

The logo for Audit West features the company name in a bold, orange, sans-serif font. The text is centered between two horizontal grey lines. A grey diamond shape is positioned at the top center, with its point facing downwards towards the top line. Another grey diamond shape is positioned at the bottom center, with its point facing upwards towards the bottom line.

Audit West

Final Internal Audit Report
Confidential

**Avon Pension Fund - Annual
Pension increases**

September 2024

Executive Summary

Audit Opinion:

| Assurance Rating | Opinion |
|--|--|
| Level 5 - Full Assurance | The systems of internal control are excellent with a number of strengths, no weaknesses have been identified and full assurance can be provided over all the areas detailed in the Assurance Summary. |
| Level 4 - Substantial Assurance | The systems of internal control are good with a number of strengths evident and substantial assurance can be provided as detailed within the Assurance Summary. |
| Level 3 - Reasonable Assurance | The systems of internal control are satisfactory and reasonable assurance can be provided. However, there are a number of areas detailed in the Assurance Summary which require improvement and specific recommendations are detailed in the Action Plan. |
| Level 2 - Limited Assurance | The systems of internal control are weak and only limited assurance can be provided over the areas detailed in the Assurance Summary. Prompt action is necessary to improve the current situation and reduce the levels of risk exposure. |
| Level 1 - No Assurance | The systems of internal control are poor, no assurance can be provided and there are fundamental weaknesses in the areas detailed in the Assurance Summary. Urgent action is necessary to reduce the high levels of risk exposure. |

Assurance Summary:

| Assessment | Key Control Objectives |
|--------------|---|
| Satisfactory | Policy –the pension service applies annual pension increases based on the scheme requirements and pension regulations. |
| Satisfactory | Use of schedule – has been developed and enables the service to process annual pension increases timely and accurately. |
| Satisfactory | Procedure guidance and process mapping – the pension service has developed clear procedures for staff (following recent project). |
| Satisfactory | Use of test environment -annual pension increases are reviewed in a test environment before they are applied onto the live system. |
| Excellent | System tables/parameters -annual pensions increases are applied using system parameters which are updated correctly on the pension system and enable recalculation of pension. |
| Weak | Reconciliation of pension records – is undertaken during the process of uploading pension increases on both the test and live system. |
| Weak | Management and exception reports - are reviewed timely to identify any errors during the annual increase process. |
| Satisfactory | Secondary check and sign off - ensuring there are reviews and sign off at key stages of the process. |
| Satisfactory | Sample checking - manual calculations are carried out to provide assurance on the accuracy of individual pension increases/ payments. |
| Excellent | Notification of pension increase - confirmation is issued to pensioners where pension increases have been applied. |
| Satisfactory | Payroll records are maintained and kept up to date – to evidence annual pension increase processes (including any checks undertaken and sign off). |

Detailed Report

Opinion

Internal Audit has undertaken a review of the risks and controls related to Avon Pension Fund - Annual Pension increases and assessed the framework of internal control at **Level 3 - Reasonable Assurance**. A total of 7 audit recommendations are detailed in the Action Plan.

Scope and Objectives

The scope and objectives of our audit were set out in the Audit Brief and a summary of our opinion against each of the specific areas reviewed has been detailed in the Assurance Summary section above.

Context & Audit Comment

Background/Context

As part of the Avon Pension Fund (APF) 2024/25 audit plan, Internal Audit has undertaken a review of the annual pension increase process to provide assurance that annual pension increases are correctly applied to all relevant pensions each year and that internal controls are operating effectively.

We previously supported the APF as part of the Pension increase (PI) project and provided feedback on the internal control environment. The purpose of this audit was to review “business-as-usual” and, therefore, the focus was the April 2024 annual pension increase.

Under the LGPS scheme active pension accounts, deferred pensions and pensions in payment are adjusted each April in line with the cost of living. The increase is based on the September-to-September change in the Consumer Prices Index (CPI). The CPI increase for the year up to September 2023 was 6.7%. This means active pension accounts, deferred pensions, and pensions in payment in the LGPS should have been increased by 6.7% from 8th April 2024.

There are several scenarios where annual pension increases are not applied or not fully applied on individual pensions and these include:

- Individual pensions affected by Guaranteed Minimum Pension (GMP) (pensioners may receive part pension increase in LGPS and part from state pension). A GMP is a minimum pension normally provided through a workplace pension scheme to people who contracted-out of the additional State Pension between 6 April 1978 and 5 April 1997.
- New pensions - a proportional increase is applied (if retired for less than 12 months).
- Pensioners under age 55 (excluding those retired under ill health). LGPS rules state that the LGPS pension can be taken any time from age 55 to 75.

Pension increase (PI) Project

In 2023/24 a project team was set up for managing retrospective pension increases that had been missed on some individual pensions in previous years.

The APF remediated 801 members (£672k+) applying an agreed process to process retrospective pension increase to the individual pension account. This included 696 members who were paid arrears, interest and correction of their monthly pensions and 105 members records corrected in preparation for the 2024 Pension increase.

As reported to the Avon Pension committee in June 2024, the Member services team have identified 491 cases where annual pension increases have not been applied and require further work to investigate. The APF intend to resolve these issues by December 2024 as highlighted in their pension increase project and wider service plans.

The project team identified three main causes for missed pension increases, validated by Heywood, and these were:

- Timing of when the Pensioner / Dependant record was set up.
- Incorrect dates being input to the Pension Details page for records that had been amended.
- Dependent records being manually amended, but with incorrect pension types or dates updated on the system.

To address the above causes, training was carried out with the APF Member services team on 23 April 2024.

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Pension increase processes and controls.

The Pension Payroll Manager (with support from the Quality Assurance (QA) team) was responsible for managing the annual pension increase applied in April 2024 (process undertaken between March and April payroll).

The APF has not developed internal guidance or process mapping to illustrate the PI process. However, the pension service received recent PI training and guidance from Heywood's (software provider).

A test environment was not used to review all pension increases before they were applied onto the live system (as recommended by Heywood's PI guidance). Provisional PI runs were used to identify and clear errors arising on both Admin and Payroll systems during this year's PI process (Provisional PI runs do not update the member information but enables data errors to be corrected and calculation results checked before performing the actual run.).

The APF did not undertake a full reconciliation of pension admin and payroll records (prior to and following uploading of the pension increases). This was due to known data issues (including missed PI's which still require further work to resolve). This reconciliation process is referenced in the Heywood's guidance which also includes a separate payroll reconciliation procedure.

The Altair system has tables (parameters) which are required to be updated to generate the annual pension increases. These tables were updated by the financial systems team based upon instructions from Heywood's (software provider) and were checked by the Pensions Payroll Manager and the QA team.

There is a range of management and exception reports which are generated by the Altair system, and these are used by the pension service when uploading the pension increases onto the system. These include the pension increase calculation and the payroll interface reports.

Exception reports provide a breakdown of errors and warning messages identified by the pension system. The QA team reviewed all PI errors that were identified in this year's PI process but, warning messages from these reports have not been reviewed.

The following warning and error messages were identified from the management reports generated for this year's PI process.

| Management report | Warnings | Errors | Comments |
|--|----------|--------|---|
| Deferred PI's | 17 | 32 | These errors were reviewed and corrected manually in April/May 2024 by the Pension Payroll Manager and the QA team. Warning messages were not reviewed and analysed. |
| Deferred Pension Debits PI's | 20 | 32 | |
| Annual Pension Increase – Pensioner report. | 4974 | 304 | These errors were reviewed by the QA team. The majority of these were known errors and due to be reviewed and addressed in Phase 2 of the PI project (Autumn). |
| Annual Pension Increase – Pension report (widowers) | 1588 | 103 | Warning messages were not reviewed and analysed. |
| Payroll Interface File | 2600 | 518 | These errors were referred to Heywood's who advised these errors related to suspended pensions so therefore no actions required to review and clear these error messages. Warning messages were not reviewed and analysed. |

As part of the annual PI process, the Pensions Payroll Manager and the QA team performed sample checks to provide assurance that PIs have been correctly applied and calculated on individual pensions. However, the service has not maintained a record to evidence the checks that have been undertaken.

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The Pension Payroll team generate and administer payslips for payroll members (payslips are normally issued to pensioners where there is £5+ variance to pensions including annual pension increases). For this year, the Payroll Manager added additional text to these payslips to inform the relevant pensioners of this year's pension increase (as referred to in Heywood's PI guidance).

The Pensions Payroll team maintain a central record to document annual pension increases. This includes system table updates (parameters), management reports used by the pension service for the latest annual pension increases, and notifications to pensioners. There are separate records maintained by the QA team, and PI project records which evidence review of existing PI errors.

Conclusion

Overall, there are controls within the annual pension increase process which should ensure that increases are being paid accurately and timely to the majority of pensioners. Internal Audit acknowledge that the QA team are still progressing cases where PIs have not been previously applied (400+ cases) which are expected to be resolved by end of December 2024.

As part of the PI project, the service identified the root causes for previous PI errors, and this has led to training being provided to Member Service officers.

We did identify some areas where improvements should be made to current PI controls, and these include:

- **Lack of reconciliation of pension admin and payroll records** - the service will need to ensure that a full reconciliation is undertaken for future annual pension increases because this could lead to discrepancies between these records, incorrect payments to pensioners, and compliance issues.
- **Warning messages** - Management reports generated for this year's PI increase did pick up a high volume of warning messages. Whilst these messages will not prevent a PI from being processed, these should be analysed as part of the PI process.
- **Use of Test environment** – was not used for the PI process. Heywood's PI guidance recommends comprehensive testing of pension increase processing in a test environment before processing an actual pension increase in the live environment.
- **Limited procedural guidance** – procedural guidance has not been developed. Developing effective guidance would help reduce the likelihood of errors and inconsistency when administering PI.
- **Lack of formal PI Schedule/timetable** - tasks and timelines have not been formally set out by the pensions service. This would be useful to the service in demonstrating that key PI processes are completed, undertaken timely, and used to clarify roles and responsibilities.

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We identified the following strengths

- Use of PI Project - APF are aware of PI errors on existing pensions and there is a project in place to resolve these by the end of December 2024.
- APF Member services training - was undertaken in April 2024 in responding to the PI issues (root causes) identified by the PI project.
- System tables/parameters - have been correctly updated/uploaded onto the live system based upon instructions provided by the software provider.
- Use of provisional runs – were undertaken to identify and clear errors arising on both Admin and Payroll system before performing the actual run.
- Back up arrangements - the system was backed up before running the PI calculation in actual mode (in line with the software guidance).
- Management reports - reports have been generated and used by the service as part of this year's pension increase process. This includes reviewing errors identified on system exception reports.
- Pension errors identified during the PI process were subject to review – with assistance from the Financial Systems Lead, Quality Assurance team and Heywood's (software provider).
- Service records – There is a good record to support the work undertaken on this year's pension increases.
- Notification to pensioners – all relevant pensioners were notified of this year's annual pension increase.

We identified the following weaknesses

- Existing PI errors - There are still 400+ pensions which require to be reviewed and resolved by the PI project.
- Reconciliation between Admin and Pension records - The Pensions Payroll Manager/Quality Assurance team has not undertaken a full reconciliation between Admin and Payroll records for this year's annual pension increases. We would anticipate this will be undertaken for all future PI's following completion of the PI project.
- Warning messages (identified in system management reports) were not fully reviewed and analysed during the PI process.
- Use of Test environment - pension increases are not being reviewed in a test environment as recommended by the software provider (Heywood).
- Procedure guidance & process mapping - has not been fully developed and could be useful in supporting the service when undertaking annual processes such as applying pension increases.
- Use of formal Schedule/timetable - has not been developed and could be useful to inform timely process and highlight individual roles and responsibilities.
- Segregation of duties/secondary checks – The Pension Payroll Manager undertook this year's PI with support from the financial systems lead and Quality Assurance team. There could be opportunity to allocate PI processes to other payroll staff which would allow more effective secondary checking, segregation and oversight.
- Sample checking – limited evidence to demonstrate that individual pension increases applied for this year have been checked for accuracy.

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Audit & Risk Personnel

Lead Auditor: David Hodgson, Senior Internal Auditor

Acknowledgements:

Sincere thanks to Anna Capp, Member Services Manager, Matt Williams Financial Systems & Projects Lead Pensions and the Quality Assurance team for all their help and assistance throughout the Audit Review.

Action Plan

| HIGH RISK EXPOSURE | | | | |
|--------------------|--|---|--|--|
| | Weakness Found | Implication of Potential Risk | Recommendation(s) | Responsible Officer Management Comments Implementation Date |
| H1 | <p><u>Reconciliation - Admin and Payroll records.</u> The Pension service has not undertaken a full reconciliation of Admin and Payroll records. Heywood user guidance, recommend a reconciliation between the admin and payroll records.</p> <p>Internal Audit was informed that this lack of reconciliation is due to known issues with the pension data, including ongoing issues with missed pension increases identified by the Pension Increase project.</p> | <p>Pension values may not reconcile between Admin and Payroll records which could result in incorrect pension amounts being applied.</p> <p>Unreconciled data could cause overpayments or underpayments, creating financial discrepancies that could be costly and time-consuming to correct.</p> <p>Incorrect data could result in non-compliance with regulatory requirements.</p> <p>Could lead to increase in operational costs and inefficiencies if problems are not addressed.</p> <p>Consistent errors and issues due to unreconciled data could erode trust and cause reputational damage.</p> | <p>A full reconciliation between Admin and Payroll records should be undertaken as part of any future PI increases.</p> <p>This should include performing a reconciliation at the start of the process (prior to generating the PIs) and at the end of the process (as referred to in the Heywood’s pension increase guidance).</p> <p>The pension payroll team should also perform a reconciliation between Admin and Payroll records as part of the monthly payroll process.</p> | <p>Agreed.</p> <p>Responsible Officer: Pensions Payroll Manager, Anna Capp.</p> <p>Implementation Date: April 2025</p> <p>Management Comments: This can start once future phases of the PI project have been completed and will look to implement this by April 2025. We can review how regularly this can be run.</p> |

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| HIGH RISK EXPOSURE | | | | |
|--------------------|---|---|--|--|
| | Weakness Found | Implication of Potential Risk | Recommendation(s) | Responsible Officer Management Comments Implementation Date |
| H2 | <p><u>Warning Messages</u> As part of the PI process, the pension system generates various exception reporting (including warning messages).</p> <p>Warning messages were not reviewed and analysed during this year’s PI process.</p> <p>The following volume of warning messages were identified during this year’s PI exercise:</p> <ul style="list-style-type: none"> • Pensioner report, 4974 cases • Pensioner report - widows and dependents, 1588 cases • Payroll Interface report, 2600 cases • Pension debit report, 20 cases • Deferred debit report, 17 cases <p>Furthermore, there is no formal sign off to evidence review of the exception reports which have been generated during the PI process.</p> | <p>Unaddressed warnings could lead to overpayments or underpayments, causing financial discrepancies that could be costly to rectify.</p> <p>Warning messages could indicate underlying system issues. Ignoring them may compromise the integrity of the pension system, leading to broader operational issues.</p> | <p>All exception report warning messages should be subject to review.</p> <p>All exception reviews should be subject to appropriate sign off and a record maintained for audit purposes.</p> | <p>Agreed.</p> <p>Responsible Officer: Pensions Payroll Manager, Anna Capp.</p> <p>Implementation Date: April 2025</p> <p>Management Comments: A sample of the warning messages can be reviewed to establish the relevance and impact on the process at the next bulk PI update in 2025.</p> <p>Due to the volume this would need to be shared across the teams (Payroll/QA/MS).</p> |

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| MEDIUM RISK EXPOSURE | | | | |
|----------------------|--|--|---|--|
| | Weakness Found | Implication of Potential Risk | Recommendation(s) | Responsible Officer Management Comments Implementation Date |
| M1 | <p><u>Use of Test environment</u> In 2024/25 the APF applied pension increases on the live system without carrying out testing within a test environment.</p> <p>Internal Audit acknowledges that provisional runs were used for the PI process. However, Heywood’s guidance recommends 'comprehensive pension increase testing should be carried out in a test environment before processing an actual pension increase in the live environment. This should cover the following areas.</p> <ul style="list-style-type: none"> • Calculation results. • Member data updates. • Payroll interface processing. | <p>Any issues/errors within the process may not be identified at an early stage and could lead to delays in applying pension increases on the live system.</p> <p>Implementing changes directly in the live environment increases the risk of system crashes or downtime, disrupting operations and affecting users.</p> <p>Fixing issues in the live environment often requires more resources and time compared to addressing them in a controlled test environment.</p> | <p>Use a Test environment when processing pension increases.</p> <p>Test documentation should be subject to appropriate sign off before the PI is applied onto the live system. A record should be maintained for audit purposes.</p> | <p>Agreed.</p> <p>Responsible Officer: Pensions Payroll Manager, Anna Capp.</p> <p>Implementation Date: December 2024</p> <p>Management Comments: The test and live service aren’t run in parallel. The test service is very quickly out of date, however we could have a test to live refresh at the start of the year to run the PI process in test to identify errors, however the important place to start clearing errors is in the live service with provisional runs once the PI table has been released and updated at the start of the new year, unfortunately until the update is in place testing cannot start. To be reviewed in 2025 to see what we can achieve.</p> <p>We will contact the software provider to understand to understand the relevance of running the process in the test service. Pensions Payroll Manager owner prior to the 2025 PI update.</p> |

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| MEDIUM RISK EXPOSURE | | | | |
|----------------------|--|--|---|--|
| | Weakness Found | Implication of Potential Risk | Recommendation(s) | Responsible Officer Management Comments Implementation Date |
| M2 | <p><u>Procedure guidance</u> The pension service does not have detailed internal procedure guidance to document the PI process.</p> <p>As discussed with the Pensions Payroll Manager maintaining clear procedure guidance would help support the service when undertaking this annual process and would also enable PI processes to be undertaken by other staff.</p> <p>The APF recently used an external company to develop mapping of payroll processes, although this did not cover the annual pension increases.</p> | <p>If staff are not aware of procedures, then this would increase the risk of mistakes and errors being made during the PI process which could result in incorrect pension calculations and payments to pensioners.</p> <p>The lack of procedure guidance would make it difficult to train and support staff on the PI process.</p> <p>Potential inefficiencies within processes and controls.</p> | <p>Internal procedure guidance should be developed to illustrate the PI process. This should include a checklist which sets out key stages of the process and allows for review and sign off by an appropriate member of staff.</p> <p>We also recommend the APF should develop a process map to document the pension increase (PI) process and controls.</p> | <p>Agreed.</p> <p>Responsible Officer: Pensions Payroll Manager Anna Capp.</p> <p>Implementation Date: December 2024</p> <p>Management Comments: Check list already implemented and used. Happy to review this and provide clarity for the team. Internal process notes will be reviewed and tied in the Heywood guidance.</p> <p>Pensions Payroll Manager and supported by training team.</p> |

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| MEDIUM RISK EXPOSURE | | | | |
|----------------------|--|--|---|---|
| | Weakness Found | Implication of Potential Risk | Recommendation(s) | Responsible Officer Management Comments Implementation Date |
| M3 | <p><u>Use of schedule/timetable</u> The APF has not developed a formal PI Timetable for applying annual pension increases.</p> <p>Benefits of a PI Timetable include:</p> <ul style="list-style-type: none"> • Ensuring that tasks/activities are undertaken correctly, timely and in compliance with regulations. • Could be used to allocate roles and responsibilities. | <p>Without a clear schedule the process could be delayed, causing pension increases to be applied late. This could lead to dissatisfaction among pensioners and potential financial penalties.</p> <p>A lack of a timetable can result in disorganised workflows, making it difficult to coordinate tasks and resources effectively. This could increase operational costs and reduce efficiency.</p> <p>Tasks may not be identified and, further, undertaken in the correct sequence to prevent mistakes/errors.</p> <p>PI tasks may take longer than anticipated and/or lead to mistakes due to rushed work. This could result in increases in staff pressure and performance.</p> | <p>A formal PI Timetable should be developed and used to inform annual pension increases.</p> <p>The PI Timetable should be reviewed, agreed and signed off appropriately before the start of the PI cycle.</p> | <p>Agreed.</p> <p>Responsible Officer: Pensions Payroll Manager Anna Capp.</p> <p>Implementation Date: December 2024</p> <p>Management Comments: Formal timetable can be developed.</p> |

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| MEDIUM RISK EXPOSURE | | | | |
|----------------------|---|--|--|---|
| | Weakness Found | Implication of Potential Risk | Recommendation(s) | Responsible Officer Management Comments Implementation Date |
| M4 | <p><u>Segregation of Duties/Secondary checks</u></p> <p>This year’s pension increases (April 2024) was mostly completed by the newly appointed Pensions Payroll Manager.</p> <p>There are opportunities to improve this area by deploying other pension staff to undertake parts of the PI process and thereby improve segregation of duties and process oversight, examples include:</p> <ul style="list-style-type: none"> - Generating and review management reports. - Reviewing exception reports. - Generating notifications to pensioners. - Checking PI calculation results and the payroll interface. - Reconciling pension values and payroll figures. | <p>When one person carries out multiple steps in the process, there is a higher chance of mistakes going unnoticed. This can result in incorrect pension increases being applied, affecting beneficiaries’ payments.</p> <p>If duties are not segregated, it becomes difficult to pinpoint responsibility for errors or fraudulent activities, making it harder to address issues and implement corrective measures.</p> <p>If there is no secondary checks and oversight, individual staff could be unfairly criticised in the event of any errors in processing.</p> | <p>Review the options for processing annual pension increases in future to allow for segregation of duties, secondary checks and oversight within the process.</p> | <p>Agreed.</p> <p>Responsible Officer: Pensions Payroll Manager Anna Capp.</p> <p>Implementation Date: March 2025</p> <p>Management Comments: Heywood delivered training to the payroll team at the start of 2024</p> <p>Process to be developed in 2025 with the payroll team.</p> |

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| MEDIUM RISK EXPOSURE | | | | |
|----------------------|---|--|---|---|
| | Weakness Found | Implication of Potential Risk | Recommendation(s) | Responsible Officer Management Comments Implementation Date |
| M5 | <p><u>Sample checking</u> Internal Audit was informed that both the QA team and the Pension Payroll team have undertaken sample checks as part of this year’s pension increase process, but we were unable to evidence that checks had been undertaken.</p> | <p>Not recording sample checks could result in undetected errors, leading to incorrect pension calculations and payments.</p> <p>Without records, it is not possible to determine the adequacy of the checks. Further, it would be difficult to track who performed the checks and when, leading to lack of accountability and potential oversight issues.</p> | <p>Evidence should be retained that sample checking has been undertaken.</p> <p>Evidence should include:</p> <ul style="list-style-type: none"> - Sample size and methodology - Sample results - Date sample check carried out - Name of the staff member carrying out the sample checking. <p>A central record of all sample checking should be retained by APF.</p> | <p>Agreed.</p> <p>Responsible Officer: Pensions Payroll Manager Anna Capp.</p> <p>Implementation Date: March 2025</p> <p>Management Comments: Technical and Compliance Manager and Pensions Payroll Manager</p> <p>Agree to be developed.</p> |