

Falkirk Council Pension Fund

- Transactional Testing
- Operational Cash Management Arrangements

2020/21 Internal Audit Review

Substantial Assurance

IAA

Report Recipients:

Director of Corporate and Housing Services
Chief Finance Officer
Pensions Manager

1. INTRODUCTION AND SCOPE

- 1.1 This review of the Falkirk Council Pension Fund forms part of our 2020/21 coverage, agreed by the Pensions Committee and Pensions Board in August 2020.
- 1.2 Internal Audit, in conjunction with the Pensions Manager, identified the key risks relating to pensions transactions, and operational cash management arrangements. The agreed Terms of Reference is at **Annex 1**.
- 1.3 Falkirk Council is the Administering Authority for the Falkirk Council Pension Fund (the Fund). The Council is responsible for administering and maintaining the Fund and is designated as a Scheme Manager under the Public Service Pensions Act 2013. The Council has delegated Fund business to a Pensions Committee consisting of Falkirk Council elected Members and Trade Union, Pensioner, and Employer representatives. Fund activities are also overseen by a Pension Board comprising four Employer and four Trade Union representatives.
- 1.4 Fund membership (see **Table 1**) comprises active, deferred, and pensioner members. Employees of participating employers who are not eligible to join one of the other public sector pension schemes are eligible for Fund membership.

Table 1
Pension Fund Membership at 02 February 2021¹

Active	Deferred	Pensioners	Total
15,088	9,027	11,543	35,658
42.3%	25.3%	32.4%	100.0%

- 1.5 Administration of the Fund is undertaken by the Council's Pensions Section, which utilises Altair Pensions Administration System (Altair). There are also ongoing agreements with the Lothian Pension

Fund to enable investment and legal expertise to be accessed as and when required.

- 1.6 The Fund needs to hold certain levels of cash to fund payments to, or in relation to, their members (operational cash) as well as to fund new or existing investments. Operational cash is required for:
- the payment of monthly pensions;
 - the payment of retirement lump sums;
 - the payment of death grants;
 - refunds to employees opting out of the Fund;
 - transfer payments for employees moving to another Fund; and
 - paying for Fund expenses such as investment manager fees or advisory fees.
- 1.7 A Cash Management Policy has been developed by the Fund to set out the principles that officers must follow in managing cash holdings. This ensures that suitable controls are in place and that balances are kept to a minimum (subject to sufficient cash being available for the Fund's needs).
- 1.8 It is important to highlight that Internal Audit work has taken place during the current Covid-19 outbreak and has been conducted remotely. To meet the challenge of keeping staff safe while continuing to deliver critical activities to Fund employers and members, the Pensions Section are using a combination of home working and periodic access to the Municipal Buildings, with safe distancing and lone working guidelines appropriately enforced.
- 1.9 Following the agreement of the Pensions Committee and Board in September 2020 that preliminary work into the feasibility of merging the Falkirk and Lothian Pension Funds could take place, the Funds have jointly engaged Deloitte to examine the case for merger. This work is currently ongoing and it is expected that Deloitte will report their findings to the

¹ Source: Pensions Section

Funds in March 2021, prior to presenting to the Committees and Boards. Should a merger be agreed, a project plan will be developed and will be based on the work conducted by Deloitte. We anticipate that any Internal Audit work (that is referred to in the Terms of Reference at **Annex 1**) in relation to this will commence later in 2021.

2. AUDIT ASSURANCE AND EXECUTIVE SUMMARY

2.1 This review has focused on two areas: transactional testing; and operational cash management arrangements.

2.2 We can provide **SUBSTANTIAL ASSURANCE** in both areas (see **Annex 2** attached for assurance category definitions).

2.3 In relation to transactional testing, we found the operational controls were working effectively. These controls relate to:

- the calculation of new member contributions;
- paying or receiving transfer values;
- refunding contributions;
- calculating deferred pensions; and
- making payments to retiring members or in respect of deceased Fund members.

2.4 We were content that there is compliance with the Fund's Cash Management Policy. We found that the Pensions Team regularly monitors the Fund's cash flow, there is appropriate segregation of duties in relation to cash management, and that concentration risk has been avoided by the number of deposits that are held.

2.5 We noted, however, that the balance on the Royal Bank of Scotland business reserve account regularly exceeded the limit of £8 million that is prescribed by the Fund's Cash Management Policy. We have

recommended that the investment limits are reviewed and (where necessary) increased.

2.6 A summary of our recommendations is set out at **Section 4** of the report, with more detail provided at **Section 3**.

3. AUDIT FINDINGS

Remit Item 1: Transactional Testing

3.1 We reviewed a sample of 47 pension transactions covering the period since April 2020. These included new members, pension payments, paying or receiving transfer values, refunds to members, deceased members, and deferred pensions.

3.2 The main purpose of the transactional testing was to:

- confirm that there is supporting documentation that has been appropriately completed and authorised;
- ensure that calculations of pension payments, transfers in, transfers out, refunds of contributions, and payments in respect of deceased members were accurate, and had been checked and authorised; and
- ensure that Altair has been accurately updated.

3.3 From our review of these transactions, we were content that the information from the forms was being accurately input to Altair.

3.4 A summary of our findings from the transactional testing is at **Table 2**.

Table 2
Transactional Testing – Summary of Findings

Category	Sample Size	Appropriate Supporting Documentation Completed	Accurate Payments or Transfers	Altair Accurately Updated
New Members	14	✓	n/a	✓
Pension Payments	10	✓	✓	✓
Transfers Out	6	✓	✓	✓
Transfers In	3	✓	✓	✓
Refunds	4	✓	✓	✓
Deceased Members	5	✓	✓	✓
Deferred Pensions	5	✓	n/a	✓

3.5 We noted that interest was added to two lump sum pension payments. This is because they were not paid within one month (as per the Local Government Pension Scheme (LGPS) Regulations). We were, however, satisfied that the delays in making the payments were not caused by the Pensions Section.

3.6 We also reviewed the controls around i-Connect² and the receipt of monthly employer contributions. i-Connect is currently used by 25 of the employers from the Pension Fund³. Our testing confirmed that:

- the Pensions Manager and Pensions Support Assistant reconcile the employee and employer contributions per Altair with i-Connect on a monthly basis to ensure that the data has been correctly transferred;
- the accuracy of the amounts paid into the Pension Fund bank account each month were checked by the Accounting Assistant. Employers were asked to provide an explanation for any differences between the actual and expected contributions; and
- reconciliations between the ledger and the Pension Fund bank account were being

² i-Connect is a web-based application that allows the electronic exchange of encrypted data between the employers and the Pensions Administration System.

³ Falkirk Council, Stirling Council, SCRA, and Scottish Autism are all due to commence using i-Connect in 2021/22.

conducted for each month. These are reviewed by the Pension Fund's Senior Accountant.

3.7 The intention is that i-Connect will eventually be used by all Pension Fund employers.

Remit Item 2: Operational Cash Management Arrangements

3.8 The Fund's updated Cash Management Policy (the Policy) was approved by the Pensions Committee at its 10 December 2020 meeting. The main objectives of the Policy are to ensure that:

- cash is invested prudently;
- any deposits are secure; and
- the Fund has sufficient access to immediate cash.

3.9 The Policy also describes / details:

- the instruments in which cash can be invested⁴;
- the minimum standard of creditworthiness of a borrower;
- the investment limits that apply to various counterparties; and
- the roles and responsibilities of the Chief Finance Officer; the Joint Investment Strategy Panel; and the Pensions Section officers.

3.10 We were content that there is appropriate segregation of duties in relation to the approval of operational cash transactions, with only senior members of the Pensions team (Pensions Manager, Senior Accountant, and Pensions Officers) being able to authorise CHAPS payments or payment requests.

⁴ The allowable instruments are UK or US Treasury Bills (unlimited investment for up to 95 days); a current or call deposit account (up to £8 million with instant access); a notice deposit account (up to £8 million for up to 95 days); a term deposit account (up to £8 million for up to 95 days); and a triple A rated money market fund (up to £8 million with daily liquidity).

Higher value payments are approved by one of the Pension Fund Authorised Signatories⁵.

3.11 From reviewing a sample of 27 cash balances emails that cover the period 11 November 2019 to 14 December 2020, we confirmed that:

- regular cash flow monitoring is undertaken by the Fund Accounting Team (this involves providing the Pensions Manager with details of cash balances and projections on a weekly basis);
- the balance of the central cash account with the Fund's Custodian (Northern Trust) was within the limit of £75 million specified in the Policy; and
- quarterly investment cash projection statements are prepared for the Joint Investment Strategy Panel (we reviewed statements for April, July, and October 2020).

3.12 As per paragraph 3.9, the Policy includes a list of approved counterparties. We reviewed the Fund's cash deposits as at 30 November 2020. A total of £14.2 million has been deposited with financial institutions (excluding the Fund's Custodian), as per **Table 3**. We were content that there is compliance with the Policy for these deposits⁶.

Table 3
Deposit Details as at 30 November 2020

Institution	Amount
Aberdeen Standard Liquidity Fund	£5,000,000.00
Bank of Scotland	£5,157,731.51
Santander UK	£4,056,746.93
Total	£14,214,478.44

⁵ The Chief Finance Officer, the Senior Service Manager – Corporate Finance, and the Accountancy Services Manager.

⁶ This is because the deposits are less than the maximum amount of £8 million; the money can be accessed immediately from Aberdeen Standard (a AAA rated money market fund) and Santander (a call deposit account); the notice period of 32 days on the Bank of Scotland account (a notice deposit account) is less than the maximum of 95 days; and the institutions are approved counterparties. Concentration risk is also avoided as there are deposits with more than one institution.

3.13 In relation to the Fund's cash deposits, we reviewed:

- the interest payments that have been received and checked that they have been processed in the ledger (see paragraph 3.14);
- the credit ratings of the counterparties to ensure that there is compliance with the Policy (see paragraph 3.15);
- the arrangements regarding the use of the RBS Bankline system to ensure an appropriate segregation of duties (see paragraph 3.17); and
- the balances on the RBS accounts to ensure compliance with the Policy's limit of £8 million (see paragraph 3.18).

3.14 We could reconcile the **Table 3** balances to the ledger, although we noted that interest on the Santander account (which is received on a monthly basis) was only included up to August 2020. The interest payments for September 2020 to December 2020 were processed through the ledger in January 2021, increasing the balance to £4,058,796.79. Income from the Aberdeen Standard Liquidity Fund is credited to the Fund's current account each month. Interest on the Bank of Scotland deposit is, however, processed at the end of each year.

3.15 We reviewed the credit ratings of the Fund's Custodian (Northern Trust) and the various counterparties with Standard and Poor's, Moody's, and Fitch Ratings as at November 2020. We were content that all achieve the minimum creditworthiness rating⁷ that is required by the Policy.

3.16 The Fund uses the Royal Bank of Scotland (RBS) for daily transactions. This comprises the types of payment that are listed at paragraph 1.6. If necessary, the deposits at **Table 3** could also be used to fund these transactions. There is a current account

⁷ Fitch Ratings – Short Term = F1 (indicates the strongest capacity for timely payment of financial commitments within a 12-month timeframe) and Long Term = A (High credit quality. A low expectation of credit risk with a strong capacity for timely payment of financial commitments).

and a business reserve account with RBS and any credit balance on the current account is automatically transferred to the business reserve account at the end of each day. The Policy specifies a limit of £8 million on RBS balances.

3.17 The Fund uses the RBS Bankline system to support cash management operations. To ensure an appropriate segregation of duties, any Fund payments are input by the Council's Treasury Team before they are authorised by the Pensions Manager or Senior Fund Accountant. None of the Pensions Team have access to input payments on RBS Bankline (they only have View Only or Authoriser access).

3.18 We reviewed the statements for both the RBS current account and business reserve account that cover 01 April 2020 to 30 November 2020. We found that the balance on the current account remained within the limit of £8 million over the eight months. We did, however, find that the balance on the business reserve account exceeded £8 million on 23 occasions between 01 April 2020 and 30 November 2020, with the highest end of day balance being £8,957,675.46 on 27 November 2020.

3.19 We, therefore, **recommend** that the investment limits for existing Fund counterparties (including RBS) are reviewed and (where necessary) increased, subject to approval by the Pensions Committee and Board. If the RBS limit was revised to £10 million (in line with Falkirk Council⁸), future breaches of the Policy could be avoided. The Policy should also be updated with the revised counterparty limits.

⁸ We noted that a Treasury Management Interim Review report that was submitted to Falkirk Council's Executive on 17 November 2020 acknowledged several breaches on limits with counterparties. To address this, the report recommended an increase of £2 million in investment limits with existing counterparties (from £8 million to £10 million) to provide more flexibility when high cash balances are held.

4. RECOMMENDATIONS AND ACTION PLAN

Classification of Recommendations		
Grade 1: Key risks and / or significant deficiencies which are critical to the achievement of strategic objectives. Consequently, management needs to address and seek resolution urgently.	Grade 2: Risks or potential weaknesses which impact on individual objectives, or impact the operation of a single process, and so require prompt but not immediate action by management.	Grade 3: Less significant issues and / or areas for improvement which we consider merit attention but do not require to be prioritised by management.

Rec. No.	Recommendation	Reason for Recommendation	Agreed Management Action	Responsible Owner	Action Due
1.	<p>RBS Business Reserve Account Balances</p> <p>The investment limits for existing Fund counterparties (including RBS) should be reviewed and (where necessary) increased.</p> <p>Report Paragraph: 3.19</p> <p>Grade 2</p>	<p>To avoid future breaches of the Fund's Cash Management Policy limits with counterparties.</p> <p>To provide more flexibility when high cash balances are held.</p>	<p>Recommendation Accepted</p> <p>We'll consult with Treasury and ensure that our limits mirror those in place at Council level as appropriate.</p> <p>The main reason for the amount of cash held was that there was an anticipated cash transfer to settle the Visit Scotland consolidation to Lothian however we subsequently found out that the majority of this was not required until March / April 2021 and so we moved the cash after this was clarified.</p> <p>We would intend to present the revised limits to the June 2021 Committee meeting.</p>	Pensions Manager	June 2021



Terms of Reference

Service:	Corporate and Housing	Audit Year:	2020/21
Director:	Stuart Ritchie	Audit Manager:	Gordon O'Connor
Pensions Manager:	Alastair McGirr	Lead Auditor:	David Macleod
Audit Area:	Pension Fund 2020/21		

SCOPE

As agreed by the Pensions Committee and Board on 13 August 2020, Internal Audit work during 2020/21 focused on two areas:

- Transactional Testing; and
- Operational Cash Management Arrangements.

Internal Audit reviewed the framework of internal controls in place to manage the risks in both these areas.

In addition, the Pensions Committee and Board agreed at its 24 September 2020 meeting that preliminary work into the feasibility of merging the Falkirk and Lothian Pension Funds could take place. In view of the significance of this, we have worked with the Pensions Manager to understand the key areas of risk and to contribute to the project plan for progressing this workstream. This is an ongoing item of work and will fall into the Internal Audit programme for 2021/22 and beyond.

PENSION FUND RISKS

Internal Audit work links to the following risks from the Pension Fund Risk Register. The purpose of our review was to confirm and assess the adequacy of the internal control framework that prevents these risks from occurring.

Transactional Testing

- inaccurate member data on Altair or incomplete member data due to employer omissions;
- staff error or backlogs in Service delivery;
- failure or delay in paying pensioners;
- contributions to the Fund are not received, processed, or recorded completely and accurately; and
- adverse impact from Covid-19 pandemic.

Operational Cash Management Arrangements

- fund has insufficient cash to meet immediate commitments;
- custody arrangements may not be sufficient to safeguard Pension Fund's assets; and
- adverse impact from Covid-19 pandemic.

Pension Fund Merger

- key risks associated with aligning Fund operations with Lothian Pension Fund not fully considered.

REMIT ITEMS

We developed our work-plan to obtain the necessary evidence to provide assurance that appropriate systems are in place to mitigate the above risks. This was done by reviewing the following:

Transactional Testing

- new member contributions to the Pension Fund have been properly calculated by Fund employers;
- transferred in rights have secured appropriate benefits for members;
- transfers out and refunds have been properly calculated;
- correct payments have been made to retiring, and in respect of deceased, Fund members; and
- controls around i-Connect are operating effectively.

Operational Cash Management Arrangements

- the clarity of roles and responsibilities;
- the management of day to day and longer-term transactions;
- the appropriateness of levels of cash held by the Fund's Custodian or deposited with other financial institutions; and
- compliance with the Fund's Cash Management Policy.

Pension Fund Merger

- provide input and comment on the project plan.

DEFINITION OF ASSURANCE CATEGORIES

Level of Assurance	Definition
Substantial assurance	Largely satisfactory risk, control, and governance systems are in place. There may be some scope for improvement as current arrangements may undermine the achievement of objectives or leave them vulnerable to error or abuse.
Limited assurance	Risk, control, and governance systems have some satisfactory aspects. There are, however, some significant weaknesses likely to undermine the achievement of objectives and leave them vulnerable to an unacceptable risk of error or abuse.
No assurance	The systems for risk, control, and governance are ineffectively designed and operated. Objectives are not being achieved and the risk of serious error or abuse is unacceptable. Significant improvements are required.