Getting ready for the Code: Understanding your controls

How do you know your controls are effective?

Welcome to the Muse series Getting ready for the Code, where we are sharing tips and tools to help you navigate the Code and Own Risk Assessment (ORA) requirements. Get in touch to find out more at governanceservices@museadvisory.com.

This third article is a practical look at understanding your controls and their effectiveness.

Why are controls important in managing risk?

Having identified the risks that are relevant to your scheme and your risk appetite, the next step is to decide how you'll address them. You will have controls in place to mitigate your risks but do you know if they are doing what you think they should be doing?

Good controls will, at an operational level:

- keep scheme operations functioning well
- maintain reliable financial reporting
- enable compliance with legislation and regulations.

However, controls can be viewed more strategically, i.e. in the context of risks that might knock your scheme off its strategic course.

Example:

Having a framework to move out of illiquid assets in a specified timeframe, and in a manner which leads to minimal financial losses, is important if you don't want to impede your objective to buy out when the opportunity arises.

May 2022

Controls are the measures or actions you take to reduce or neutralise a risk by decreasing its likelihood and/or its consequences.

Do we know what our controls are and where they are?

What are our controls?

Controls can take different forms. They can be policies, processes, standards to be followed, activities e.g. monitoring, testing, reviewing information, taking specialist advice.

Their purpose is to provide safeguards and protection against things going wrong or inappropriate actions being taken. They might prevent something bad happening, i.e. they are forward looking and typically the more automated they are the better. For example, segregation of duties is a key control in financial transactions, particularly when moving scheme assets and paying benefits, to minimise mistakes (such as payment of investment funds to the wrong account or erroneous benefit payments to members) and fraud.

Controls might also detect errors after they have occurred, e.g. financial reporting in the Trustee Report and Accounts and internal audit. They could also correct an error and prevent it happening again in future, e.g. new policies, automation of financial processes.

Where are our controls?

Trustees, in many cases, rely on outsourced providers and the controls those providers have in place within their own businesses.

Those controls are to some extent out of your control. However, checking the efficacy of their design, how they operate and whether they are effective at managing your scheme's specific risks are within the trustees' remit. As trustees you will want to know that those controls are managing your risk in line with your risk appetite and are effective for what you need from them.

Many controls will still be within the gift of the trustees to implement and monitor. Being clear on what is a control helps determine the extent to which the risk is being mitigated and whether more needs to be done to strengthen that mitigation.

If you don't have the right controls or right level of controls in place, you might not be managing your risk as well as you think.

Example:

You might have cyber risk as a key risk on your risk register. If your administrator is a third party, you will likely rely on the controls they have in place regarding their IT systems and people. You can discuss your cyber risk ad infinitum but if you don't ask the right questions and you don't get the right reporting on how the effectiveness of controls is being tested, you might never know that your member data is being inadvertently sold on the dark web.

Being proportionate

Understanding your risk appetite will help you assess if the controls you have in place are proportionate for the level of risk you are experiencing. Controls cost time, money and energy which you might find can be better spent on managing more material risks.

Taking member benefit payments as an example, whilst you may have a low appetite for errors, eliminating them could be too costly. You will want to ensure that your controls prevent systematic errors but you may be comfortable with ad hoc errors below a certain threshold. Your risk appetite effectively dictates the controls you would like in place for risks in different areas of your scheme management.

How do we test the effectiveness of our controls?

Sometimes it can be helpful to take a process that is understood, like payment of a member's benefit, and map the process and controls that are in place at each step. It can help answer the "how do you know?" question. How do you know that the controls in place for paying benefits reduce the risk of errors? By seeing and challenging the strength of the controls with your in-house admin team, or third party, you can assess if they are sufficient for your needs, or if you need to take action to strengthen them.

Talking to your advisers and providers and rating controls to get a view overall of how well a risk is being mitigated on a red, amber, green (RAG) basis is helpful. Assessing how well a control is doing the job being asked of it is a good starting point. You can then look at all the controls that mitigate the risk in question in the round.

Experience can also guide you – have there been any instances where controls have let you down? Was the remedial action taken sufficient? Can you demonstrate that you do what your policies say? This may sound like common sense but it's not unheard of for a scheme to have a formal written process, which isn't being followed in practice.

Understanding your control framework means that you can ask the right questions and take action to make improvements where you find gaps.

Understanding your control framework, the strengths and weaknesses, puts you in control.

An effective set of controls is not static though. Risks associated with achieving your objectives may also change over time as you make progress, so your internal controls framework will need to adapt.

The governance benefits

You want to have an effective control framework – knowing what works, what doesn't and taking action to strengthen and improve.

Where controls are policies and processes, having these documented and saved in one easily accessible place, means you can reference them easily and keep them updated, ready for your ORA.

The ORA is an assessment of your system of governance – helping you determine whether you have the right controls in place and that they are effective in managing your risks.

The Getting Ready for the Code series

Contact us for practical help and independent advice at **governanceservices@museadvisory.com**

Knowing how you manage your internal controls is a key part of the ORA and Code requirements.

Our next article will look at sources of assurance and getting the right information to know that your specific risks are being managed.