

Scottish Parliamentary Contributory Pension Fund

Report on the 2008/09 audit

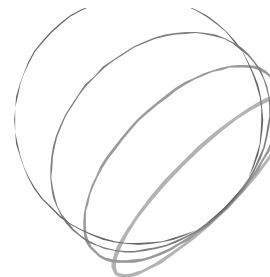
November 2009

The logo for Audit Scotland, featuring a stylized blue 'A' with a checkmark inside a circle to its left.

AUDIT SCOTLAND

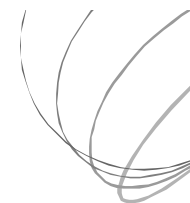
Scottish Parliamentary Contributory Pension Fund

Report on the 2008/09 Audit



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Key messages

Our audit was based on understanding the key strategic and financial risks being faced by the Scottish Parliamentary Contributory Pension Fund (SPCPF). We audited the financial statements and we also reviewed relevant aspects of corporate governance. This report sets out our key findings.

Financial Statements

We have given an unqualified opinion on the financial statements of the SPCPF for 2008-09. We 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; and that pension contributions have been paid in line with Fund rules and the recommendation of the Actuary.

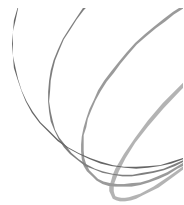
Financial position

The SPCPF is relatively new and as such contributions into the Fund will exceed benefits paid out of the Fund for many years (2008-09: net income £1.8 million; 2007-08: net income £1.3 million). Accordingly the investment policy is predominantly equity based, increasing the probability of higher investment return over the long term. In line with volatility in equity markets, the value of the pension fund investments has decreased significantly over the financial year from £19.5 million at 31 March 2008 to £17.1 million at 31 March 2009. The pension liabilities at 31 March 2009 have been estimated, for accounts purposes, at £21.2 million by the Government Actuary's Department (2008: £21.0 million). As a result the accounts record a shortfall of assets in the Fund at 31 March 2009 of £4.1 million (2008: £1.5 million).

It is helpful to provide some context to the year end deficit of £4.1 million. The value of investments has increased significantly since the year end, such that, adopting 30 September 2009 values would eliminate the deficit. Also, the most recent actuarial view of the deficit in funding the SPCPF, as assessed by a full valuation of the Pension Scheme, was £0.2 million. This was based on the last full valuation of the Pension Scheme, as at 31 March 2008, by the Government Actuary's Department; and represented a reduction in the deficit of £0.5 million reported in the previous full valuation as at 31 March 2005.

Governance

SPCPF's corporate governance and control arrangements operated satisfactorily in the period under review as reflected in the Statement on Internal Control; we undertook a range of testing which confirmed the position. During 2008-09, we liaised with SPCB staff on their preparation for introducing new legislation for MSP's pensions, including the provisions for accounts and audit. The new Pension Scheme rules came into effect from 1 September 2009 and SPCB staff explained the changes to arrangements that were planned and introduced; and that the implementation of recommendations arising from the previous corporate governance review would be considered as part of the development of the arrangements for the new Pension Scheme.

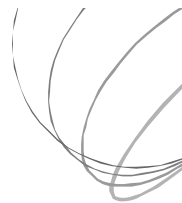


Looking Forward

During 2009/10 SPCPF will continue to develop the governance arrangements for the new Pension Scheme. Also, subject to any views of incoming Trustees, the current intention is to produce one account for 2009/10, which will be audited by auditors appointed by the Trustees. So 2008/09 is the last year of our appointment as auditors under the old Pension Scheme rules. We will continue to liaise with SPCB, should there be a need, on any matters arising relating to the old Pension Scheme arrangements, which ended on 31 August 2009.

I would like to record my thanks to management and staff for their co-operation and assistance.

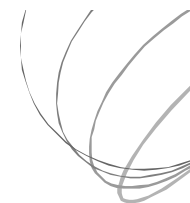
Murdoch McCamley CA,
Senior Audit Manager,
November 2009



Introduction

Scope of the Audit

1. This report summarises the findings from our 2008-09 audit of the Scottish Parliamentary Contributory Pension Fund (SPCPF), which is the Fund for the pensions of MSP's and Law Officers under the terms of the Scottish Parliamentary Pension Scheme (SPPS). For simplicity we adopt the abbreviation SPCPF in most circumstances in this report. The scope of the audit was set out in our Audit Plan, which was discussed and agreed with management and reviewed and approved by the Advisory Audit Board on 1 April 2009. The Audit Plan described the work we planned to carry out, the primary focus being an audit of the financial statements and provision of an opinion on whether they present a true and fair view of the financial position of SPCPF and its expenditure and receipts for the year. We also review aspects of the SPCPF's arrangements for governance and internal control.
2. This report to management sets out the findings on the completion of our audit as at September 2009. Any weaknesses outlined are only those which have come to our attention during the course of our normal audit work and are not necessarily all the weaknesses which may exist. It is the responsibility of management to determine the extent of the internal control system appropriate to the SPCPF. We would stress, however, that an effective internal control system is an essential part of the efficient management of any organisation.
3. The contents of this report have been agreed with relevant officers to confirm factual accuracy. The assistance and co-operation we received during the course of our audit is gratefully acknowledged. This report will be submitted to the Auditor General for Scotland and will be published on our website at www.audit-scotland.gov.uk.



Financial Statements

Our Responsibilities

4. We audit the financial statements and give an opinion on whether:

- they give a true and fair view of the financial transactions of the Fund for the year ended 31 March 2009 and of the amount and disposition at that date of its assets and liabilities, other than liabilities to pay benefits after the end of the Fund year;
- they have been properly prepared in accordance with the Public Finance and Accountability (Scotland) Act 2000 and the Scotland Act 1998 (transitory and Transitional Provisions) (Scottish Parliamentary Pension Scheme) Order 1999 and directions made thereunder;
- in all material respects the expenditure and receipts shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers; and
- the Contributions payable to the Fund during the year ended 31 March 2009 have been paid in accordance with the Fund rules and the recommendation of the Actuary.

5. We also review the Statement on Internal Control by:

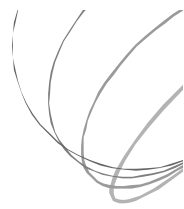
- considering compliance with Scottish Public Finance Manual guidance;
- considering the adequacy of the process put in place to obtain assurances on systems of internal control by the members of the Scottish Parliamentary Corporate Body (SPCB) in their role as Managers of the Fund; and
- assessing whether disclosures in the Statement are consistent with the information emerging from our normal audit work.

Overall Conclusion

6. We have given an unqualified opinion on the financial statements of the SPCPF for 2008-09.

Issues arising from the audit of the financial statements

7. In line with agreed plans, the first draft account was submitted for audit on 29 July 2009 with supporting schedules provided shortly after. We were pleased with the high standard of working papers to support the draft accounts and the related management review processes. The draft accounts and the outcome of the audit were considered by the Advisory Audit Board on 30 September 2009, with the accounts presented to the Corporate Body at their meeting on 28 October 2009 and were then signed by the Presiding Officer.



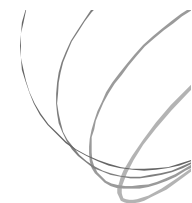
8. International Standard on Auditing (ISA) 260 requires auditors to report certain matters arising from the audit of the financial statements to 'those charged with governance' prior to the accounts being signed. As indicated we reported in the terms of ISA 260 to the members of the Advisory Audit Board on 30 September 2009. We were pleased to confirm that there were no significant issues or concerns that merited inclusion in this report.

Regularity assertion

9. 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 were incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers. We have addressed the requirements of the regularity assertion through a range of procedures, including written assurances from the Presiding Officer as to his view on adherence to enactments and guidance. No significant items were identified for disclosure.

Statement on Internal Control

10. A Statement on Internal Control was signed by the Presiding Officer on 28 October 2009. This set out the arrangements operated for risk identification and review, management of identified risks and assurance of effectiveness.
11. We are satisfied that the Statement complies with Scottish Public Finance Manual guidance; that satisfactory processes have been put in place to obtain assurances on systems of internal control by the Presiding Officer and by the members of the SPCB in their role as Managers of the Fund; and that the contents of the Statement are not inconsistent with the information emerging from our normal audit work.

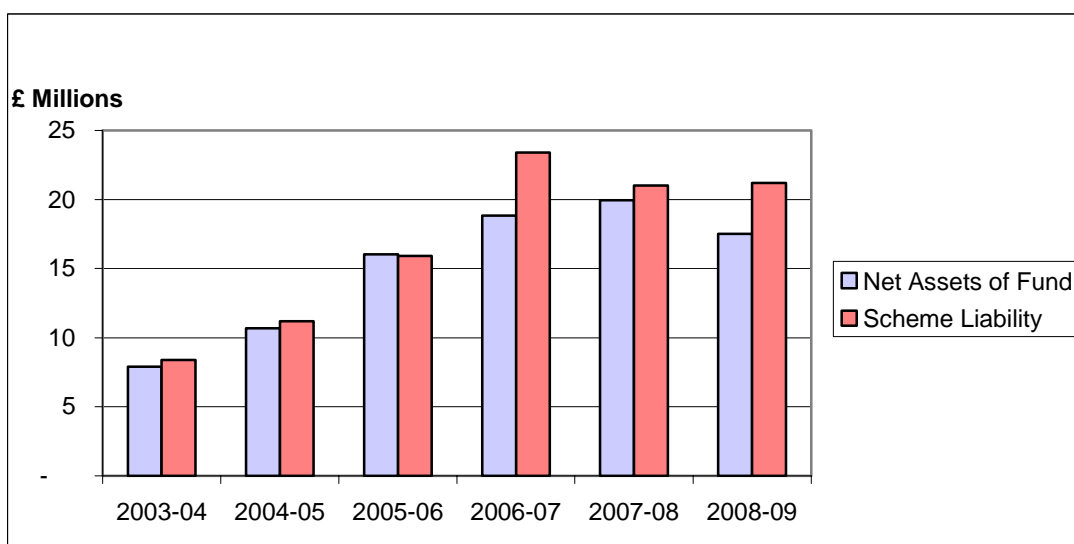


Financial Position

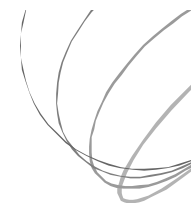
12. The Fund Account for the year records a total income for the financial year of £2.317 million (2007-08: £2.050 million), comprising contributions into the Fund, transfers into the fund from those joining the Scheme and other income. The main reasons for the increase in income were an increase in Other Income £0.165 million relating to a death in service payment; an increase in Contributions Received of £0.119 million and a reduction of £0.017 million in Transfers in from Other Schemes. The expenditure for the financial year was £0.478 million, a decrease of £0.257 million from 2007-08 expenditure of £0.735 million. The main decrease related to Transfers out of the Scheme of £0.035 million (2007-08: £0.403 million); Benefits Payable increased by £0.099 million to £0.323 million; Administration Expenditure and Other Payments increased by £0.012 million to £0.120 million. The net return on investments held by the Fund was a decrease of £4.274 million (2007-08: £0.190 million decrease).
13. The overall effect of the movements described above was a decrease in the net assets of the Fund of £2.4 million, taking the Fund value at the year end to £17.5 million, (2007-08: £1.1 million increase and £19.9 million). These figures include Additional Voluntary Contribution Schemes with contributions made of £12 thousand (2007-08: £14 thousand) with an investment movement of £22 thousand loss (2007-08: £17 thousand gain) and with a year end value of £259 thousand (2007-08: £270 thousand).

Exhibit 1

Scottish Parliamentary Contributory Pension Scheme: Comparison of Nets Assets and Fund Liability



Source: Audited Accounts 2003-04 to 2008-09



14. In line with the Accounts Direction the accounts exclude the Scheme's liability to pay future benefits. The Scheme liabilities, excluding liabilities associated with Additional Voluntary Contributions, have been estimated by the Actuary at £21.2 million as at 31 March 2009 (2007-08: £21.0 million). The value of the related pension fund at that time is £17.1 million. Exhibit 1 shows the shortfall of assets in the Fund (excluding Additional Voluntary Contributions) is £4.1 million, a significant increase on the £1.5 million shortfall reported at 31 March 2008.

Scheme liabilities

15. The small change for the Scheme's liabilities between 2007-08 and 2008-09 is the combined effect of an increase in the percentage rate applied to estimated future pension payments (to state them at their present value at the balance sheet date) and a lower actuarial (experience) gain. The discount rate applied is linked to the rate of interest on corporate bonds; and this rose from 3.1% to 3.8% between 2007-08 and 2008-09. The higher the discount rate the lower the present value of the liabilities. An experience gain is the difference between actuarial estimates and the actual experience in relation to interest rates, demographic factors, salary growth etc. Demographic assumptions on the longevity of Scheme members have remained unchanged from 31 March 2008.

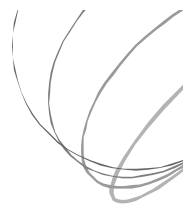
Exhibit 2

Scottish Parliamentary Contributory Pension Scheme: Movement in Liability

	2008/09	2007/08
Scheme liability at 1 April	21.0	23.4
Current service cost increase	2.3	2.6
Transfers in/ (out)	0.0	(0.3)
Past service costs	0.0	0.0
Interest on pension liabilities	1.5	1.3
Benefits paid	(0.1)	(0.2)
Actuarial (gain)/loss	(3.5)	(5.8)
Scheme liability at 31 March	21.2	21.0

Source: Government Actuary's Department report 2007-08 to 2008-09

16. The main factors in the movement of the overall position of the Fund is a £0.2 million increase in the Scheme's liabilities combined with a £2.4 million decrease in the value of the Scheme's pooled investments. Exhibit 2 shows increases in the costs of current service of £1.8 million (2007-08: £2.6



million) and the interest cost of scheme liabilities of £1.5 million (2007-08: £1.3 million); these increased costs of £3.3 million (2007-08: £3.9 million) are offset by an experience gain (change in actuarial assumptions) and net transfers totalling £3.1 million, resulting in the net increase in Scheme liabilities of £0.2 million. (2007-08: £6.3 million experience gain and £3.9 million costs led to a decrease in liabilities of £2.4 million).

Full actuarial valuation

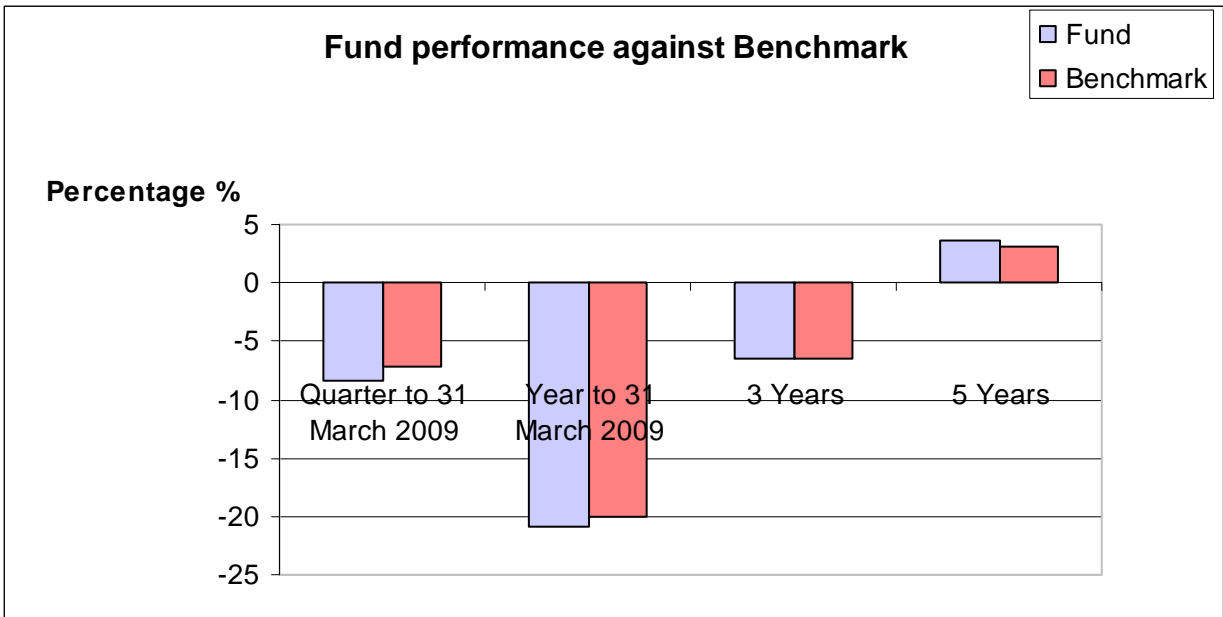
17. The Government Actuary's completed a full actuarial valuation of the Scheme as at 31 March 2008, which reported that the Schemes liabilities at 31 March 2008 were £21.0 million; and that the deficit on the Scheme was £0.2 million. The previous full actuarial valuation in 2005 reported that the Scheme deficit was £ 0.5 million. This improvement over the three year period illustrates why a long term view should be taken when assessing SPCPF's financial position. The report of the Government Actuary's Department recommended that the standard contribution rate payable by the Scottish Consolidated Fund should be increased from 20.3% of pensionable payroll to 21%, until the next full actuarial review as at 31 March 2011. The report noted that the proportion of the contribution payable to address the deficit reduces from 0.8% of pensionable payroll to 0.2%.

Investment performance

18. Baillie Gifford reported that the Managed Pension Fund decreased in value by 20.8% over the year to 31 March 2009 compared to a decrease of 20.0% for the target benchmark (Exhibit 3).

Exhibit 3

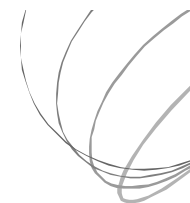
Baillie Gifford managed pension fund performance against benchmark



Source: Baillie Gifford



19. The 3 year performance for the pooled fund was a decrease of 6.5% per annum, which exactly matched the benchmark. (The benchmark is the Combined Actuarial Performance Service (CAPS) median Balanced Pooled Fund over a rolling 3 year period). However, performance in the 6 months to 30 September 2009 has seen a 29% recovery in the value of the pooled fund which has been broadly in line with the benchmark. These investments are being held for the long term and we agree with SPCB that it would not be appropriate to adjust the investment values in the accounts as a post balance sheet event; or to disclose the value at the date at which the accounts are signed.



Governance

Introduction

20. Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviour at the upper levels of an organisation. This section sets out the main findings arising from our review of the SPCPF's corporate governance as it relates to systems of internal control and the review of internal audit.

Overall Governance Arrangements

21. During our audit we updated and confirmed our understanding of the governance systems operating in relation to SPCPF. The Fund relies on SPCB systems and arrangements for aspects of the financial accounting and payroll; and aspects of these are in turn based on Scottish Government arrangements. Pension aspects and accounts preparation are carried out by the Scottish Public Pensions Agency under a Service Level Agreement, although we noted that SPCB staff were more involved in accounts preparation than in previous years. Baillie Gifford are Investment Managers.
22. Our understanding of arrangements builds on our reviews of systems and controls in previous years, any relevant findings of internal audit and our current year work. In the current year we carried out systems and controls work as necessary to support our audit of the financial statements of SPCPF. This mainly comprised examining pension transactions: contributions due and their transmittal to the investment managers; transfers in and out of the Scheme and benefits payable.
23. In relation to the broader aspects of the governance and control environment, Audit Scotland carry out annual work on systems and controls at the SPCB and the Scottish Government, including the Scottish Public Pensions Agency. The coverage includes the main accounting system (SEAS) and payroll; and also the pension arrangements at the Scottish Public Pensions Agency, who manage this aspect of the Scheme's operations on behalf of the SPCB. There are no matters we wish to bring to attention from this work. In addition, in relation to the investments held, Baillie Gifford prepared a statement on their internal control framework. KPMG, as reporting accountants, provided positive assurance on the statement.
24. Overall therefore we are content that the broader governance arrangements are soundly based.

Internal Audit

25. 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. Audit Scotland have reviewed and placed reliance on the internal audit services provided to the SPCB and the Scottish Government, including the Scottish Public Pensions Agency.



Follow up of prior year audit findings

26. As part of the 2008-09 audit we followed up the previous internal audit review of governance arrangements. We discussed progress on the 4 recommendations which had been accepted by SPCB and found that limited progress had been made in addressing the recommendations arising but that their implementation would be considered as part of the development of the arrangements for the new Pension Scheme.

Looking forward

27. During 2009/10 SPCPF will continue to develop the governance arrangements for the new Pension Scheme. Also, subject to any views of incoming Trustees, the current intention is to produce one account for 2009/10, which will be audited by auditors appointed by the Trustees. So 2008/09 is the last year of our appointment as auditors under the old Pension Scheme rules. We will continue to liaise with SPCB, should there be a need, on any matters arising relating to the old Pension Scheme arrangements, which ended on 31 August 2009.