ITEM No …8……..

REPORT TO: **PENSION SUB-COMMITTEE OF THE CITY GOVERNANCE COMMITTEE & PENSION BOARD – 17 MARCH 2025**

REPORT ON: **TAYSIDE PENSION FUND INTERNAL AUDIT REPORTS – THIRD PARTY MANAGEMENT REVIEW**

REPORT BY: **EXECUTIVE DIRECTOR OF CORPORATE SERVICES**

REPORT NO: **97-2025**

1 PURPOSE OF REPORT

To submit audit reports prepared by the Fund's Internal Auditor, Pricewaterhouse Coopers (PwC).

2 RECOMMENDATIONS

Members are asked to note the content of the report on the audit review undertaken, and to approve the management response.

3 FINANCIAL IMPLICATIONS

None.

4 MAIN TEXT

4.1 The report details the review undertaken that focused on Third Party Management of service providers. PwC have provided an overall rating of this area as 'Satisfactory' driven by one medium-rated and three low-rated findings.

The following areas of good practice were identified -

● Management recognises the growing need for enhanced governance of the pension fund and is currently undertaking a structured review to improve its governance and operations across the Fund. Additionally, management has engaged with other similar pension funds to gather insights and best practices.

● The Management team is informed and knowledgeable over the third-party management of the Fund.

Further details are included in Appendix A of this report.

4.3 The findings and recommendations of the audit have been discussed with management and responses are contained within the report. 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 subject to the Pre-IIA Screening Tool and does not make any recommendations for change to strategy, policy, procedures, services or funding and so has not been subject to an Integrated Impact Assessment. An appropriate senior manager has reviewed and agreed with this assessment.

6 CONSULTATIONS

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

7 BACKGROUND PAPERS

None

ROBERT EMMOTT
EXECUTIVE DIRECTOR OF CORPORATE SERVICES **10 MARCH 2025**

Internal audit report 2024/25

Third Party Management Review

Tayside Pension Fund (“TPF”)

March 2025

pwc

Contents

Distribution list

For action:
Stuart Norrie (Senior Banking & Investment Officer)
Paul Thomson (Head of Corporate Finance)

Executive summary

Report classification

Satisfactory

Total number of findings

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

Background and scope

Tayside Pension Fund has been administered by Dundee City Council since 1st April 1996. It is part of the Local Pension Government Scheme (LGPS), which is a statutory scheme established under the primary legislations of the Superannuation act 1972 and Public Service Pensions Act 2013. The Fund has investment assets of c.£5.4billion, and a membership of over 56,900 across 40 plus participating employers. The fund engages a diverse array of third-party suppliers to provide essential outsourced services, including fund managers, investment advisors, actuaries, custodians, system providers, performance measurement services, legal advisors, and covenant advisors.

The effective management of all third parties is key to ensuring the objectives of the Fund are met. Managing and monitoring third-party relationships is crucial for pension schemes due to their direct impact on performance, compliance, and risk profiles. Ensuring third parties deliver expected returns and services is essential for meeting financial objectives and managing risks such as operational disruptions, financial instability, compliance breaches, reputational damage, and data security threats. To mitigate these risks, pension schemes should conduct thorough due diligence, establish clear contractual agreements, implement continuous performance monitoring, and maintain open communication. Regular risk assessments, technology and security evaluations, and compliance checks further safeguard the scheme and ensure it fulfills its commitments to beneficiaries. It is therefore expected that Tayside Pension Fund (TPF) have adequate and appropriate oversight; and that monitoring controls are in place to enable a holistic and effective approach to third party management.

An audit of Third Party Management is included in the 2024/2025 Internal Audit plan approved by the Pension Sub-Committee. This review assessed the design and operating effectiveness assessment of key controls in respect of third party management and has focussed on the following areas:

- Policy and procedures;
- Monitoring and oversight; and
- Training and communication.

See Appendix B for more details.

Executive summary

Summary of findings

The overall rating of this report is 'Satisfactory' driven by one Medium-rated and three Low-rated findings. These are summarised in the table below. Full details, alongside agreed actions from management are within the following sections of the report.

The following areas of good practice were identified:

- Management recognises the growing need for enhanced governance of the pension fund and is currently undertaking a structured review to improve its governance and operations across TPF. Additionally, management has engaged with other similar pension funds to gather insights and best practices.
- The Management team is informed and knowledgeable over the third party management of the fund.

Sub-process	Scope Objectives	Summary of findings
Policy and procedures	• Third party supplier policies and procedures exist in relation to third party management, which clearly outline roles and responsibilities for managing outsourcing arrangements.	**Finding 1 - Absence of formal policy for outsourcing and third-party management (Medium):** TPF does not have a comprehensive and documented policy for managing third-party relationships throughout their lifecycle, which is essential for effective governance and compliance. There is also no training in place for staff. Although established practices, such as utilizing the Norfolk Framework for supplier recruitment, are in place, there is no overarching policy which governs the third party management process.
Monitoring and oversight	• Appropriate controls are in place at TPF to ensure regular and consistent monitoring and oversight of performance management of third parties; including performance management meetings, review of MI and performance packs, and their availability to senior management. • 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.	**Finding 2 - Incomplete monitoring of third-party performance (Low)**: The fund engages a diverse array of third-party suppliers to provide essential outsourced services, including fund managers, investment advisors, actuaries, custodians, system providers, performance measurement services, legal advisors, and covenant advisors. Whilst a structured performance evaluation process established for fund managers and investment advisors (which carry the largest financial risk to the Fund with over 95% of management costs), formalised performance monitoring mechanisms are not in place for other service providers, creating potential risks that may affect service quality and the overall effectiveness of the fund's operations. **Finding 3 - Absence of register of third party service providers (Low)**: The fund includes a listing of its third-party service providers in its annual report, but there is no centralised and documented list that captures the essential elements necessary for effective governance and oversight. This situation may hinder the fund's ability to appropriately manage supplier risks and ensure adequate oversight of outsourced services. Management has indicated that the procurement team is actively working on developing a comprehensive centralized listing of all third-party suppliers with relevant details.

Executive summary (cont.)

Sub-process	Scope Objectives	Summary of findings
Training and communication	• Robust risk training and awareness programmes exist to support core third party supplier management procedures and are reviewed to reflect any updates or changes to key third party supplier processes. • Training completion rates amongst staff are tracked and reported on, with enforceable consequences for lack of completion.	**Finding 4 - Insufficient documentation of engagement with third-party suppliers (Low):** Quarterly meetings are held with the Fund Managers, Custodian, and Investment Advisor where management engages in discussions about the reports provided by each party. These discussions include inquiries regarding the content of the reports, evaluations of the services rendered, and identification of required improvements. While the reports from these third parties are retained and follow-up emails shared by the suppliers, there is no formal documentation detailing the minutes of these meetings. Specifically, there is no evidence to indicate that management's comments, challenges, decisions made, along with action items from these discussions, are consistently recorded.

Current year findings

1 Absence of formal policy for outsourcing and third-party management

Control Design

Finding rating

Impact	3
Likelihood	iv
Rating	Medium

Finding and root cause

There is currently no formalised and documented policy governing the management of outsourcing and third-party management across the key stages of the third party management lifecycle. This policy should cover critical components such as:

- Due diligence and initial risk assessment
- Selection process
- Ongoing oversight and performance monitoring
- Business continuity planning
- Offboarding process or the procedure for transitioning away from a third-party provider

According to the Pension Regulator guidelines, there should be established, mutually agreed-upon, and documented policies for appointments. These policies must be reviewed at least every three years and must be approved by the governing body prior to commencing any procurement or appointment processes.

While we noted that the fund has established certain practices, such as utilising the Norfolk Framework—a National Local Government Pension Scheme (LGPS) framework—for supplier recruitment and appointing fund managers through the advisory services of Isio, there is no comprehensive policy or procedures document that addresses all aspects of the third-party management lifecycle. This absence could present potential risks to effective governance and compliance.

Furthermore, it has been observed that there is no training provided for staff regarding these processes. This absence of training, along with the absence of a documented policy, may contribute to potential errors, inconsistencies, and inefficiencies, particularly for new employees who might not fully understand the appropriate procedures and expectations.

Potential implications

- Potential non-compliance with regulatory requirements set forth by the Pension Regulator. This may expose the fund to legal risks, potential penalties, and reputational damage.

- The absence of training and a comprehensive policy can hinder staff effectiveness, particularly among new employees who may be unaware of established procedures and expectations. This could lead to inconsistencies, errors, and inefficiencies in managing third-party relationships.

Current year findings

1 Absence of formal policy for outsourcing and third-party management

Control Design

Finding rating

Impact	3
Likelihood	iv
Rating	Medium

Recommendations

1. Management should establish a formal documented policy for managing outsourcing and third-party providers, encompassing all lifecycle stages—due diligence, selection, ongoing oversight, business continuity planning, and offboarding. Ensure the policy aligns with regulatory requirements and best practices and that it is approved by the governing body.
2. Schedule regular reviews of the policy at least every three years, as per the Pension Regulator's guidance.
3. Establish a training program for relevant staff on the policy's requirements and procedures. This will promote compliance, enhance understanding, and drive consistent application.

Management action plan

All of the above recommendations will be implemented on or before relevant target date.

Responsible person/title:

Service Manager – Financial Services

Target date:

September 2025

Current year findings

2 Incomplete monitoring of third-party performance

Control Design

Finding rating

Impact	3
Likelihood	iii
Rating	Low

Finding and root cause

The fund engages a diverse array of third-party suppliers to provide essential outsourced services, including fund managers, investment advisors, actuaries, custodians, system providers, performance measurement services, legal advisors, and covenant advisors. While a structured performance evaluation process is effectively implemented for fund managers, custodian and investment advisors (which carry the largest financial risk to the Fund with over 95% of management costs), conducted on a quarterly basis and reported to the Pensions Committee, there are currently no formalised performance monitoring mechanisms in place for the remaining service providers.

Potential implications

- The absence of established performance evaluation processes for service providers may lead to compliance risks and operational inefficiencies.
- The fund may be unaware of underlying risks, making it challenging to address issues before they escalate.

Recommendations

1. Develop and implement a formal performance monitoring framework for all third-party, outlining specific evaluation criteria, frequency of assessments, and reporting processes to the governing body.
2. Schedule regular reviews of third-party supplier performance, ensuring that findings are documented and communicated to relevant stakeholders. This will facilitate ongoing oversight and accountability across all service providers.

Current year findings

2 Incomplete monitoring of third-party performance

Control Design

Management action plan

All of the above recommendations will be implemented on or before relevant target date.	Responsible person/title: Service Manager – Financial Services Target date: December 2025

Finding rating

Impact	3
Likelihood	iii
Rating	Low

Current year findings

3 Absence of register of third party service providers

Control Design

Finding rating

Impact	3
Likelihood	iii
Rating	Low

Finding and root cause

We noted that the fund includes a listing of its third-party service providers in its annual report as part of the annual accounts process. However, there is currently no centralised and documented list of third-party suppliers that incorporates the essential elements necessary for effective governance and oversight. Key components of a comprehensive supplier list should include:

- Supplier name
- Contact information
- Nature of services provided
- Contract start and end dates
- Risk assessment outcomes
- Contract Status
- Contract Value

While the annual report provides a listing, it does not serve as a centralised resource containing the details needed to manage the third party relationships effectively. This approach may limit the fund's ability to address supplier risks appropriately and ensure adequate oversight of the outsourced services provided.
From discussions with management, we understand that the procurement team is in the process of developing a centralised listing of all third-party suppliers, which will include all relevant details.

Potential implication

- The absence of a centralised and detailed list of third-party suppliers may hinder the fund's ability to maintain adequate visibility into their performance and associated risks.

Recommendations

1. Management should develop and maintain a centralized, documented list of all third-party suppliers that includes essential elements such as name, services provided, contract details, performance metrics, and risk assessments. This list should be easily accessible for ongoing reference and oversight.

2. Implement a process to regularly update and review the third party list to ensure that it remains accurate and comprehensive. This process should include periodic assessments of third party performance and compliance status, facilitating proactive risk management and effective oversight.

Current year findings

3 Absence of register of third party service providers

Control Design

Finding rating

Impact	3
Likelihood	iii
Rating	Low

Management action plan

All of the above recommendations will be implemented on or before relevant target date.

Responsible person/title:

Service Manager – Financial Services

Target date:

December 2025

Current year findings

4 Insufficient documentation of engagement with third-party suppliers

Control Design

Finding rating

Impact	3
Likelihood	iii
Rating	Low

Finding and root cause

Quarterly meetings are held with the Fund Managers, Custodian, and Investment Advisor where management engages in discussions about the reports provided by each party. These discussions include inquiries regarding the content of the reports, evaluations of the services rendered, and identification of required improvements.

While the reports from these third parties are retained and follow-up emails shared by the suppliers, there is no formal documentation detailing the minutes of these meetings. Specifically, there is no evidence to indicate that management's comments, challenges, decisions made, along with action items from these discussions, are consistently recorded.

Potential implications

- The absence of formal documentation from these meetings may hinder management's ability to provide clear evidence of their engagement and discussions with third-party providers.
- Without formal records, there is an increased risk that key action items may be overlooked, leading to unresolved issues.
- Not having written documentation may conflict with best practices for corporate governance and could expose the fund to regulatory scrutiny regarding due diligence and oversight.

Recommendations

Management establish a formal process for documenting minutes of all quarterly meetings with the suppliers. This process should ensure that discussions, management reviews, action items, and decisions are appropriately recorded and distributed to relevant stakeholders.

Current year findings

4 Insufficient documentation of engagement with third-party suppliers

Control Design

Management action plan

All of the above recommendations will be implemented on or before relevant target date.	Responsible person/title: Service Manager – Financial Services Target date: December 2025

Finding rating

Impact	3
Likelihood	iii
Rating	Low

Appendices

Appendix A: Basis of our classifications

Individual finding ratings

Findings are assessed on their impact and likelihood based on the assessment rationale in the tables below.

Impact rating	Assessment rationale
6	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.
5	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 large fines and consequences; or • Significant impact on the reputation or brand of the organisation.
4	A finding that could have a: • Major impact on operational performance; or • Major monetary or financial statement impact; or • Major breach in laws and regulations resulting in significant fines and consequences; or • Major impact on the reputation or brand of the organisation.
3	A finding that could have a: • Moderate impact on the organisation's operational performance; or • Moderate monetary or financial statement impact; or • Moderate breach in laws and regulations with moderate consequences; or • Moderate impact on the reputation of the organisation.

Appendix A: Basis of our classifications

Individual finding ratings

Impact rating	Assessment rationale
2	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.
1	A finding that could have a: • Insignificant impact on the organisation's operational performance; or • Insignificant monetary or financial statement impact; or • Insignificant breach in laws and regulations with little consequence; or • Insignificant 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.

Likelihood

Likelihood rating	Assessment rationale
vi	Has occurred or probable in the near future
v	Possible in the next 12 months
iv	Possible in the next 1-2 years
iii	Possible in the medium term (2-5 years)
ii	Possible in the long term (5-10 years)
i	Unlikely in the foreseeable future

Appendix A: Basis of our classifications

Finding rating

This grid is used to determine the overall finding rating. Issues with a low impact and likelihood rating will not be reported.

	Impact rating					
Likelihood rating	**6**	**5**	**4**	**3**	**2**	**1**
vi	Critical	Critical	High	High	Medium	Medium
v	Critical	High	High	Medium	Medium	Low
iv	High	High	Medium	Medium	Low	Low
iii	High	Medium	Medium	Low	Low	Low
ii	Medium	Medium	Low	Low	Low	Not reportable
i	Medium	Low	Low	Low	Not reportable	Not reportable

Report classifications

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

Findings rating	Points
Critical	40 points per finding
High	10 points per finding
Medium	3 points per finding
Low	1 point per finding

Report classification		Points
Satisfactory		6 points or less
Satisfactory with exceptions		7 – 15 points
Needs improvement		16 – 39 points
Unsatisfactory		40 points and over

Appendix B: Terms of reference

This review is being undertaken as part of the 2024/25 internal audit plan approved by the by the Pension Sub-Committee.

Background and audit objectives

The effective management of all third parties is key to ensuring the objectives of the Fund are met. It is therefore expected that Tayside Pension Fund (TPF) have adequate and appropriate oversight; and that monitoring controls are in place to enable a holistic and effective approach to third party management.

TPF 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 2024, Tayside Pension Fund had investment assets of c.£5.4billion, and a membership of over 56,900 across 41 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 is included in the 2024/2025 Internal Audit plan approved by the Pension Sub-Committee. The objectives of this audit is to assess the design and operating effectiveness of key controls in respect of third party management.

Appendix B: Terms of reference

Sub-process	Objectives	Risks
Policy and procedures	• Third party supplier policies and procedures exist in relation to third party management, which clearly outline roles and responsibilities for managing outsourcing arrangements.	• There is no clearly articulated procedures and guidance for the management of outsourcing risk resulting in a lack of clarity over roles and responsibilities, governance and oversight.
Monitoring and oversight	• Appropriate controls are in place at TPF to ensure regular and consistent monitoring and oversight of performance management of third parties; including performance management meetings, review of MI and performance packs, and their availability to senior management. • 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.	• Insufficient oversight and challenge of the functions and activities outsourced to third parties. • Lack of third party monitoring may result in issues and underperformance going unnoticed. • Insufficient oversight and challenge of the functions and activities outsourced to third parties.
Training and communication	• Robust risk training and awareness programmes exist to support core third party supplier management procedures and are reviewed to reflect any updates or changes to key third party supplier processes. • Training completion rates amongst staff are tracked and reported on, with enforceable consequences for lack of completion.	• Training is insufficient, inadequate or misaligned to good practice. • Evidence of training completion is not monitored leading to knowledge gaps amongst staff.

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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