

Scottish Public Pensions Agency

Report on the 2006/07 Audit



November 2007





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Executive Summary

Introduction

In 2006/07 we audited the financial statements of the Scottish Public Pensions Agency (SPPA) and we looked at aspects of performance management and governance. This report sets out our key findings.

Financial Position

We have given an unqualified opinion on the financial statements of SPPA for 2006/07.

During financial year 2006/07, the Scottish Public Pensions Agency recorded income of £62k from operating activities and received financing of £9,350k including non cash funding of £289k from the Scottish Government. The Agency incurred a net operating cost of £8,823k for the same period. The balance sheet moved from an opening position of £1,087k to a closing balance of £1,624k.

The movement in the Scottish Public Pensions Agency's financial position is explained mainly by the surplus of Scottish Government funding over the Agency's net costs for the 2006/07 financial year (£527k).

The Scottish Public Pensions Agency operated within the budget provided by the Scottish Government.

Financial Statements

We have concluded that the financial statements of the Scottish Public Pensions Agency give a true and fair view of the state of affairs of the Agency as at 31 March 2007.

We have also concluded that in all material respects, the expenditure and receipts shown in the financial statements were incurred or applied in accordance with applicable enactments and relevant guidance, issued by Scottish Ministers.

We have also reviewed the other issues which we are required to consider as part of our audit opinion, such as the Management Commentary, the Remuneration Report and the Statement on Internal Control. We can confirm that there are no further matters that we need to bring to the attention of the Scottish Public Pensions Agency.

Efficient Government

As part of its commitment to the Efficient Government Initiative, the Scottish Public Pensions Agency agreed efficiency savings targets for 2006/07 with the Scottish Government.

The Scottish Public Pensions Agency has reported projected outturn efficiency savings of £488k in 2006/07. This compares with efficiency saving targets of £635k agreed with the Scottish Government.



Plans are under development to achieve further efficiencies as part of the Initiative in 2007/08. Planned efficiencies of £635k are anticipated to be generated. It will be challenging for the Scottish Public Pensions Agency to deliver on savings, with existing financial constraints and national strategic change underway.

Performance

The Scottish Public Pensions Agency published its last 3 year corporate plan for the period 2005-08. This sets out nine key performance targets for the period. The Agency's annual report sets out its progress against each of the key targets.

Governance

Corporate Governance is concerned with the structures and process for decision making, accountability, control and behaviour at the upper levels of an organisation. The establishment and operation of an efficient and effective internal audit function forms a key element of effective governance and stewardship. The Scottish Public Pensions Agency's internal audit service is provided by the Scottish Government Internal Audit Division. We reviewed internal audit and concluded that they continue to comply with Government Internal Audit Standards. We were able to place both general reliance on their work and specific reliance on individual assignments.

We note that the Scottish Public Pensions Agency is developing appropriate governance arrangements for its new management structure.

Overall the corporate governance and control arrangements for the Agency operated satisfactorily during the year, as reflected in the Statement on Internal Control. There remain opportunities to improve internal controls relating to fixed asset accounting arrangements and VAT accounting arrangements, as discussed elsewhere in this report.

We examined the key financial systems which underpin the organisation's control environment. We concluded that financial systems and procedures operated sufficiently well to enable us to place reliance on them and to mitigate the risks of material misstatement of the accounts, error or fraud.

In our audit plan we identified information and computer technology as a priority area for 2006/07. We completed, and reported separately on, a review of computer services. We also conducted a 'Your Business@Risk' survey. Both ICT reviews revealed examples of good practice and areas for improvement.

Audit Scotland
30 November 2007



Introduction

1. This report summarises the findings from our 2006/07 audit of the Scottish Public Pensions Agency. The scope of the audit was set out in our Audit Plan, which was presented to the Audit Committee on 6 March 2007. The plan set out our views on the key business risks facing the organisation and described the work we planned to carry out on financial statements, performance and governance.
2. In the Audit Plan, we identified a number of audit risks which informed our audit procedures. From our audit work we can conclude that these risks are being satisfactorily managed by the Scottish Public Pensions Agency. Appendix A of this report sets out the key risks highlighted in this report and the action planned by management to address them.
3. This is the first year of a five year audit appointment. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officers and members of the Scottish Public Pensions Agency during the course of our audit. This report will be submitted to the Auditor General for Scotland and will be published on our website, www.audit-scotland.gov.uk.
4. The principles of independence, the wider scope of the audit and the ability to report in public are central to public sector audit. All Audit Scotland staff are bound by its Staff Code of Conduct which incorporates the Seven Principles of Public Life identified by the Nolan Committee on Standards in Public Life and conforms to International Standards on Auditing. All staff also confirm annually that they comply with the Code's ethical values and principles. Staff are also subject to the relevant ethical standards and guidance of the professional bodies of which they are members.



Financial Statements

5. In this section we summarise key outcomes from our audit of the Scottish Public Pensions Agency's financial statements for 2006/07, and comment on the key financial management and accounting issues faced.

Our Responsibilities

6. We audit the financial statements and give an opinion on whether:
 - they give a true and fair view of the financial position of the Scottish Public Pensions Agency and its expenditure and income for the period in question.
 - whether they have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements, and
 - the regularity of the expenditure and receipts.
7. We also review the statement on internal control by:
 - considering the adequacy of the process put in place by the Chief Executive as accountable officer to obtain assurances on systems of internal control; and
 - assessing whether disclosures in the statement are consistent with our knowledge of the Scottish Public Pensions Agency.

Overall Conclusion

8. We have given an unqualified opinion on the financial statements of the Scottish Public Pensions Agency for 2006/07.

Financial Position

2006/07 outturn

9. The net cost of operations of the Scottish Public Pensions Agency increased by 9% to £8,823k (2005/06 £8,094k). The total net assets increased by 49.4% to £1,624k (2005/06 £1,087k).
10. The net cost of operations after cost of capital charges increased by 9% to £8,823k (2005/06 £8,094k) due to an increase in expenditure, offset by an increase in operating income. Expenditure increased by 9% mainly resulting from higher staffing levels and TUPE costs relating to the transfer of the NHS superannuation scheme payroll function (previously performed by Paymaster (1836) Limited) to the Scottish Public Pensions Agency. Total operating income increased by 29% to £62k (2005/06 £48k)



due to an increased level of activity of Pension Sharing on Divorce work, combined with increased charge rates. Financing by the Scottish Government increased by 27.6% to £9,350k (2005/06 £7,325k). Supplementary funding of £600k was required in 2006/07 due to factors which were not anticipated when the Agency's three year budget allocation was set, in 2004, mainly the significant extension of the pension reform agenda following the 2005 UK General Election and a growth in the day to day caseload.

11. The changes in the balance sheet mainly result from the surplus of Scottish Government funding over the Agency's net costs for the 2006/07 financial year (£527k) combined with a small surplus on revaluation of fixed assets during the year (£10k).

Issues Arising from the Audit

12. As required by auditing standard ISA260 we reported as follows to the audit committee on 14 August the main issues arising from our audit of the financial statements. A separate management letter will cover our recommendations in relation to minor findings for unallocated receipts, fixed assets, creditors and provisions, and FReM disclosures.

13. **Capitalisation of Resourcelink Costs:** Fixed asset additions amounting to £627k were capitalised at year end rather than during the course of the year according to current practice. No depreciation charge was calculated for the period between the various invoice dates and capitalisation date. The practice in the Scottish Public Pensions Agency is to commence the depreciation in the subsequent year. Expenditure in this area is increasing and there is a risk that there could be a material misstatement of the accounts.

Refer Action Plan No. 1

14. **Potential Recovery of VAT by HMRC:** Changes to the VAT rules in 2003 have meant that the Scottish Public Pensions Agency cannot recover the input VAT on its rent payments. Although the Agency is no longer reclaiming the VAT on these payments there is an issue in relation to previous years. HMRC could potentially seek to recover VAT previously claimed in error.

Refer Action Plan No. 2

15. **Difference between VAT balance on SEAS and VAT return:** The VAT debtor balance on the SEAS ledger system differed from the balance per the VAT return by £30,285. The VAT returns are prepared by the Scottish Government.

Refer Action Plan No. 3



Statement on Internal Control

16. The Statement on Internal Control provided by the Scottish Public Pensions Agency's Accountable Officer reflected the main findings from both external and internal audit work. This recorded management's responsibility for maintaining a sound system of internal control and sets out the Agency's approach to this.

Regularity Assertion

17. The Public Finance and Accountability (Scotland) Act 2000 imposes a responsibility on auditors that requires us to certify that, in all material respects, the expenditure and receipts shown in the accounts was incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers. We have been able to address the requirements of the regularity assertion through a range of procedures, including written assurances from the Accountable Officer as to his view on adherence to enactments and guidance. No significant issues were identified for disclosure.



Performance

18. Public audit is more wide-ranging than in the private sector and covers the examination of, and reporting on, performance and value for money issues. As part of our audit we are required to plan reviews of aspects of the arrangements to manage performance, as they relate to economy, efficiency and effectiveness in the use of resources.
19. Accountable officers also have a duty to ensure the resources of their organisation are used economically, efficiently and effectively. These arrangements were extended in April 2002 to include a duty to ensure 'best value' in the use of resources.
20. The Scottish Public Pensions Agency is required to publish its corporate plan every three years. The latest plan was published in 2005 and covers the period 2005 – 2008. This sets out nine key performance targets for the period. The Agency's annual report sets out its progress against each of the key targets.



Governance

Overview of arrangements

21. This section sets out our main findings arising from our review of the Scottish Public Pensions Agency's governance arrangements. This year we reviewed:
- key systems of internal control;
 - internal audit; and
 - aspects of information and communications technology (ICT).
22. We also discharged our responsibilities as they relate to prevention and detection of fraud and irregularity; standards of conduct; and the organisation's financial position (see paragraphs 9-11). Our overall conclusion is that arrangements within the Scottish Public Pensions Agency are sound and have operated throughout 2006/07.
23. We note that the Scottish Public Pensions Agency is developing appropriate governance arrangements and that a number of changes are currently underway which will take account of the reorganised management structure.

Systems of internal control

24. Key controls within systems should operate effectively and efficiently to accurately record financial transactions and prevent and detect fraud or error. This supports a robust internal control environment and the effective production of financial statements. In his annual report for 2006/07 the head of internal audit provided his opinion that, based on the internal audit work undertaken during the year, there was substantial assurance on the adequacy and effectiveness on the systems of internal control.
25. As part of our audit we reviewed the high level controls in a number of Scottish Public Pensions Agency systems that impact on the financial statements. We examined general higher level financial controls, fixed assets and aspects of payroll system controls within the Agency. Our overall conclusion was that key controls were operating effectively.

Internal audit

26. The establishment and operation of an effective internal audit function forms a key element of effective governance and stewardship. We therefore seek to rely on the work of internal audit wherever possible and as part of our risk assessment and planning process for the 2006/07 audit we



assessed whether we could place reliance on the Scottish Public Pensions Agency's internal audit function. We planned to place reliance on the work of internal audit work for Administration Costs, Governance and Risk Management Arrangements.

27. Audit Scotland's Scottish Government team reviewed the work of the Division in general and we reviewed the work carried out on the Scottish Public Pensions Agency. We were in agreement with the findings of their reports. We concluded that the internal audit service operates in accordance with the Government Internal Audit Manual and therefore placed reliance on the areas covered by these audit reviews in coming to our conclusions.

Information and Communication Technology

Computer services review

28. As part of our risk based assessment, we identified Information and Communication Technology (ICT) as a priority area for review in 2006/07. Management were asked to complete a Computer Service Review Client Questionnaire (CSR-CQ) and we reported our detailed findings from this exercise separately in our report issued in September 2007.
29. The seven key areas covered by the review were: ICT strategy, organisational structure, installation management, service delivery, asset protection and security, business continuity/contingency and data networking.
30. We identified several examples of good practice:
 - installing good access and environmental controls in the key computer room;
 - undertaking the Scottish Government's COBRA security assessments to highlight system risks;
 - implementing an over-arching training and development strategy and undertaking annual staff appraisals;
 - participating in an information governance survey to gauge levels of awareness amongst staff; and
 - implementing the Government Secure Intranet (GSI) SCOTS network provided by the Scottish Government.
31. Areas for improvement included:
 - formally signing up to a service level agreement (SLA) with the Scottish Government's ISIS department for the SCOTS network;



- establishing clear roles, responsibilities and monitoring of information security between the Scottish Government and SPPA; and
- driving Business Continuity Management throughout SPPA;

Your Business @Risk Survey

32. Your Business @ Risk (YB@R) is a web-based survey that helps auditors and public sector organisations to focus on the business risks associated with information and communications technology (ICT). The Graham Committee report on the Standards of Conduct in Public Life and the Standards Commission for Scotland endorsed this type of tool and recommended that they be used throughout the whole of the public sector.
33. The ICT user survey identified additional areas of good practice and knowledge of awareness in topics that staff were reminded of on a regular basis, such as:
 - monitoring of internet and email use through awareness of the user acceptance policy and aware mis-use may be treated as a disciplinary offence; and
 - knowing where to obtain help regarding computer problems and advice on handling sensitive information.
34. Areas for improvement included:
 - business continuity management protocols;
 - information security management including policy, guidance and key responsibilities;
 - anti-fraud strategy and procedures;
 - data protection policy, guidance and their responsibilities under the Data Protection Act;
 - understanding actions to take regarding IT virus protection;
 - whether installing and copying software on computers is permitted; and
 - whether all computer equipment is clearly security marked and departments keep an up to date record of all its assets.



National Fraud Initiative

35. In 2006/07 the Scottish Public Pensions Agency again took part in the National Fraud Initiative (NFI) in Scotland. Among other things, NFI aims to help identify and reduce fraud by bringing together data from councils, police and fire boards, health bodies and other agencies, to help detect a wide range of frauds against the public sector. These include housing benefit fraud, occupational pension fraud, tenancy fraud and payroll fraud. In the Agency's case, its pensioners are also compared with a government register of dead persons which eliminates the need for the issue of life certificates, as this is a costly and relatively ineffective process. In the period up to 2005, Scottish bodies have identified £27 million of savings from their involvement in NFI.
36. The NFI 2006/07 results (data matches) were available to the Agency via a secure web based application in late January 2007 and the Agency is required to follow up the matches, as appropriate, and report its progress by updating its area of the NFI web site. We monitored the Agency's involvement in NFI 2006/07 during the course of the audit.
37. As at the date of this report, the Agency had cleared 1,334 cases out of a total of 2,088 matches. No savings have been recorded to date. The Agency has shown commitment to the NFI process by appointing a key contact and designating staff from within the Agency to follow up matches. Some preliminary investigations were carried out by the Agency at a relatively early stage. However, in respect of deceased pensioners, Certificate of Entitlement letters were not issued until the end of August 2007 and investigation of re-employment cases had not progressed beyond the preliminary stage at this date.

Refer Action Plan No. 4

38. We also noted that the Agency did not make full use of the filter tools available within the web-based NFI application in order to prioritise cases for investigation, in accordance with the guidance available on the web-based application.

Refer Action Plan No. 5



Looking Forward

39. The Scottish Public Pensions Agency faces a number of challenges in 2007/08, which include:

- **Financial Strategy** - There may be a financial impact arising from changes in strategic direction in line with adjustments to national priorities and the Spending Review.
- **New Pension Administration System** – A contractor has now been appointed to deliver the new IT system for the administration of pensions. The system is currently undergoing testing with the intention that the Scottish Teachers' Superannuation Scheme will 'go-live' early in 2008. The NHS Superannuation Scheme (Scotland) is expected to follow two to three months later. Subsequently, electronic access will be made available to members and employers. We will monitor the project management arrangements in place to deliver this ambitious project.
- **Pension reform** – Reforms to both the Scottish Teachers' Superannuation Scheme and the NHS Superannuation Scheme (Scotland) are planned as part of wider ranging reforms to occupational pensions. Members and employers have been consulted on proposed changes to the schemes and reforms to the Scottish Teachers' Scheme were effected 1 April 2007. Reforms to the NHS Scheme (Scotland) are planned to take effect on 1 April 2008.
- **Best Value** - As part of the 2007/08 audit we will be reviewing the progress that the Scottish Public Pensions Agency has made in strengthening its arrangements for securing Best Value since our baseline review work in 2005/06. Over the next year we will also be developing and refining our approach to the audit of public bodies' arrangements to secure economy, efficiency and effectiveness in the use of resources, as this is one of our key objectives as auditors, set out within the new Code of Audit Practice approved by the Auditor General. This will inform our ongoing work to develop an approach to the audit of Best Value across the Scottish public sector. We intend to consult with both clients and stakeholders at key stages of these initiatives.
- **Efficient Government** - The achievement of future Efficient Government targets represents a challenge for the organisation.

Appendix A: Action Plan

Key Issues and Planned Management Action

| Action Point | Issue Identified | Planned Action | Responsible Officer | Target Date |
|--------------|---|--|---|--------------------------|
| 1 | <p>Capitalisation of Resourcelink Costs</p> <p>Fixed asset additions amounting to £627k were capitalised at the year end rather than during the course of the year according to current practice. No depreciation charge was calculated for the period between the various invoice dates and capitalisation date. The practice in SPPA is to commence the depreciation in the subsequent year.</p> <p>Expenditure in this area is increasing and there is a risk that there could be a material misstatement of the accounts.</p> <p><i>We recommend that SPPA institutes quarterly capitalisation of Resourcelink costs for the 2007/08 accounts.</i></p> | <p>This asset was only capitalised in February 2007 so there was no risk of a material mis-statement. Expenditure on Resourcelink will not reach these limits again. However, we accept this recommendation in principle and will capitalise all large projects quarterly from now on when applicable.</p> | <p>Due to staff moves -TBC.</p> | <p>31/03/2008</p> |
| 2 | <p>Potential Recovery of VAT by HMRC</p> <p>Changes to the VAT rules in 2003 have meant that SPPA cannot recover the input VAT on its rent payments. Although SPPA is no longer reclaiming the VAT on these payments there is an issue in relation to previous years. HMRC could potentially seek to recover VAT previously claimed in error. Scottish Government process VAT claims on behalf of SPPA.</p> | <p>Recommendation accepted. The Agency has written to the SG advising them officially of this error and have asked the SG to take up with HMRC on our behalf.</p> | <p>Mark Howells, Director of Corporate Services</p> | <p>November 2007</p> |

| Action Point | Issue Identified | Planned Action | Responsible Officer | Target Date |
|--------------|--|--|--|----------------------|
| | <p><i>We recommend SPPA obtains a view from the Scottish Government on the likelihood of a repayment request by HMRC.</i></p> | | | |
| 3 | <p>Difference between VAT balance on SEAS and VAT return</p> <p>The VAT debtor balance on the SEAS ledger system differed from the balance per the VAT return by £30,285. The VAT returns are prepared by the Scottish Government.</p> <p><i>We recommend that SPPA liaises with the Scottish Government to ensure that appropriate procedures are put in place to fully reconcile VAT return balances to SEAS.</i></p> | <p>SPPA are contacting the SG VAT team regarding this issue.</p> | <p>Stuart Dickson, Finance Manager</p> | <p>November 2007</p> |

| Action Point | Issue Identified | Planned Action | Responsible Officer | Target Date |
|--------------|---|---|--|-------------|
| 4 | <p>National Fraud Initiative - investigation of matches</p> <p>The NFI 2006/07 results (data matches) were available to the Agency in late January 2007. SPPA has cleared 1,334 cases out of a total of 2,088 matches. No savings have been recorded to date. Some preliminary investigations were carried out by SPPA at a relatively early stage however, in respect of deceased pensioners, Certificate of Entitlement letters were not issued until the end of August 2007 and investigation of re-employment cases had not progressed beyond the preliminary stage at this date.</p> <p>There is a risk that SPPA may not achieve the agreed reporting timescales for NFI.</p> <p><i>We recommend that SPPA reviews its arrangements for completion of the 2006/07 NFI exercise to ensure completion within the agreed timescale. Planning and resourcing of future NFI exercises should be reviewed to ensure that matches are investigated and followed up timeously.</i></p> | SPPA will take the requirements of NFI into account for future exercises. | Ian Clapperton, Director of Operations | 31/3/2008 |

| Action Point | Issue Identified | Planned Action | Responsible Officer | Target Date |
|--------------|---|---|---|------------------|
| 5 | <p>National Fraud Initiative - use of filters to prioritise matches</p> <p>SPPA did not make full use of the filter tools available within the web-based NFI application in order to prioritise cases for investigation, in accordance with the guidance available on the web-based application.</p> <p>There is a risk that SPPA may not be targeting matches in order of priority in order to use resources in the most effective manner.</p> <p><i>We recommend that SPPA ensures that staff involved in investigating matches are given appropriate guidance on the use of the web-based application's filter tools for prioritisation of matches.</i></p> | <p>Staff have already been given advice on filter tools and are now making use of the facility.</p> | <p>Ian Clapperton, Director of Operations</p> | <p>31/3/2008</p> |