**Essential Update November 2019 Number 2 –** **Update on Procurement, Pension Contributions and direct staff costs**

**Procurement**

In August 2019 we issued an [Essential update](file:///C%3A%5CUsers%5Cnhogg%5CAppData%5CLocal%5CMicrosoft%5CWindows%5CINetCache%5CContent.Outlook%5C2J0KJ8Y4%5CBBO%20Essential%20update%20-%20August%202019.docx) about Procurement, in which we explained thatthere is an increasing focus on procurement by the A127 and A125 teams.

We thought it might be helpful to follow this up with an example: One of our grant holders was recently audited by the A127 team, who looked at several items of expenditure that used a contracted costs model to pay a Spot Purchase Partner. Procurement of the related contract was not in compliance with the public procurement regulations.

The value of these contracts was over £250k.  The organisation did not have any evidence of advertising the contract notice or the award notice and while they believed the contracts had been advertised locally and on their own website, they were not advertised on Contracts Finder or the EU website.

As a result, **all** expenditure associated with these contracts that has been claimed to date is deemed ineligible.  In this case, this amounts to circa £400k, which will be clawed back.  We would strongly advise you to review your own procurement processes, including checking if your organisation is a contracting authority and check  that the national procurement guidance has been adhered to, as well as making sure future procurement is compliant.

If you are in doubt, we strongly advise you to take your own legal advice on procurement, as there may be **retrospective action** you can take that would at least mitigate any financial penalty. Unfortunately, we are not able to provide any advice on procurement or legal matters. For your information, we have attached the checklist the Managing Authority issues to direct bid projects where new procurement is identified. This is just one area that the A125 and A127 teams will look at.  They will check other aspects of your compliance too.

**Pension Contributions and direct staff costs – employer pension contributions including past deficit**

For all employees who are included within the ‘direct staff costs’ budget of a BBO project (full cost, 1720 or fixed percentage), their employer is entitled to claim the associated employers pension contribution. In many cases employer pension contributions include an element related to “past service deficits”. On 16 October 2019 the Managing Authority issued [Action Note 040/19](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/839942/04019_Pension_Deficit.pdf), this followed the receipt of legal advice as to whether these increased pension contributions should be considered eligible costs.

The Action Note confirms that in some circumstances increased pension contributions resulting from past service deficit payments are considered eligible expenditure. However, this is only in the following circumstances:

* The payment must be directly attributable to staff working on the project and cannot be apportioned.
* The past service deficit payments must not be paid separately from the main employer pension contribution.

Where an organisation’s pension deficit contribution includes an additional lump sum payment, it is not an eligible cost. It cannot be directly attributed to staff that spend time delivering the project.

The Managing Authority have confirmed that this ruling is correct from date of publication (16 October 2019) and is not retrospective.

**In cases where increased pension costs are eligible, a letter must be provided confirming that a higher percentage is being claimed because it includes an element of “past service deficit”. The letter should explain which staff are covered by this and give their names and the specific pension schemes they belong to.**

Pension schemes operate in many ways, and you must consider the impact of the [Action Note's](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/839942/04019_Pension_Deficit.pdf) contents on a case-by-case basis.

Where a single employer pension contribution is made per employee, which includes all costs associated with an individual, including an element of “past service deficit” the cost is eligible. However, this is not always the case. We have set out an example below, based on a local government pension scheme, as an illustration of whether pension deficit contributions could be claimed in practice. Please note, this will not be representative of all schemes.

**Example**

The scheme has a range of member organisations that include local government, housing associations and charities. It has two types of employer pension contributions.  A primary (employer future service) contribution and a secondary (past service deficit) contribution. The secondary contribution can be allocated as either a lump sum or a percentage of salary. (N.B. The percentage contribution varies greatly by member organisation.)

* Organisation A: pays a primary contribution of 23.2 per cent and a secondary contribution of £188,000 per year.  This secondary contribution is an ineligible cost as it is a lump sum.
* Organisation B: pays a primary contribution of 19 per cent with a secondary contribution of 2.3 per cent, giving a total of 21.3 per cent as a minimum contribution to the scheme per year.  Whether this secondary contribution is an eligible cost is less clear cut than in organisation A. We need to consider how the cost is defrayed.

Organisation B has a secondary employer pension contribution. The action note tells us two things:

* *“The employer is obliged to make the payment, which* ***must be directly attributed to staff*** *working on the project and is the cost of employing staff.”*
* *“Where it is recorded that the increased contribution includes an element of a “past service deficit” this is an eligible cost as the percentage for the deficit* ***is not paid separately*** *and is set by pension trustees and reflects the actual, unavoidable cost of employing an individual on the project. In these cases it is not possible to apportion costs between contributions attributable to past shortfalls and those attributable to current service, as both payments must be made in respect of the employee to secure the ongoing viability of the employer’s pension fund”*

Therefore:

* If 21.3 per cent is paid each month as the employer’s pension contribution andyou can follow the cost through the defrayal evidence as being attributed to the individual, even if the primary and secondary contribution are shown separately, the secondary contribution would be eligible.
* If the 2.3 per cent secondary contribution is paid separately and the cost is apportioned by the employer, it is not eligible. Although the employer is required to make payments ‘*to secure the ongoing viability of the employers pension fund’*, the cost cannot be directly attributed to an individual employed on the project.

Where finance reports show secondary pension contributions, you must investigate the defrayal evidence to identify whether this is a payment that can be fully attributed to the individual (and is therefore eligible), or whether it demonstrates that the “past service deficit contribution” is a separate payment being apportioned (and is therefore ineligible).