

Pension Scheme Benefit Calculation Audit Guidance

What is a Benefit Audit?

It is a check to confirm that the benefit calculations undertaken through the life of the pension scheme are accurate, ensuring that the scheme rules have been appropriately applied prior to the scheme transferring to the Pension Protection Fund (PPF). The Benefit Audit, wherever possible, should be undertaken by an independent third party, this could be the scheme actuary or auditor.

Why complete a Benefit Audit?

The purpose of the Benefit Audit is to ensure that members receive the correct amount of compensation from the PPF. If the pension benefits have been calculated incorrectly the compensation payable by the PPF to the member will also be incorrect. Not only does it affect the recipients but there is also a financial impact on those pension schemes who continue to pay the levy.

The Benefit Audit will enable you, as Trustees, to give your members and their potential dependants, assurance that the correct level of benefits will be recorded in the Valuation. This forms the basis for the decision of whether to accept the scheme into the PPF, so it is imperative that the data provided to the actuary, on which the valuation is undertaken, is complete and accurate.

For any members or categories of members where the Benefit Audit highlights a discrepancy it will give you the opportunity to take any necessary corrective action, whether that be adjusting future payments or addressing any under or overpayments previously made, prior to the scheme transferring to the PPF. The former action may well be an important factor in determining the final funding level of the scheme and therefore must be carried out in a timely and efficient manner.

A failure to calculate benefits in accordance with the governing Trust Deed and Rules can result in significant under or overpayments to members. To put this in context let us assume that a systematic error in a calculation routine resulted in 100 pensioners being overpaid by £200 each per annum. The capital cost to the scheme of continuing to pay benefits incorrectly for the lifetime of the members would be in the region of £500,000.

What is involved in completing a Benefit Audit?

The Benefit Audit is a three stage process which involves looking at data, identifying areas of risk and then reproducing the calculated benefits. It should not be viewed as a tick box exercise, selecting a random sample of members, but it does not necessarily require you to check each calculation.

We have provided you with an approach to follow that should assist you in giving us the assurance we need. By following this approach, and documenting the process and the findings, you should be able to identify the cases which have the highest risk of error and provide the evidence needed in order for the PPF to sign off the audit.

Data Review

You need to review the data you hold – do you have all the data / information you need to be able to recreate the calculation for every member of the scheme? If not then you need to let us know what data you do have so we can discuss and agree the associated risk. It may be possible to complete any gaps by carrying out a comparison with DWP, old employer HR & payroll records, previous administrator files, archived records and asking members direct. If the scheme records are not sufficiently detailed to allow a recalculate to be undertaken your caseworker will expect the Trustee to explain how previous benefits have been calculated.

Risk Analysis

You then need to identify the key data risk facing the scheme. These will be used to select a representative sample of case calculations which can be reviewed.

Identifying key events and benefit changes within the lifetime of the scheme will allow you to ascertain if the calculations before and after have been consistently and correctly undertaken.

The PPF expects you to identify periods where the risk of miscalculation of benefits is increased. The following key risks areas have been identified, but the list is not exhaustive, and you should use your knowledge of the scheme and its history to identify any other events relevant to your scheme. Areas to consider are:-

- increased/decreased administration activity, maybe due to a bulk transfer exercise or a large scale redundancy programme. Increased activity could have resulted in a less robust checking process being undertaken whereas a decrease in volumes could have resulted in calculations being undertaken manually; rather than investing in system upgrades as changes occurred.
- automation of certain calculation routines – were these programmed from an approved pro forma & final results signed off by the scheme actuary?
- where certain automated calculations are now being done manually – are these documented on approved pro forma & signed off by the scheme actuary?
- upgrades that have been applied to the administration system, either bespoke or routine – did the scheme administrator undertake a full regression test exercise across all programmed calculations, against a signed off test pack?
- where changes were made to the scheme Rules which affected benefits e.g. scheme equalisation – were these programmed from approved pro forma & signed off by the scheme actuary?
- any changes in scheme specific factors - were these updated onto approved pro forma & system updated programmed from these and all results signed off by the scheme actuary?
- change of administrator, this could either be the Third Party Provider (TPA) or a key individual within a TPA– if so was an independent audit undertaken of calculations post transfer and/or parallel running of calculations during the transition period?
- were any issues relating to members benefits identified as part of the annual audit of the scheme – if so were these fully investigated and resolved and was corrective action taken to prevent similar errors in future?

Each risk that is relevant to the scheme should then have a weighting given to it, which will be determined by

- a) the likelihood of that risk occurring i.e. the number of cases that could have been affected by it, determined by analysing when the risk occurred and what the membership movements were in that period
- b) the impact that risk could have had if an error had occurred i.e. financial implications to members' benefits.

The results can then be plotted on a risk analysis table (example below).

Example:-

A scheme has identified 8 risks and has assessed the likelihood and impact of each. The results were plotted and it indicates that the Benefit Audit should initially focus on cases which were actioned when risks 1, 3 & 5 occurred.

| | Low Likelihood | Medium Likelihood | High Likelihood |
|---------------|----------------|-------------------|-----------------|
| High Impact | | 5 | 1 |
| Medium Impact | 6,2 | | 3 |
| Low Impact | 4,7 | | 8 |

The cases associated with any risks classed red or amber should be analysed and, depending on the numbers involved, either all cases should be checked or else a sample. If the sample shows errors in the calculations the scope of the audit should be widened to look at all possible affected cases.

By selecting cases which were actioned during the periods of highest risk, the sample for the benefit audit becomes selective rather than random. The analysis may indicate that a smaller number of cases is required than a random 10%, for example, as those chosen are more likely to show any errors in calculations as they were undertaken during periods of risk/change.

Calculation Audit

You now need to establish that you are confident that the benefits recorded for each record selected from the risk analysis are accurate and have been calculated in accordance with the scheme rules and governing regulations. The PPF require evidence of the exercise undertaken to reach this conclusion.

The audit should be undertaken from first principles, taking just the raw member data and scheme governing documentation. The results should then be compared against the recorded benefits held on the administration records. Any discrepancies will then need to be investigated. If these are found to be due to errors in the original calculations, then as indicated above, the scope of the audit may need to be extended to look at other cases which may also have been incorrectly calculated.

The results of the audit should be discussed with the PPF Caseworker and a plan of remedial action agreed if errors were found; as these may impact on other tasks being undertaken as part of the scheme wind up Project Plan.