

ITEM No ...9.....

REPORT TO: PENSION SUB-COMMITTEE OF THE POLICY & RESOURCES COMMITTEE & PENSION BOARD – 13 DECEMBER 2021

REPORT ON: TAYSIDE PENSION FUND INTERNAL AUDIT REPORT – OUTSOURCING & THIRD-PARTY MANAGEMENT

REPORT BY: EXECUTIVE DIRECTOR OF CORPORATE SERVICES

REPORT NO: 345-2021

1 PURPOSE OF REPORT

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

2 RECOMMENDATIONS

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

3 FINANCIAL IMPLICATIONS

None.

4 MAIN TEXT

4.1 Internal Audit Report - Outsourcing and Third-Party Management (Appendix A)

The report details the review of the framework in place to ensure that the Fund is provided with adequate reporting to enable monitoring and oversight of key service providers. They assessed evidence of review and challenge of the reporting as appropriate; and whether there is a framework in place to ensure that value for money is assessed on a regular basis.

4.2 PwC have rated the control environment as Medium Risk, and further details are included in section 3 of their report. PwC classify medium risk as that a finding could have moderate impact on operational performance, reputation, financial impact, or regulatory breach.

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

5 POLICY IMPLICATIONS

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

6 CONSULTATIONS

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

7 BACKGROUND PAPERS

None

**ROBERT EMMOTT
EXECUTIVE DIRECTOR OF CORPORATE SERVICES**

03 DECEMBER 2021

Internal audit report 2021/2022 Draft



Outsourcing and Third Party Management
Tayside Pension Fund

November 2021



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Distribution list

For action:
Senior Manager Financial Services

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



Executive summary (1 of 2)

Report classification



Medium Risk

Trend

A review of this nature has not been performed in previous years.

Total number of findings

| | Critical | High | Medium | Low | Advisory |
|-------------------------|----------|------|----------|----------|----------|
| Control design | - | - | 3 | 1 | - |
| Operating effectiveness | - | - | - | - | - |
| Total | - | - | 3 | 1 | - |

Introduction

This review was undertaken in line with the 2021/2022 Internal Audit plan, as approved by the Pension Sub-Committee on 8th March 2021.

We reviewed the framework in place to ensure that the Fund is provided with adequate reporting to enable monitoring and oversight of key service providers; that there is evidence of review and challenge of the reporting as appropriate; and that there is a framework in place to ensure that value for money is assessed on a regular basis.

Overall, we have rated the control environment as Medium Risk. We have raised three medium risk and one low risk finding. Further details are included in section 3 of this report.

Summary of key findings

Three medium risk findings are summarised below:

Finding 1 - No formal policy which sets out the minimum requirements for managing outsourcing and third party service providers [Medium Risk].

There is no overarching policy or procedures in place that cover the key aspects of the outsourcing lifecycle; initial risk assessment, ongoing oversight and business continuity planning.

Finding 2 - No formal policy which sets out the required criteria for assessing value for money [Medium Risk].

Although value for money is considered as part of the procurement process and performance reviews, the Fund does not have a formal policy in place which sets out the required criteria for assessing the value for money of the functions and activities outsourced to third parties, or the required frequency of assessment.

Finding 3 - No register of third party service providers [Medium Risk].

There is no register in place to identify, record and categorise all third party service providers. The current listing does not consider the criticality of services, impact of failure, contract renewal dates, frequency of required reporting or service level review.

Executive summary (2 of 2)

Management comments

- A formal Procurement Policy will be developed to accommodate the risks identified. This will be presented for approval with other key policies in March 2022.
- A formal contract register will be introduced from January 2022. This will be subject to regular review in line with recommendations made.
- Recommendations in relation to service reviews will be implemented from January 2022.

Background and scope

Background

Tayside Pension Fund has been administered by Dundee City Council since 1st April 1996. It is part of the Local Government Pension Scheme (LGPS), which is a statutory scheme established under the primary legislations of the Superannuation act 1972 and Public Service Pensions Act 2013.

As at 31st March 2021, Tayside Pension Fund had investment assets of £4.85 billion, and a membership of over 51,000 across 45 participating employers. These participating employers include 3 local authorities, as well as their subsidiary companies and contractors; a number of universities and colleges; and a range of organisations with funding or service links to local government.

There are approximately 100 LGPS funds in the UK, with 11 of these in Scotland. Tayside is the 4th largest of the 11 Scottish LGPS funds in asset size. The LGPS is a multi-employer defined benefit scheme, whose benefits up until 31st March 2015 was based upon final salary. Since this date, benefits are based upon career average.

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

An audit of Outsourcing and Third Party Management was included in the 2021/2022 Internal Audit plan approved by the Pension Sub-Committee on 8th March 2021. This audit focused on assessing the processes in place for ensuring there is sufficient oversight of key service providers and that value for money is assessed.

Limitations of Scope

This audit focused on assessing the processes in place for ensuring there is sufficient oversight of key service providers and that value for money is assessed, specifically the scope was limited to the objectives noted above.

Management determined the key service providers as being:

- Investment Advisor
- Custodian
- Investment Managers

The “Investment Strategy and Investment Managers” review was carried out as part of the 20/21 audit plan, which included a review of the oversight and monitoring of Investment Managers. As such this review excluded Investment Managers and focused on the remaining key service providers.

Current year findings (1 of 4)

1

No formal policy which sets out the minimum requirements for managing outsourcing and third party service providers

Control Design

Finding rating

Rating

Medium

Finding and root cause

There is no formal policy in place that sets out the minimum standards and requirements for managing outsourcing and third party service providers across the key stages of the outsourcing lifecycle:

1. Initial risk assessment and selection of service providers;
2. Ongoing oversight and performance monitoring;
3. Business continuity planning.

It was noted that there are practices in place around the selection and monitoring of providers, for example the fund only uses suppliers from the National Local Government Pension Scheme (LGPS) or Crown Commercial Service Frameworks and follows the formal procurement process in line with public sector requirements. However, there is no overarching policy or procedures in place that cover all aspects of the outsourcing lifecycle.

Potential implications

Where there is no policy in place, there is a risk of inconsistent or poor practice in the management of outsourcing and third party service providers.

In the 2018 statement "Managing Service Providers" the Pension Regulator summarises their expectations of good practice on the management of service providers, one of which is that- there are "procedures in place, and a clearly documented procedures manual, to enable a continuous and consistent service".

There is a risk that by not having a formal policy in place that includes these key stages of the outsourcing lifecycle, The Pension Regulator's expectations are not met.

Recommendation

An outsourcing and third party service providers policy should be put in place which documents the required standards for managing outsourcing and third party service providers across each stage of the outsourcing lifecycle.

Management action plan

A formal third party outsourcing policy will be put in place which documents the required standards for managing outsourcing and third party service providers.

Responsible person/title:

Tracey Russell, Senior Manager
Financial Services

Target date: 31 March 2022

Current year findings (1 of 4)

2 No formal policy which sets out the required criteria for assessing value for money

Control Design

Finding rating

Rating

Medium

Finding and root cause

It was noted that there are practices in place to ensure value for money is considered, including:

- The use of National Local Government Pension Scheme (LGPS) or Crown Commercial Service Framework suppliers which ensure pre-negotiated pricing levels;
- Assessing value for money as part of the procurement process;
- Assessing value for money as part of performance reviews.

However, there is no policy in place which sets out the required criteria for assessing the value for money of the functions and activities outsourced to third parties, or the required frequency of assessment.

Potential implications

Where there is no policy in place, there is a risk of inconsistent or poor practice when assessing the value for money of the functions and activities outsourced to third parties.

In the 21st Century Trusteeship Series, Value for Members - The Pension Regulator notes "there is no 'one size fits all' approach to value for money assessments, it is therefore up to the trustees to determine a proportionate approach to their assessment based on the characteristic of their scheme. However, this approach should be a framework that the trustees repeat each year".

There is a risk that by not having a formal policy in place, The Pension Regulator's expectations are not met.

Recommendation

A Value for Money policy should be put in place which documents the criteria for assessing value for money of the functions and activities outsourced to third parties.

Management action plan

The formal third party outsourcing policy which will be put in place to address finding 1, will include the criteria for assessing value for money of the functions and activities outsourced to third parties.

Responsible person/title:

Tracey Russell, Senior Manager
Financial Services

Target date: 31 March 2022

Current year findings (1 of 4)

3 No register of third party service providers

Control Design

Finding rating

Rating

Medium

Finding and root cause

It was noted that there is a listing of third party service providers which is maintained as part of the annual accounts process.

There is also a risk register which considers the impact that failure of the Global Custodian and Investment Managers would have on the fund.

However, there is no formal register in place to identify, record and categorise all third party service providers. The current listing does not consider the criticality of services, impact of failure, contract renewal dates, frequency of required reporting or service level review.

Potential implications

Without a formal register of third party service providers, there is a risk that suppliers are not appropriately identified, recorded and categorised. This may lead to inadequate monitoring and oversight of service providers.

Recommendation

A formal third party provider register should be put in place which records a list of all current suppliers, and categorises each supplier by the level of criticality or dependence for the Funds critical functions.

This register should be reviewed on a regular basis to ensure it remains up to date.

To demonstrate good governance, we suggest a formalised register that tracks:

- Contract renewal date
- Level of criticality
- Frequency of Service Level Review linked to criticality
- Frequency of reporting

Management action plan

A formal third party provider register will be put in place.

Responsible person/title:

Tracey Russell, Senior Manager
Financial Services

Target date: 31 January 2022

Current year findings (1 of 4)

4 There is no formally retained evidence of review and challenge of reporting provided by third party service providers

Control Design

Finding rating

Rating

Low

Finding and root cause

Quarterly meetings are held with the Custodian and Investment Advisor where management discuss the reporting provided by each, including questions over the content of reporting, a review of the services provided and any required improvements. Whilst the reporting provided by the Custodian and Investment Advisor are retained, evidence of management's review and challenge and the decisions taken at the review meetings are not.

Potential implications

Where the decisions and actions from the quarterly meetings are not recorded, there is a risk that they are not completed, or not completed within expected time frames which may lead to performance issues or poor service.

In order to demonstrate good governance, and to evidence the oversight of service providers, evidence such as meeting minutes or action trackers should be maintained.

Recommendation

Decisions taken and actions from review meetings with suppliers should be sufficiently documented to ensure they are completed and that evidence of monitoring and challenge is maintained.

Management action plan

Formal minutes and actions log of future service review meetings will be maintained.

Responsible person/title:

Tracey Russell, Senior Manager
Financial Services

Target date: 31 January 2022

Appendices

Appendix A: Basis of our classifications

Individual finding ratings

Critical

A finding that could have a:

- **Critical** impact on operational performance; or
- **Critical** monetary or financial statement impact; or
- **Critical** breach in laws and regulations that could result in material fines or consequences; or
- **Critical** impact on the reputation or brand of the organisation which could threaten its future viability.

High

A finding that could have a:

- **Significant** impact on operational performance; or
- **Significant** monetary or financial statement impact; or
- **Significant** breach in laws and regulations resulting in significant fines and consequences; or
- **Significant** impact on the reputation or brand of the organisation.

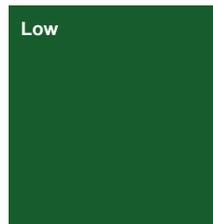
Medium

A finding that could have a:

- **Moderate** impact on operational performance; or
- **Moderate** monetary or financial statement impact; or
- **Moderate** breach in laws and regulations resulting in fines and consequences; or
- **Moderate** impact on the reputation or brand of the organisation.

Appendix A: Basis of our classifications

Individual finding ratings



Low



A finding that could have a:

- **Minor** impact on the organisation’s operational performance; or
- **Minor** monetary or financial statement impact; or
- **Minor** breach in laws and regulations with limited consequences; or
- **Minor** impact on the reputation of the organisation.



Advisory



A finding that does not have a risk impact but has been raised to highlight areas of inefficiencies or good practice.

Report classifications

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

| Findings rating | Points | Report classification | Findings rating | Points |
|-----------------|-----------------------|-----------------------|-----------------|--------------------|
| Critical | 40 points per finding | | Low risk | 6 points or less |
| High | 10 points per finding | | Medium risk | 7 – 15 points |
| Medium | 3 points per finding | | High risk | 16 – 39 points |
| Low | 1 point per finding | | Critical risk | 40 points and over |

Appendix B: Terms of reference

This review is being undertaken as part of the 2021//2021 internal audit plan, as approved by

Background

Tayside Pension Fund has been administered by Dundee City Council since 1st April 1996. It is part of the Local Government Pension Scheme (LGPS), which is a statutory scheme established under the primary legislations of the Superannuation act 1972 and Public Service Pensions Act 2013.

As at 31st March 2021, Tayside Pension Fund had investment assets of £4.85 billion, and a membership of over 51,000 across 45 participating employers. These participating employers include 3 local authorities, as well as their subsidiary companies and contractors; a number of universities and colleges; and a range of organisations with funding or service links to local government.

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

An audit of Outsourcing and Third Party Management is included in the 2021/2022 Internal Audit plan approved by the Pension Sub-Committee on 8th March 2021. This audit will focus on assessing the processes in place for ensuring there is sufficient oversight of key service providers and that value for money is assessed.

Audit Objectives

- Ensure there is a framework in place to provide adequate reporting to enable monitoring and oversight of key service providers.
- Ensure there is evidence of review and challenge of the reporting as appropriate.
- Ensure there is a framework in place to ensure that value for money is assessed on a regular basis.

Appendix B: Terms of reference

Scope

We will review the design and operating effectiveness of key controls relating to outsourcing and third party management during the 12 month period to 31st August 2021

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

| Process | Objectives | Risks |
|--|--|---|
| Monitoring and oversight of functions and activities outsourced to third parties | Ensure there is a framework in place to provide adequate reporting to enable monitoring and oversight of key service providers. This will include ensuring there is evidence of review and challenge as appropriate. | <ul style="list-style-type: none"> Insufficient oversight and challenge of the functions and activities outsourced to third parties. |
| Assessing the value for money of the functions and activities outsourced to third parties | Ensure there is a framework in place to ensure that value for money is assessed on a regular basis. | <ul style="list-style-type: none"> Insufficient assessment of the value for money of the functions and activities outsourced to third parties. |

Appendix B: Terms of reference

Limitations of scope

This audit will focus on assessing the processes in place for ensuring there is sufficient oversight of key service providers and that value for money is assessed, specifically the scope is limited to the objectives noted above.

Management have determined the key service providers as being:

- Investment Advisor
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The “Investment Strategy and Investment Managers” review was carried out as part of the 20/21 audit plan, which included a review of the overnight and monitoring of Investment Managers. As such this review will exclude Investment Managers and focus on the remaining key service providers.

Audit approach

Our audit approach is as follows:

- Obtain an understanding of outsourcing and third party management through discussions with key personnel and review of policies and supporting guidance documentation.
- Identify the key processes and controls which ensure sufficient oversight of key service providers and that value for money is assessed.
- Evaluate the design of the key processes and controls in place.
- Test the operating effectiveness of the key processes and controls in place.

Appendix C: Limitations and responsibilities

Limitations inherent to the internal auditor's work

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

Internal control

Internal control systems, no matter how well designed and operated, are affected by inherent limitations. These include the possibility of poor judgment in decision-making, human error, control processes being deliberately circumvented by employees and others, management overriding controls and the occurrence of unforeseeable circumstances.

Future periods

Our assessment of controls is for the period specified only. Historic evaluation of effectiveness is not relevant to future periods due to the risk that:

- The design of controls may become inadequate because of changes in operating environment, law, regulation or other changes; or
- The degree of compliance with policies and procedures may deteriorate.

Responsibilities of management and internal auditors

It is management's responsibility to develop and maintain sound systems of risk management, internal control and governance and for the prevention and detection of irregularities and fraud. Internal audit work should not be seen as a substitute for management's responsibilities for the design and operation of these systems.

We endeavour to plan our work so that we have a reasonable expectation of detecting significant control weaknesses and, if detected, we carry out additional work directed towards identification of consequent fraud or other irregularities. However, internal audit procedures alone, even when carried out with due professional care, do not guarantee that fraud will be detected.

Accordingly, our examinations as internal auditors should not be relied upon solely to disclose fraud, defalcations or other irregularities which may exist.

Thank you

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This document has been prepared only for Tayside Pension Funds and solely for the purpose and on the terms agreed with Tayside Pension Funds in our agreement dated 28 January 2021. We accept no liability (including for negligence) to anyone else in connection with this document, and it may not be provided to anyone else.

This is a draft prepared for discussion purposes only and should not be relied upon; the contents are subject to amendment or withdrawal and our final conclusions and findings will be set out in our final deliverable.

In the event that, pursuant to a request which Tayside Pension Funds has received under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004 (as the same may be amended or re-enacted from time to time) or any subordinate legislation made thereunder (collectively, the "Legislation"), Tayside Pension Funds is required to disclose any information contained in this document, it will notify PwC promptly and will consult with PwC prior to disclosing such document. Tayside Pension Funds agrees to pay due regard to any representations which PwC may make in connection with such disclosure and to apply any relevant exemptions which may exist under the Legislation to such. If, following consultation with PwC, Tayside Pension Funds discloses any this document or any part thereof, it shall ensure that any disclaimer which PwC has included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.

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