of Employer returns.</p> <p>Responsible manager - Alison Mings, Treasury and Investments Manager</p> | <p>Timescales</p> <p>Ongoing</p> <p>31 December 2016</p> |

| 2. Succession Planning | |
|---|---|
| <p><u>Issue and Potential Root Cause</u> There is no succession plan in place to ensure staff are recruited and trained appropriately.</p> <p>Risk Contributions may not be accounted for correctly.</p> <p>Root Cause The Treasury and Investments team is reliant on a very few individuals who have the necessary skills and knowledge to review and monitor the contributions each month.</p> | <p>Risk Rating</p> <div style="border: 1px solid blue; background-color: #90ee90; padding: 5px; display: inline-block;"> <p>Low</p> </div> |
| <p><u>Management Action Plan</u></p> <p>We are focussing efforts on developing a robust and documented system for processing employer contributions which reduces reliance on the staff themselves.</p> <p>Current staff are encouraged to add to their knowledge and understanding of employer issues in particular by reference to the Pensions Regulator’s guidance. Plans are under discussion for the recruitment of a successor to the Kent Accountancy Trainee who is due to move to another placement at the end of August.</p> <p>Responsible manager - Alison Mings, Treasury and Investments Manager</p> | <p>Timescales</p> <p>Ongoing</p> <p>31 August 2016</p> |

Appendix A – Definition of Audit Opinions

In order to assist management in using our reports we categorise our **audit opinion** according to our assessment of the risks, the controls in place to manage those risks and the level of compliance with these controls. The definitions of assurance levels are as follows:

-  **High** There is a sound system of control operating effectively to achieve service/system objectives.
Any issues identified are minor in nature and should not prevent system/service objectives being achieved.
-  **Substantial** The system of control is adequate and controls are generally operating effectively.
A few weaknesses in internal control and/or evidence of a level of non compliance were noted during the audit that may put a system/service objective at risk.
-  **Adequate** The system of control is sufficiently sound to manage key risks.
However there were weaknesses in internal control and/or evidence of a level of non compliance with some controls that may put system/service objectives at risk.
-  **Limited** Adequate controls are not in place to meet all the system/service objectives and/or controls are not being consistently applied.
Certain weaknesses require immediate management attention as if unresolved they may result in system/service objectives not being achieved.
-  **No Assurance** The system of control is inadequate and controls in place are not operating effectively. The system/service is exposed to the risk of abuse, significant error or loss and/or misappropriation.
This means we are unable to form a view as to whether objectives will be achieved.

Appendix B – Definition of Risk Ratings

We categorise our issues according to **risk rating** as follows:



There is a gap in the control framework or a failure of existing internal controls that results in a significant risk that service or system objectives will not be achieved.



There are weaknesses in internal control arrangements which lead to a moderate risk of non-achievement of service or system objectives.



There is scope to improve the quality and/or efficiency of the control framework, although the risk to overall service or system objectives is low.

Appendix C – Prospects for Improvement

| <u>Prospects for Improvement</u> | |
|---|--|
| Very Good | There are strong building blocks in place for future improvement with clear leadership, direction of travel and capacity. External factors, where relevant, support achievement of objectives. |
| Good | There are satisfactory building blocks in place for future improvement with reasonable leadership, direction of travel and capacity in place. External factors, where relevant, do not impede achievement of objectives. |
| Adequate | Building blocks for future improvement could be enhanced, with areas for improvement identified in leadership, direction of travel and/or capacity. External factors, where relevant, may not support achievement of objectives. |
| Uncertain | Building blocks for future improvement are unclear, with concerns identified during the audit around leadership, direction of travel and/or capacity. External factors, where relevant, impede achievement of objectives. |