Scottish Public Pensions Agency

Report on the 2010/11 Audits

AUDIT SCOTLAND

Prepared for Scottish Public Pensions Agency and the Auditor General for Scotland

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Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

Contents

Key messages

2010/11 Financial statements

We have given an unqualified opinion on the financial statements of all three accounts: the Scottish Public Pensions Agency (SPPA), the Scottish Teachers' Superannuation Scheme (STSS) and the NHS Superannuation Scheme (Scotland) (NHSSS).

There were no significant issues arising from our audit of the Agency accounts.

Our 2010/11 audits took place against a context of significant business change for the Agency Against this backdrop, we are concerned that the high level of error identified during our audits of the scheme accounts over the past few years has continued again this year. Continuing issues raise questions about the capacity of the Agency to make sufficient and timely improvements to key processes. Improvements are required to a number of areas including:

- accounts preparation processes
- the quality of information provided to support the actuarial valuation of liabilities
- controls over contributions
- review and retention of evidence of capitalised pension calculations from NHS employers.

HM Treasury has suspended all unfunded pension scheme valuations pending decisions by the UK Government on pension reform proposals. As a result, completion of full scheme valuations of both schemes has been delayed. Pension liabilities for both schemes therefore required to be estimated based on previous valuations.

The Agency needs to put arrangements in place to consider the implications of changes to the membership profile for interim valuations and to keep employers informed about the progress of valuations.

Financial position

SPPA operated within the 2010/11 budget provided by the Scottish Government. Both scheme accounts operated within the 2010/11 budgets provided by the Scottish Government. A change in indexation from retail price index to consumer price index resulted in a negative past service cost of £3.3 billion and £2.1 billion being credited to the respective NHSSS and STSS Statements of Comprehensive Net Expenditure.

Outlook

The Scottish Government has proposed real terms increases in the resources made available to SPPA over the next three years. Immediate priorities include the maintenance of service standards, contribution to the development of policy arising from the pension reform agenda and to commence implementing the necessary administrative arrangements for the NHS and teachers' schemes. As the Agency considers how best to develop its capacity to meet these challenges it needs to consider a number of organisational issues.

Introduction

1. This report is the summary of our findings arising from the 2010/11 audits of the Scottish Public Pensions Agency (SPPA), the Scottish Teachers' Superannuation Scheme (STSS) and the NHS Superannuation Scheme (Scotland) (NHSSS). The purpose of the annual audit report is to set out concisely the scope, nature and extent of the audits, and to summarise the auditor's opinions (i.e. on the financial statements) and conclusions and any significant issues arising. The report is divided into sections which reflect the extent of our public sector audit model.

2. A number of reports have been issued in the course of the year in which we make recommendations for improvements (Appendix A). We do not repeat all of the findings in this report, but instead we focus on the financial statements and any significant findings from our wider review of SPPA.

3. Appendix B is an action plan setting out the high level risks we have identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "planned management action". We do not expect all risks to be eliminated or even minimised. What we expect is that SPPA understands its risks and has arrangements in place to manage these risks. The Board and Accountable Officer should ensure that they are satisfied with the proposed management action and have a mechanism in place to assess progress.

4. This report is addressed to SPPA and the Auditor General and should form a key part of discussions with the Audit and Risk Committee, either prior to or as soon as possible after the formal completion of the audit of the financial statements. Reports should be made available to stakeholders and the public, where appropriate. Audit is an essential element of accountability and the process of public reporting.

5. This report will be published on our website after consideration by the SPPA Audit and Risk Committee.

6. The management of the audited body is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems. Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

SPPA financial statements

7. Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources.

8. Auditors are required to audit financial statements in accordance with the timescales set by Audit Scotland, which may be shorter than statutory requirements, and give an opinion on:
   - whether they give a true and fair view of the financial position of audited bodies and their expenditure and income
   - whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements
   - the regularity of the expenditure and income (except for local government bodies).

9. Auditors review and report on, as appropriate, other information published with the financial statements, including the management commentary, statement on internal control and the remuneration report. Where required, auditors also review and report on the Whole of Government Accounts return. This section summarises the results of our audit on the financial statements.

Audit opinion

10. We have given an unqualified opinion that the financial statements of the SPPA for 2010/11 give a true and fair view of the state of the body's affairs and of its net operating cost for the year.

11. SPPA is required to follow the 2010/11 Government Financial Reporting Manual (the FReM) and we confirm that financial statements have been properly prepared in accordance with the FReM.

Regularity

12. In accordance with the requirements of the Public Finance and Accountability (Scotland) Act 2000, we have also provided an opinion, that in all material respects, the expenditure and receipts in the financial statements were incurred or applied in accordance with applicable enactments and guidance.

Remuneration report and statement on internal control

13. In our opinion, the audited part of the remuneration report has been properly prepared and the remaining elements of the remuneration report and management commentary are consistent with the financial statements.

14. We also confirm that we have no issues to report to you on the statement of internal control at SPPA and its compliance with Scottish Government guidance.

Accounting issues

Accounts submission

15. The financial statements were submitted for audit on 30 May, in accordance with a pre-agreed timetable. The audit fieldwork was completed on 17 June and matters arising were discussed with the Direct Running Cost Finance Manager on a regular basis. The final clearance meeting was on 21 June. A report covering any significant matters on the financial statements was issued on 8 July for the Audit and Risk Committee on 19 July. The revised financial statements were signed by the Accountable Officer on 23 August.

Presentational and monetary adjustments to the unaudited accounts

16. A number of presentational changes were required to the annual report and accounts as a result of our review of the disclosures required by the FReM. One immaterial monetary error was identified by the client and corrected in the final accounts.

Prior year adjustments

17. All central government bodies have been affected by the removal of the cost of capital in the 2010/11 FReM and some by the change in disclosure of heritage assets. These changes have had no material impact on SPPA accounts.

Whole of government accounts / consolidation packs

18. The whole of government accounts (WGA) are the consolidated financial statements for all branches of government in the UK. SPPA prepares a consolidation pack for the Scottish Government under the Government Resources and Accounts Act 2000 requirements; the amounts involved are below the threshold for audit involvement.

Issues arising from the audit

19. As required by auditing standards we reported to the Audit and Risk Committee on 19 July 2011 the main issues arising from our audit of the financial statements. There were no significant issues to be brought to the Audit and Risk Committee's attention.

Outlook

Changes in financial reporting framework for 2011/12

20. The main change in the financial reporting framework commencing 2011/12 is that grants and donated assets should be recognised immediately, unless there is a condition that the recipient had not satisfied that would lead to repayment. Most grants and donated assets should be recognised as income, but grants from a sponsoring department to an NDPB should be credited to general reserves. As a consequence, the government grant reserve and donated asset reserve will no longer exist.

21. Looking further ahead, from 1 January 2013 changes to international financial reporting standards (IFRSs) will become effective. This includes the introduction of:

- IFRS 9 - financial instruments (replacing IAS39)
- IFRS 10 - consolidated financial statements (replacing IAS27)
- IFRS11 - joint arrangements (replacing IAS31)
- IFRS12 - disclosure of interest in other entities (replacing IFRS12)
- IFRS 13 - fair value.

22. Revisions to the FReM for 2013/14 are included in the Financial Reporting Advisory Board (FRAB) forward work programme for 1 December 2011.

23. These changes should also be considered in the context of the scheme accounts, as appropriate.

Audit appointment for 2011/12

24. Audit appointments are made by the Auditor General for Scotland (AGS), either to Audit Scotland staff or to private firms of accountants for a five year term. 2010/11 is the last year of the current audit appointment term.

25. The procurement process for the next five years was completed in May 2011 and the AGS has decided to re-appoint Audit Scotland as the auditors of SPPA, STSS and NHSSS for the five years commencing 2011/12. We look forward to continuing the good working relationship that exists between Audit Scotland and SPPA, and thank staff, officers and members of the board and committees for their assistance during the last five years.

NHSSS and STSS financial statements

Audit opinion

27. We have given an unqualified opinion on the financial statements of STSS and NHSSS for 2010/11.

Regularity

28. In accordance with the requirements of the Public Finance and Accountability (Scotland) Act 2000, we have also provided an opinion, that in all material respects, the expenditure and receipts in the financial statements were incurred or applied in accordance with applicable enactments and guidance.

Statement on internal control and annual report

29. The statement of internal control has been prepared in compliance with Scottish Government guidance and highlights a need for improvements in the control of contribution income and in the accounts preparation process covering both STSS and NHSSS. There are no other matters that we feel need to be brought to your attention within this statement.

30. We can also confirm that the information contained in the annual report is consistent with the financial statements.

Accounting issues

Accounts submission

31. The financial statements were presented for audit on 8 August 2011. Due to issues arising from our audit of the final accounts, we were unable to conclude our audit within the agreed timetable. A special meeting of the Audit and Risk Committee was therefore convened for Tuesday, 25 October 2011 at which we provided our conclusions and draft audit opinions. The report and accounts were signed by the Chief Executive on 28 October 2011. The audit opinion was signed on the 31 October 2011.

Presentational and monetary adjustments to the unaudited accounts

32. A number of presentational changes were required to the annual report and accounts as a result of our review of the disclosures required by the FReM. All monetary errors identified were corrected in the final accounts.

Whole of government accounts/ consolidation packs

33. The whole of government accounts (WGA) is the consolidated financial statements for all branches of government in the UK. NHSSS and STSS are required to submit a consolidation pack to HM Treasury for inclusion in the consolidation process, the submission deadline for which was 26 August. However, SPPA is unable to meet this deadline despite a lengthy accounts preparation timetable (comparable scheme accounts in England are laid before Parliament in July).This year's final consolidation pack was received on 2 November for both schemes and we have confirmed that the information being provided to the WGA process is consistent with the accounts.

Issues arising from the audit

34. The key issues arising from the audit of the NHSSS and STSS financial statements were reported to the Audit and Risk Committee on 25 October. Other matters arising have been discussed with SPPA staff during the course of the audit and in various wash-up meetings at the conclusion of the audit. Key issues are outlined below. The matters raised refer to both schemes unless otherwise indicated.

Capacity

35. Our 2010/11 audits took place against a context of significant business change for the Agency which included:

- The development of the UK Government’s pension reform agenda following the publication of Lord Hutton’s interim report in November 2010 and his final report in March 2011
- Continued increases in caseload and transactional activity as a result of a combination of workforce demographics and employer workplace reforms
- A significant number of new tasks associated with external drivers such as the implementation of new HMRC taxation arrangements, new auto enrolment arrangements for pension schemes, the NHS pensions choice exercise, and the development of more rigorous methods for handling Guaranteed Minimum Pensions
- Continued development of existing business processes and related systems, including the Axise-e pensions administration casework system and the EPICOR financial reconciliation system
- The implementation of a new data cleanse programme designed to improve the quality of scheme member data, and
- The development of a significant bid for additional resources as part of the 2011 Spending Review exercise.

36. Against this backdrop, we are concerned that the high level of error identified during our audits over the past few years has continued again this year. The more significant issues are briefly summarised below. Many of these relate to continuing system weaknesses and deficiencies in the accounts preparation process, on which we have previously reported. Continuing issues

raise questions about the capacity of the Agency to make sufficient and timely improvements to key processes within the complex and dynamic nature of its core business. In our view, undue reliance is placed on the audit process to identify problem areas and recommend appropriate actions to remedy these.

37. Our experience over recent years is that much of the Agency's effort is spent reacting to mitigate the impact of problem areas and deal with emerging issues. This has diverted resources from dealing with underlying operational and development matters. This has meant delays in implementing EPICOR and addressing key control issues such as contribution reconciliations. Significant pension reform will present further challenges to the capacity of the organisation.

38. The Scottish Spending Review and Draft Budget proposes real terms increases in the resources made available to SPPA over the next three years at a time that expenditure in many other areas of the public sector is being reduced. Immediate priorities set out in the budget document include the maintenance of service standards, contribution to the development of policy arising from the pension reform agenda and to commence implementing the necessary administrative arrangements for NHS and teachers' schemes.

39. We would highlight the following issues as the SPPA considers how best to develop its capacity to meet these challenges:

- **Board / Audit Committee level.** In view of the complexities of revaluation and pension administration we previously recommended that SPPA give consideration to the appointment of a qualified actuary to the Board. We remain of the view that a non-executive director with specialist expertise in this field would strengthen the role of the board, especially in the context of providing challenge on the details of pension accounting and administration, and thereby provide additional support to the Chief Executive in these areas. We therefore suggest that SPPA give further consideration to this matter, ensuring that it has direct access to appropriate expertise.
- **Senior Management Team**. In our view the role and function of the SMT could be strengthened through improved communication and co-ordination, especially between the operations and finance functions where there is an overlap of responsibilities in terms of accounts preparation and financial reporting.
- **Finance teams.** We have previously highlighted concerns about the adequacy of resources within the finance function. Whilst some progress has been made in addressing this issue, in our view there remains a need to strengthen both the numbers and skill mix within finance, including consideration of the recruitment of qualified accountants to lead the finance teams and provide additional support to the Director of Finance and the SMT. A broader structure of this kind would also reduce dependency on key staff.
- **General staffing mix.** In our view the recurring nature of resourcing issues facing the Agency, combined with challenges ahead, indicate a need for a review of both staffing numbers and skill mix across the Agency, with the emphasis on increasing specialist knowledge in key areas.

- **Succession planning.** The Agency has recognised the need to improve its succession planning processes to safeguard it against the loss of knowledge in key areas arising from staff turnover, and is working to improve its workforce planning. This risk is particularly acute within the finance function.

Action plan 1

Valuation of scheme liabilities

40. In October 2011 HM Treasury suspended all unfunded pension scheme valuations pending decisions by the UK Government on pension reform proposals. As a result, completion of full scheme valuations of both schemes has been delayed. Pension liabilities for both schemes therefore required to be estimated based on previous valuations.

41. The most recent full actuarial scheme valuation of the NHS scheme was carried out as at March 2004. As the valuation as at 31 March 2008 was largely complete at the point the suspension was announced, it was possible for the actuary to use this more recent membership data in estimating the liability as at 31 March 2011, albeit that this has not been formally published. We are content that this is fairly stated.

42. The most recent full actuarial valuation of the Teachers' scheme was carried out as at March 2005. While the valuation as at 31 March 2009 had commenced at the point the suspension was announced, it was not sufficiently advanced for the actuary to use in estimating the liability as at 31 March 2011. In the circumstances, we were concerned that there was a risk that the membership profile had changed sufficiently to materially affect the valuation of scheme liabilities and that this had not been sufficiently considered in assessing the liabilities stated in the accounts. Following discussion with officials, the SPPA sought further actuarial advice and the valuation was revised based on more recent information, including Scottish Government statistics. This resulted in a significant adjustment to the amounts recognised in the accounts. Following this change, we are content that amounts are fairly stated.

43. The delay in the completion of valuations has been disclosed in the accounts. Scheme employers had not, however, been formally notified about the delay and the reasons for this. In our view, it is important that employers are kept appropriately informed about matters which may affect their future costs.

Action plan 2

44. We also found significant differences between contribution income that had been used in estimating scheme liabilities and the corresponding figures in the respective scheme accounts. The errors arose because actuarial valuations were based on draft account figures which SPPA had not subsequently updated. This resulted in the actuary having to rework the valuations, which delayed clearance of the accounts.

Action plan 3

Weaknesses in accounts preparation process

45. In our report on last year's audit we drew attention to weaknesses in the quality review arrangements carried out by SPPA management on the financial statements prior to their presentation for audit. In response, SPPA agreed that improved procedures would be implemented this year. However, we have again identified a high volume of substantive errors and presentational issues in the scheme financial statements presented for audit which have resulted in additional work for both auditors and SPPA staff. This contributed to delays in clearing the accounts.

46. We recommend that SPPA further reviews its quality control process, with specific consideration being given to: establishing a set of formal guidelines for all staff involved in the process; and, improving co-ordination between business units, particularly between Finance and Operations.

Action plan 4

Control over contributions

47. We have previously highlighted, over a number of years, the absence of a reconciliation process between actual contributions received from employers (which is now managed within EPICOR) and AXISe data derived from employer annual returns. In our view, this is a key control over the completeness and accuracy of contribution income.

48. In response SPPA has started to carry out reconciliations on a sample basis, looking at small employers last year and larger employers this year. However, we found that the results from last year showed small error rates on both schemes which were not fully investigated and the results from this year's work were not available at the time of our audit. Whilst this sample testing may be useful in targeting higher risk areas, in our view its effectiveness is limited when compared to annual reconciliation across all employers.

49. We found that the ratio reports produced by EPICOR were not being used for monitoring purposes by finance staff. This report enables staff to identify where the relationship between employer and employee contributions is outside normal parameters, which could be as a result of under or over-payments. In our view, given long standing weaknesses in contribution reconciliations procedures, it is a particularly important control.

50. Our testing identified that one Council had been paying employer contributions at the wrong rate for two and a half years, resulting in a £1 million underpayment to the Teachers' scheme. The controls in operation had not identified this. Amounts due have subsequently been recovered and the accounts have been corrected accordingly. Following notification of this error, SPPA conducted a review of contributions and has confirmed that this was an isolated incident. However, the underpayment illustrates the risks associated with weak reconciliation controls.

Action plan 5 - 7

Other significant issues

51. Other significant issues identified and reported on in the course of our audit of the accounts included:

- a posting error of £9.6 million between the schemes was not identified by SPPA controls
- insufficient evidence to substantiate capitalised receipts of £7.3 million from NHS employers
- limited disclosure of membership data
- underlying error rates in the calculation of awards and an increase in the level of award overpayments to £1.2 million
- limited progress in making legacy refunds.

Action plan 8 - 13

SPPA financial position

52. Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based.

53. Auditors consider whether audited bodies have established adequate arrangements and examine:

- financial performance in the period under audit
- compliance with any statutory financial requirements and financial targets
- ability to meet known or contingent, statutory and other financial obligations
- responses to developments which may have an impact on the financial position
- financial plans for future periods.

54. These are key areas in the current economic circumstances. This section summarises the financial position and outlook for the organisation.

Financial results 2010/11

55. Overall, SPPA operated within the budget limits set by the Scottish Government.

56. During financial year 2010/11 SPPA recorded income of £0.2 million from operating activities and received net funding of £9.2 million (2009/10 £10.8 million) from the Scottish Government. The Agency incurred a net operating cost (excluding cost of capital) of £10.3 million (2009/10 £10.6 million) against a budget of £10.7 million; a net underspend of £0.4 million on operating costs (2009/10 £0.6 million). There was a net underspend of £0.5 million (2009/10 £0.2 million) against the capital budget of £1.1 million (2009/10 £2.1million).

Exhibit 1: Performance against resource budget 2010/11 (£ million)

Limits	Budget	Outturn	Difference
Operating	10.7	10.3	0.4
Capital	1.1	0.6	0.5
Total	**11.8**	**10.7**	**0.9**

Source: SPPA annual accounts 2010/11

Budgetary control

57. Our review of SPPA budget setting and monitoring arrangements was satisfactory. We found that senior management were receiving budget monitoring reports on a regular (monthly) basis. Action was taken by management to address any negative variances. Initiatives to

control expenditure in 2010/11 included a voluntary exit scheme, and the establishment of a Programme Board which identified a range of projects and tasks designed to improve efficiency and reduce costs.

Financial position at 31 March 2011

58. SPPA statement of financial position at 31 March 2011 shows total net assets of £6.3 million compared to £7.2 million as at 31 March 2010, with the decrease due mainly to disposal of software licences. There were no other significant movements.

Workforce reduction

59. During 2010/11 SPPA was part of a Scottish Government wide Early Retirement Scheme under which seven employees of different grades chose to accept packages at a total cost of £0.2 million. Further reductions in staff are likely during 2011/12.

Outlook

2011/12 budget

60. Scottish Ministers have agreed a resource budget for the SPPA of £11.2 million for 2011/12. This comprises operating expenditure of £10.7 million and capital expenditure of £0.5 million. This represents an increase of £0.3m or 2.8% from 2010/11 (Exhibit 2). Taking into account the impact of wage and other inflation, this allowed the Agency to limit the reductions in its overall staffing complement to 8.3 full time equivalent posts compared to the 2010/11 complement.

Exhibit 2: Outturn 2010/11 against resource budget 2011/12 (£ million)

Limits	Outturn 2010/11	Budget 2011/12
Operating	10.3	10.7
Capital	0.6	0.5
Total	**10.9**	**11.2**

Source: Scottish Government Spending Plan and draft budget 2011/12

61. The increase in budget recognises the significant challenges facing SPPA over the next few years as a result of the UK government's pension reform proposals.

Schemes' financial position

Financial results 2010/11 - NHSSS

Outturn 2010/11

62. The NHS Superannuation Scheme (Scotland) had net income for the year of £1,671 million, an increase of 235% (£2,911 million) from 2009/10 (outgoings £1,240 million). This increase is due mainly to the change in indexation from retail price index (RPI) to consumer price index (CPI). Scheme liabilities have decreased by £4,100 million (14.5%) from £28,200 million to £24,100 million. The increase in the liability for the prior period was £8,800 million (45.4%).

63. In accounting for pensions, International Accounting Standard 19 (Employee Benefits) is based on the principle that an organisation should account for retirement benefits at the point at which it commits to paying them, even if actual payment will be made in future years. This requirement results in very large future liabilities being recognised in financial statements. In summary, the IAS 19 liability has moved as shown in exhibit 3 since the standard was first introduced in 2003/04.

Exhibit 3: NHSSS IAS 19 liability (£ billion)

	2003/04 £billion	2004/05 £billion	2005/06 £billion	2006/07 £billion	2007/08 £billion	2008/09 £billion	2009/10 £billion	2010/11 £billion
IAS 19 Liability	11.6	12.7	16.2	21.9	21.1	19.4	28.2	24.1

Source: NHSSS published accounts from 2003/04 to 2010/11

Financial results 2010/11 - STSS

Outturn 2010/11

64. The Scottish Teachers' Superannuation Scheme had net income for the year of £811.4 million, an increase of 172% (£1,944 million) from 2009/10 (outgoings of £1,133 million). The increase is due mainly to the change in indexation from retail price index to consumer price index. Scheme liabilities have decreased by £2,400 million (9.8%) from £24,370 million to £21,970 million. The decrease in the liability is due largely to changes in actuarial assumptions, particularly the discount rate.

65. In summary, the IAS19 liability has moved as set out in exhibit 4 since 2003/04:

Exhibit 4: STSS IAS 19 liability (£ billion)

	2003/04 £billion	2004/05 £billion	2005/06 £billion	2006/07 £billion	2007/08 £billion	2008/09 £billion	2009/10 £billion	2010/11 £billion
IAS 19 Liability	10.7	12.4	14.6	18.7	19.3	18.4	24.4	21.9

Source: STSS published accounts from 2003/04 to 2010/11

Outlook

Pension reform

66. The Hutton review of public sector pension schemes was commissioned by the UK Government and forms the basis of major reforms proposed by the government to all public sector schemes across the UK. The first of these changes has already been implemented, namely a change in the annual indexation of pension payments and liabilities, from RPI to CPI. The government has also announced that employee contributions for some of the larger unfunded schemes should increase by an average of 3.2% of pay by April 2014, with the increase being implemented in stages commencing April 2012. These proposals are being applied to both STSS and NHSSS, with further major reforms anticipated.

67. The pension reform agenda presents a significant challenge for SPPA, especially in terms of resourcing the additional work load involved at a time when the public sector is under pressure to reduce costs. In recognition of these circumstances, the Scottish Government has agreed an increase in SPPA's budget provision over the current spending review period, with the possibility that additional funding may be required beyond that period. Nevertheless, the changes proposed will require strong financial and operational management within SPPA if they are to be delivered on time and within budget limits.

Governance and accountability

68. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all audited bodies, whether their members are elected or appointed, or whether they comprise groups of people or an individual accountable officer.

69. Through its chief executive or accountable officer, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.

70. Consistent with the wider scope of public audit, auditors have a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to:

- corporate governance and systems of internal control
- the prevention and detection of fraud and irregularity
- standards of conduct and arrangements for the prevention and detection of corruption.

71. In this part of the report we comment on key areas of governance.

Corporate governance

Management structure

72. The Chief Executive of SPPA is the accountable officer responsible for the administration of SPPA. The role of the Accountable officer is supported by an External Management Board comprising four non-executive directors. There is also an Audit and Risk Committee (ARC) comprising three non-executive directors. The Board and the ARC meet three or four times annually.

73. There is also a Senior Management Team (SMT) comprising the directors of SPPA which is chaired by the Chief Executive. The SMT meets monthly as part of the Agency's formal monitoring and accountability processes.

Internal control

74. The Statements on Internal Control provided by the SPPA Accountable Officer reflected the main findings from both external and internal audit work. These recorded management's responsibility for maintaining a sound system of internal control and set out SPPA's approach to this. For both NHSSS and STSS, the respective Statement included a paragraph by SPPA drawing attention to the need for improved controls over contribution income and the accounts preparation process.

Prevention and detection of fraud and irregularities

75. Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. Auditors review and report on these arrangements.

76. The SPPA has appropriate arrangements in place to help prevent and detect fraud, inappropriate conduct and corruption, including policies and codes of conduct for staff and Board members. It has a policy of not accepting gifts or hospitality. During the audit we examined staff expenditure (e.g. travel), gifts and hospitality to ensure procedures had been complied with. We found items had been appropriately recorded and authorised.

NFI in Scotland

77. The National Fraud Initiative (NFI) in Scotland brings together data from councils, police boards, fire and rescue boards, health bodies and other agencies, to help identify and prevent a wide range of frauds against the public sector. The Chief Executive and the Director of Corporate Services have expressed their support for the exercise and results and updates of NFI investigations are reported to the Audit and Risk Committee. SPPA has taken part in the NFI exercise for the third time this year and has made good progress in reviewing the NFI reports and taking appropriate action. Work is on-going to investigate a number of matches and at the time of the audit SPPA had recovered £64,000.

Standards of conduct and arrangements for the prevention/ detection of bribery and corruption

78. Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and have proper arrangements in place for implementing and monitoring compliance with standards and codes of conduct, standing orders and financial instructions. Auditors consider whether bodies have adequate arrangements in place. We have concluded that the arrangements in SPPA are satisfactory and we are not aware of any specific issues that we need to identify in this report.

Best Value, use of resources and performance

79. Accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value.

80. The Auditor General may require that auditors consider whether accountable officers have put in place appropriate arrangements to satisfy their corresponding duty of Best Value. Where no requirements are specified for auditors in a period they may, in conjunction with their audited bodies, agree to undertake local work in this area.

81. As part of their statutory responsibilities, the Auditor General and the Accounts Commission may procure, through Audit Scotland, examinations of the use of resources by audited bodies and publish reports or guidance. Auditors may be requested from time to time to participate in:

    - a performance audit which may result in the publication of a national report
    - an examination of the implications of a particular topic or performance audit for an audited body at local level
    - a review of a body’s response to national recommendations.

82. Auditors may also consider the use of resources in services or functions, where the need for this is identified through local audit risk assessments

83. During the course of their audit appointment auditors should also consider and report on progress made by audited bodies in implementing the recommendations arising from reviews in earlier years.

84. This section includes a commentary on the Best Value/ performance management arrangements within SPPA. We also note any headline performance outcomes/ measures used by SPPA and any comment on any relevant national reports and the body's response to these.

Management arrangements

Best Value

85. In March 2011, the Scottish Government issued new guidance for accountable officers on Best Value in Public Services. The new guidance, in essence, required public bodies to take a systematic approach to self-evaluation and continuous improvement.

86. The guidance identifies the themes which an organisation needs to focus on in order to deliver the duty of Best value, but notes that implementation should be appropriate and proportionate to the priorities, operating environment, scale and nature of the body's business.

87. The five themes and two cross-cutting themes (some of which we have commented on earlier in this report) are:

- vision and leadership
- effective partnership
- governance and accountability
- use of resources
- performance management
- equality (cross-cutting)
- sustainability (cross-cutting).

Vision and strategic direction

88. The Scottish Public Pensions Agency published its corporate plan for 2008 – 2011 in May 2008. The plan focuses on four key themes:

- Improving service quality
- Improving organisational efficiency
- Expanding organisational knowledge, and
- Developing and supporting our staff.

89. The corporate plan also noted fifteen key challenges during 2008-09 to 2010-11 that would affect these themes.

90. Within each theme the SPPA has set key milestones for action within yearly timescales. The SPPA will have to keep targets under review to ensure achievement of key actions. The delivery of the corporate plan objectives will be particularly challenging given the tight financial constraints over the same period. This is an area we will keep under review.

Performance management

91. The Agency Board regularly reviews the SPPA's performance against the corporate plan through quarterly performance reports. The reports are discussed in Board meetings and the format of the report is tailored to the issues being reported to ensure that appropriate information is provided.

Risk management

92. There a number of key challenges and risks for the Agency in delivering its plan. The Board has put in place appropriate systems for the identification and management of risk with the adoption of a single corporate risk register, corporate risk management policies and the issuing of guidance for managers. These corporate risk arrangements are supported by directorate risk registers and arrangements. A continuing challenge for the Agency is embedding a risk aware culture within the organisation for the future management of existing and emerging risks in the medium to long term.

Performance overview

93. The Scottish Public Pension Agency's corporate plan identifies ten key performance targets between 2008 and 2011. Of these, one - 'realise efficiency gains and service improvements following the introduction of new pensions administration IT system' - is not applicable this year.

94. Of the remaining eight targets, six have been achieved. The target relating to customer satisfaction levels was not achieved due in the main to adverse customer assessments of the new telephone call management system. The system is being modified to address these criticisms. The other missed target relates to the replacement of the payroll system, which has been deferred following a decision to continue with the existing system.

National performance reports

95. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. Reports in the last year of direct interest to SPPA are set out in 5. All of these reports can be accessed our web site.

Exhibit 5: Selected performance audit reports 2010/11

- Improving energy efficiency: a follow-up report
- Scotland's public finances: responding to the challenges
- The cost of public sector pensions in Scotland

Source: www.audit-scotland.gov.uk

96. The report on *the cost of public sector pensions in Scotland* set out a number of recommendations for the Scottish Government in considering how to respond to the findings of the Independent Public Services Pensions Commission. These included:
    - providing a clear statement of the aims and objectives of the public sector pension schemes in Scotland
    - ensuring that it is meeting these aims and objectives by putting put in place arrangements to scrutinise pension provision across the public sector in Scotland, within the context of other aspects of public sector pay and conditions; and as part of this, consider increasing the role of experts to strengthen scrutiny and decision-making
    - considering whether differences among schemes in areas such as contribution rates and level of benefits are necessary to realise the objectives of each scheme
    - within the legal and financial constraints which apply, deciding how best to incorporate changes made at a UK level into the equivalent Scottish schemes to meet its objectives for public sector pension schemes in Scotland.

97. As noted above supporting pension reform will be a key issue for SPPA in the years ahead.

Appendix A: audit reports

External audit reports and audit opinions issued for 2010/11

Title of report or opinion	Date of issue	Date presented to Audit Committee
Annual Audit Plan – SPPA, NHSSS, STSSS	18 January 2011	18 January 2011
Review of EPICOR	12 July 2011	19 July 2011
Report on financial statements to those charged with governance -SPPA	6 July 2011	19 July 2011
Audit opinion on the 2010/111 financial statements-SPPA	2 September 2011	2 September 2011
Report on financial statements to those charged with governance -Schemes	20 October 2011	25 October 2011
Audit opinion on the 2010/11 financial statements-Schemes	31 October 2011	October 2011

Appendix B: action plan

Key Risk Areas and Planned Management Action

Action Point	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1	**Capacity** Continuing issues raise questions about the capacity of the Agency to effectively deal with its existing workload, improve the control environment and meet the significant challenges that lie ahead. We recommend that the Agency considers how best to ensure it has sufficient capacity in the following areas: • Board/ Audit Committee • Senior Management Team • Finance teams • General staffing mix • Succession planning.	Agreed. The Agency will conduct a strategic review by January 2012 to identify areas where further resourcing may be required, and where succession planning arrangements need to be strengthened. This will be discussed with the External Management Board who, together with the Audit and Risk Committee, will undertake similar reviews at their meetings in February 2012.	Chief Executive	31 March 2012

Action Point	Risk Identified	Planned Management Action	Responsible Officer	Target Date
2	**Delays in scheme valuations** Late changes were necessary to the valuation of Teachers' scheme liabilities as a result of changes to membership profile. Employers have not been formally notified of the suspension of scheme valuations. We recommend that the Agency puts arrangements in place to consider the implications of changes to membership profile for interim valuations and to keep employers informed about the progress of valuations.	Agreed. SPPA will ensure that membership profile data are updated each year, and that any changes are assessed by the Schemes' actuary in order to establish their impact on overall liabilities. Once HMT have established the timings of future valuations we will determine the appropriate timescales for the production of interim valuations. SPPA will continue to inform stakeholders about progress of valuations through its existing use of stakeholder meetings, circulars, website and newsletters.	Director of Finance/ Director of Operations Director of Operations	Data to GAD by 30 April
3	**Contribution figures used in actuarial valuations** Actuarial valuations were based on estimated contribution figures that were superseded. We recommend that SPPA improve its procedures to ensure the provision of up-to-date information to the actuary.	Agreed. Actuarial valuations are based on the recorded contributions. A new, web-based, contributions process will be developed in 2012-13 and implemented for the 2013-14 financial year. This will help eliminate most known error types and will ensure that accurate information is available to the actuary at an earlier stage.	Director of Finance	New Web based contributions process to be implemented by 31 March 2013

Action Point	Risk Identified	Planned Management Action	Responsible Officer	Target Date
4	**Weaknesses in accounts preparation process** Weaknesses in scheme accounts preparation process contributed to errors arising and not being detected, which also contributed to delays in clearing the accounts. We recommend the Agency improves quality control over preparation of the scheme accounts.	Agreed. The Agency's strategic staffing review will consider the specific skills and resources required (refer to recommendation 1). We will also consider the scope for reducing error through the refinement of existing processes and the creation of system-based solutions to replace manual processes (refer to recommendation 3).	Director of Finance	31 March 2012 (Staffing); 31 March 2013 (System-based solutions)
5	**Reconciliation of contribution income with annual returns** Reconciliation of employer contributions continues to be ineffective. We recommend the introduction of annual reconciliations of contributions from all employers.	Agreed in part. The Agency will continue to develop its existing targeted and risk-based procedures in this area which focus on larger employers and those that are assessed as high risk. Due to the delays inherent in the processes by which employers provide SPPA with annual returns, it is not possible at this stage to reconcile 100% of returns in time to inform the annual accounts process.	Director of Finance	-

Action Point	Risk Identified	Planned Management Action	Responsible Officer	Target Date
6	**EPICOR ratio reports** Ratio reports produced by EPICOR were not being used for monitoring purposes. We recommend regular review of ratio reports, and the follow-up of any identified anomalies.	Already implemented. Epicor reports were written late in 2010-11 to compare the ratios of employers' and members' contributions. These are now being used to provide assurance on the accuracy of contributions received in Finance and to identify any follow up actions that may be required.	Director of Finance	Implemented
7	**EPICOR processing problems** Up to 25% of SCAN documents submitted every month by employers are being rejected by the system due to input errors by employers. In addition, duplicate invoices are also being created on the system as a result of employers sending in scan documents for the wrong month or submitting them twice. These issues are mainly caused by failures on the part of employers, which are not wholly within the control of SPPA. We recommend that the Agency reviews its processes in these areas with a view to minimising the impact of input errors by employers.	Agreed. The Agency has already approved a proposal to replace the current workflow process for contributions returns (SCAN forms) with a web-based system. This will contain a number of error-trapping routines, and is expected to eliminate the processing difficulties that were experienced in 2010-11 after the introduction of Epicor. We aim to have this system operational during Q4 2012-13.	Director of Finance	Q4 2012-13

Action Point	Risk Identified	Planned Management Action	Responsible Officer	Target Date
8	**Posting error between schemes** During review of reports from EPICOR we found that receipts and adjustments for the STSS had been wrongly posted to the NHSSS, resulting in an error of £9.6m between the schemes. The error arose from a manual posting mistake in EPICOR. We recommend that SPPA reviews its supervision and control procedures in this area.	Agreed. System changes developed at 7 (above) should result in the elimination of most errors. In addition, we will review our checking and authorisation arrangements.	Director of Finance	31 March 2013 (system enhancement); 31 March 2012 (procedures review)
9	**NHSSS capitalised receipts** There are £7.3m of capitalised pension receipts in the 2010/11 accounts relating to the costs of early retirement that require to be met by employers. We were unable to verify this figure due to insufficient supporting documentation. SPPA has explained that this was a bulk exercise by NSS covering some 170 cases for which no individual paperwork is available. In these circumstances the Agency has not been able to check the accuracy of calculations or retained evidence that such calculations have been checked. There is therefore a risk that liabilities that should fall on employers are being picked up by the scheme. We recommend that SPPA obtains and checks the supporting documentation for these cases, ensuring that full documentation is retained.	Agreed in part. For all future cases the Agency will continue with its current arrangement which is to provide full documentation for each case. In respect of past cases associated with the bulk exercise for 270 NHS employees, the Agency has all relevant data for each individual (albeit not in the usual format) and does not believe that a retrospective re-presentation of those data is necessary.	Director of Operations	-

Action Point	Risk Identified	Planned Management Action	Responsible Officer	Target Date
10	**Membership data** The suggested format for these pension scheme accounts (the Magenta model issued by HM Treasury) includes disclosure of in-year movements for active and preserved members as well as for pensioners and dependents in payment. However, SPPA has been unable to include the required disclosures due to continuing concerns about data reliability. Indeed, the disclosures this year are less extensive that those made last year. Delays in providing membership statistics increase the risk of changes in membership profiles not being identified and acted upon as part on the annual valuation process. We recommend that this disclosure is included in the 2011/12 accounts.	Agreed. SPPA will provide disclosures along the lines suggested for future accounts but notes that this is not an obligatory requirement of HM Treasury's guidance on the format of scheme accounts. Raw unverified data will be available at the end of July, but more refined data will be available in September.	Director of Finance/ Director of Operations	15 September 2012

Action Point	Risk Identified	Planned Management Action	Responsible Officer	Target Date
11	**Quality Assurance error rates** Quality assurance monitoring of new pension awards during the year by SPPA have found overall error rates of 5.58% and 2.13% (by volume) on cases examined for the STSS and NHSSS respectively. Although error rates have improved compared to previous years, no quantification of the financial effect is undertaken. The quality control work undertaken by SPPA in this area is in our view a key control over the accuracy of total annual award payments. We recommend that the Agency improves its evaluation of error rates, to quantify the financial impact of identified errors.	Agreed. This will be implemented with effect from 1 April 2012.	Director of Operations	1 April 2012
12	**Overpayments of pension awards** The amount of reported overpayments of awards has increased significantly this year to £1.2m. We have been advised that the increase is mainly due to improvements in accounting procedures within EPICOR, which now identifies these amounts whereas previously they were not monitored via the accounting system. We recommend that the Agency monitors error levels and ensures appropriate corrective action is taken.	Agreed. Overpayments are now reported monthly to the Senior Management Team and to each meeting of the External Management Board. An annual review of the lessons learned will be presented to the Audit and Risk Committee in February 2012, with a discussion on the future reporting cycle to be agreed at that meeting.	Director of Finance	February 2012 (future reporting arrangements)

Action Point	Risk Identified	Planned Management Action	Responsible Officer	Target Date
13	**NHSSS Legacy refunds** Last year's NHSSS accounts included a liability of £15 million representing refunds due to approximately 30,000 former short service members who are not entitled to pension benefits. The liability has decreased to £10.9 million as at 31 March 2011. The reduction includes corrections totalling £1.5 million and payments of £2.6m during the year. In our view, overall progress in making refunds has been slow, with a significant sum still to be settled. We recommend that the Agency settles outstanding refunds at the earliest opportunity.	Agreed. Between March and December 2011 the arrears of casework have been reduced by a further 60% and only 20% of the original figure remains to be processed. The SPPA is therefore on target to achieve full resolution of the problem by 31 March 2012.	Director of Operations	31 March 2012