

Internal Controls

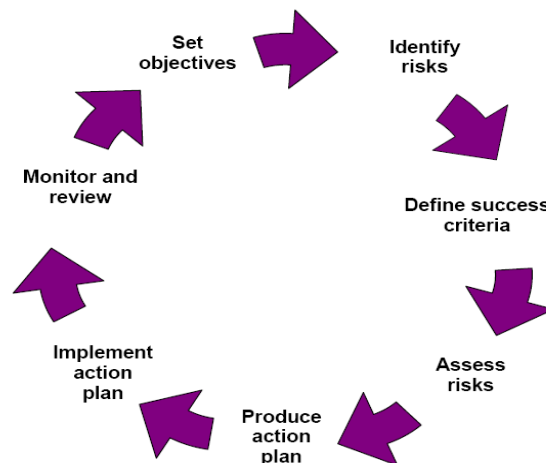
Background

The Pensions Act 2004 requires trustees to establish and operate adequate internal controls to ensure that their occupational pension scheme is administered and managed in accordance with the scheme rules and the relevant legal requirements. In November 2006, the Pensions Regulator published a Code of Practice on internal controls. The aim of the Code of Practice is to provide guidelines for good management of schemes and to encourage trustees and advisers to think about the risks to members' benefits, to take proportionate action to manage risks and to identify and implement controls where they are required. The Regulator published further guidance on a risk management process for internal controls in February 2007.

Risk Review

Trustees should determine what internal controls are required to ensure the scheme is being well managed. The nature, structure and size of the scheme and the incidence and impacts of different risks will influence the internal controls that are required. The first steps in a risk review process involve the identification of the functions and activities which are fundamental to the smooth running of the scheme and the assessment of the key risks associated with these functions and activities.

The Regulator has highlighted one possible approach to use for the risk review exercise. The diagram below summarises the stages involved in establishing and operating an internal controls framework.



Brief comments follow on each of the above stages.

Set objectives

Having identified the key scheme activities, the trustees should document the desired outcome of each activity. For the majority of schemes, the main objectives will include safeguarding scheme assets, maintaining suitable funding levels, securing the payment of contributions, paying correct benefits to members and ensuring the scheme operates within statutory requirements and adheres to the scheme rules. Agreed objectives should be recorded in a clear risk management statement.

Identify risks

The agreed risk-management objectives can be used to identify all the risks involved with each scheme activity. Scheme risks can be categorised as operational, financial, funding, regulatory or compliance. The conventional way of recording identified risks is through the use of a listing known as a risk register. The Regulator has published a sample risk register on its web site.

Define success criteria

The trustees should identify the levels of risk which they consider to be acceptable. Setting the level of acceptable risk will provide the threshold above which you may need to establish internal controls. The acceptable level of risk could be identified by its impact on the security of members' benefits, the disruption to the operation of the scheme or the direct financial cost to the scheme. The trustees will also have to identify who 'owns' the risk, that is who has responsibility for managing the risk.

Assess risks

Each risk identified in the risk register should be categorised depending on its impact and likelihood of occurring. This helps establish if an appropriate control needs to be established or whether improvements need to be made to existing controls. A number of approaches exist to categorise the severity of risks.

Produce action plan

Having identified the key risks, a decision needs to be made on how to manage them. The purpose of this stage is to produce a plan setting out the responsibilities and timescales for implementing controls (new or existing) to ensure that the required changes in procedure do take place. An effective control will be one of preventative, detective, deterrent or corrective. The plan will need to be agreed with and communicated to all the risk owners.

Implement action plan

Responsibility needs to be taken to ensure that all aspects of the action plan are implemented in accordance with timescales and priorities. During implementation, the action plan needs to be constantly reviewed to check that it is still fit for purpose.

Monitor and review

The purpose of this stage is to monitor the effectiveness of the controls and to make changes if they prove to be inadequate or new risks arise. A review of controls may be prompted by certain events, eg changes to legislation, significant changes to scheme membership or a change of scheme advisers.

Assistance for Trustees

Thomson Dickson Consulting has extensive experience of implementing bespoke systems of internal controls for occupational pension schemes. Please contact us if you would like to discuss how we can assist you with risk assessment and risk management for your scheme.

The information in this note should not be relied upon or taken as an authoritative statement of the law.