Scottish Public Pensions Agency

Annual report on the 2012/13 audits

AUDIT SCOTLAND

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

December 2013

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.

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Key messages

2012/13

The Scottish public sector is experiencing significant financial challenges in providing expected levels of service within the agreed financial framework. In 2012/13 we assessed the key strategic and financial risks faced by the Scottish Public Pensions Agency (SPPA). We audited the financial statements of the SPPA, the NHS Superannuation Scheme (Scotland) (NHSSS) and the Scottish Teachers' Superannuation Scheme (STSS). We also reviewed the use of resources and aspects of governance and performance management arrangements. This reports sets out our key findings.

Financial statements

We have given unqualified opinions on the financial statements of all three accounts for 2012/13.

The STSS financial statements required to be restated as a result of the actuary identifying a significant error in terms of the information entered into its detailed actuarial calculations. The estimate of the pension liability previously included in the financial statements for 2011/12 was overstated by £1.8 billion. The effect of the restatement was a decrease in the total comprehensive net expenditure for the year ended 31 March 2012 by £1.8 billion and a corresponding decrease in the general fund. The error affected the actuarial gains and losses. It did not affect the scheme's net expenditure for the year or outturns on the Scottish budget for 2011/12.

While the error in the published 2011/12 accounts was unwelcome, we are content that the SPPA and the actuary responded appropriately once it was identified. The actuary has outlined a number of improvements it is making to its processes. SPPA should ensure that it is monitoring the implementation of these. We are satisfied that appropriate adjustments and disclosures have been made in the 2012/13 STSS financial statements. The SPPA also confirmed that NHSSS valuations were not affected.

The SPPA purchased the Tweedbank property used as its headquarters building toward the end of 2012/13. Following an independent valuation, the property was included in the accounts based on the valuation on a Depreciated Replacement Cost basis. The valuer judged that the asset was of a size and location that meant there was no relevant or reliable evidence of sales involving a similar property, meaning that it was not appropriate to value the asset based on market value. As a result of the purchase and revaluation of the property, impairment costs of £701,000 were incurred. We are content that the property has been valued in line with accounting requirements and that the relevant accounting entries have been made.

Financial position and use of resources

SPPA and both scheme accounts operated within the 2012/13 budgets. SPPA'S budget setting and monitoring arrangements we noted as being satisfactory. SPPA expects spending in the next 2 to 3 years to remain within budget.

Governance and accountability

We found that overall, the SPPA had sound corporate governance arrangements in place and that they operated effectively during 2012/13. We examined the organisation's key financial systems underpinning the organisation's control environment and concluded that they operated sufficiently well for us to place reliance on them. Internal audit provided assurance in respect of SPPA's risk management, controls and governance arrangements and also in relation to the Scottish Government's corporate systems shared with SPPA.

Performance and best value

The SPPA's operational performance is formally reviewed by the External Management Board and Senior Management Team on a regular basis. Good performance against key performance targets was reported for the year.

Outlook

The extent of the change agenda facing the Agency will present significant challenges to the organisation's capacity. Changes required include the implementation of increases in employee contributions, the establishment of new pension schemes from 1 April 2015, new responsibilities for the administration of police and fire schemes and associated changes to IT and managerial systems. Planned increases in the available budget will help provide some additional capacity, but ensuring that effective programme and project management and good oversight arrangements are in place will be critical for the Agency.

As changes to pension schemes are implemented this will have a consequential impact on the overall cost of the schemes and how these are shared between employers, employees and the UK and Scottish Governments. Full actuarial valuations are expected to conclude in 2014 in line with HM Treasury directions and will be used to set future contribution levels. It will be necessary to manage the financial consequences of schemes against a backdrop of continuing restraints in overall government spending.

Introduction

1. This report is the summary of our findings arising from the 2012/13 audit of Scottish Public Pensions Agency (SPPA), the NHS Superannuation Scheme (Scotland) (NHSSS) and the Scottish Teachers' Superannuation Scheme (STSS). The purpose of the annual audit report is to set out concisely the scope, nature and extent of the audit, 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 Accountable Officer (and other members of the board) 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 & Risk committee 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 Audit & 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 our attention during our 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. We 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.

9. We review and report on, as appropriate, other information published with the financial statements, including the directors' report, management commentary, governance statement and the remuneration report. We also review and report on the Scottish Government Consolidation Pack incorporating 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 SPPA for 2012/13 give a true and fair view of the state of the body's affairs and its net operating cost for the year.

11. SPPA is required to follow the 2012/13 Government Financial Reporting Manual (the FReM) and we confirmed that the financial statements have been properly prepared in accordance with the FReM. We also confirmed that relevant parts of the remuneration report had been properly prepared and that information given in the directors' report and management commentary was consistent with the financial statements.

12. We also reviewed the Governance Statement and concluded that it complied with Scottish Government guidance.

Regularity

13. We confirmed that the expenditure and income in the financial statements was in accordance with applicable legislation and Ministerial guidance, the Budget Act for 2012/13 and legislation governing sums paid out of the Scottish Consolidated Fund.

Accounting issues

Accounts submission

14. The accounting statements were submitted for audit on 3 June, in accordance with the agreed timetable. The audit fieldwork was substantially completed on 21 June. The issues arising

from the audit were discussed with the Director of Finance and Deputy Director of Finance at meetings on 19 and 28 June. The Audit and Risk Committee considered the draft accounts and the findings from our audit at its meeting on 16 July 2013.

15. The Agency obtained an updated valuation of the headquarters building as described in paragraphs 16 to 19 below, and the accounts were unable to be finalised until this was received. Once the valuation was received, the accounts were appropriately amended to reflect the new valuation and the audit was able to be concluded. The audit certificate was issued on 22 August 2013.

Significant findings

16. **Property purchase and revaluation**: On 28 March 2013 the Agency bought the Tweedbank site it had occupied since 2002, at a cost of £4.8 million. The property was appropriately recognised as an addition to non-current assets, initially at purchase cost. The FReM requires non-current assets to be carried at valuation at the end of the reporting period. Following discussion of available options, on 12 July the Agency commissioned District Valuer Services (DVS) of the Valuation Office Agency to undertake a revaluation of the property as at 31 March 2013 for inclusion in the accounts.

17. The valuation report was received on 5 August 2013, and valued the land and building at £4,333,300. The FReM states that it is for the valuer to select the most appropriate valuation methodology using the Royal Institution of Chartered Surveyors professional standards, following discussion with the client. The valuer determined that Depreciated Replacement Cost was the most appropriate methodology in this case, on the grounds that the property was a specialised asset by virtue of it being of a size and location where there is no relevant or reliable evidence of sales involving a similar property.

18. Valuation using Depreciated Replacement Cost estimates how much it would cost to build the existing property from scratch (ignoring any financing costs). The Valuation Report also includes an assessment on the basis of Market Value - that is the estimated amount the property would be exchanged for between a willing buyer and a willing seller in an arms length transaction on the open market. This is significantly lower, recognising the lack of an active market for office buildings of this type in the area where SPPA is based.

19. The Tweedbank property was valued in the accounts at £4.333 million based on the valuation obtained. This resulted in an impairment of £0.479 million being charged to operating costs during the year. We are content that the property has been valued in line with the requirements of the FReM and that the relevant accounting entries have been made correctly.

20. **Leasehold Improvements**: At the point the Tweedbank property was purchased, leasehold improvements previously made to the building were being recognised as a non-current asset. We highlighted that following purchase of the building, these amounts required to be written off - with the valuation of the building as a whole reflecting the improvement works that had been previously undertaken. As a result an impairment of £0.222 million was charged to operating costs during the year. We are content that the relevant accounting entries were made correctly.

NHSSS and STSS Financial statements

Audit opinions

21. We have given unqualified opinions on the financial statements of NHSSS and STSS for 2012/13, concluding that each give a true and fair view of the state of the scheme's affairs and its net resource outturn and net cash requirement for the year.

22. SPPA is required to follow the 2012/13 Government Financial Reporting Manual (the FReM) in preparing scheme accounts and we confirmed that the financial statements have been properly prepared in accordance with the FReM. We also confirmed that information given in the Reports of the Managers, Statements by the Actuary, and Statements of the Accountable Officer's responsibilities were consistent with the financial statements.

23. We also reviewed the Governance Statements and concluded that they comply with guidance from the Scottish Ministers.

Regularity

24. We confirmed that the expenditure and income in the financial statements was in accordance with applicable legislation and Ministerial guidance, the Budget Act for 2012/13 and legislation governing sums paid out of the Scottish Consolidated Fund.

Going concern

25. In common with some other public pension schemes, the NHSSS and STSS are unfunded. The pension liabilities recorded in the financial statements are not matched by investments or other assets, and consequently the schemes show net liabilities of £29.1 billion and £24.0 billion respectively. The accounts of the schemes are prepared on a going concern basis given that funding to meet pension payments, as they fall under the Schemes' regulations, is made available from the Scottish Government's budget.

Accounting issues

Accounts submission

26. The financial statements were submitted for audit on 22 July, in accordance with a pre-agreed timetable. The audit fieldwork was completed on 20 September. The issues arising from the audits were included in matters arising schedules issued to the Deputy Director of Finance on 18 September. The more significant issues arising were discussed with the Director of Finance, the Deputy Director of Finance and the schemes' Finance Manager at a clearance meeting on 19 September.

27. Our ISA 260 report was presented to the Audit and Risk Committee on 8 October. The financial statements were signed by the Accountable Officer on 23 October and the auditor's opinions were signed thereafter, in line with the agreed timetable.

Error in prior year valuation of STSS liability

28. In January 2013 the actuary, the Government Actuary's Department (GAD), identified that it had made a significant error in estimating the STSS pensions liability at 2011/12. As a result, the estimate of the pension liability previously included in the financial statements for 2011/12 was overstated by £1.8 billion. The financial statements of 2011/12 were therefore restated in the 2012/13 accounts to correct this error. The effect of the restatement was a decrease in the total comprehensive net expenditure for the year ended 31 March 2012 by £1.8 billion (from £23.6 billion to £21.8 billion) and a corresponding decrease in the general fund. The error affected the actuarial gains and losses. It did not affect the scheme's net expenditure for the year or outturns on the Scottish budget for 2011/12.

29. The actuary's assessment for the 2011/12 financial statements was compromised by errors in some of the information it entered into detailed actuarial calculations. The actuary recognised that flaws in its processes meant these were not detected by its review and checking processes. The actuary made it clear that in its view the SPPA could not be expected to have identified the error. The SPPA's External Management Board considered explanations from GAD as to the cause of the error, and received assurances that GAD had reviewed and revised its procedures to prevent a recurrence of such an error. We are satisfied that appropriate adjustments and disclosures have been made in the STSS financial statements. The SPPA also confirmed that the NHSSS valuations were not affected.

30. On 26 April 2013, the Cabinet Secretary for Finance, Employment and Sustainable Growth wrote to the convenors of the Scottish Parliament's Public Audit and Finance Committees to bring the error in the valuation included in the 2011/12 accounts to the attention of Parliament. Following a request for further information from the Public Audit Committee, the Cabinet Secretary outlined further details of the circumstances and reasons for the error. This incorporated a letter from the Government Actuary which included a summary of the changes being made to procedures to avoid such a situation arising again in the future. More detail was provided in a further letter to SPPA from the Deputy Government Actuary: Director of Actuarial Operations.

31. The published accounts of public sector organisations are a key part of the framework for government. Transparent, comprehensive and reliable financial reporting supports accountability, decision making and public confidence. Where a significant error is made in the figures reported, it can undermine this process. Such cases are rare. Where they do arise it is important that there is transparency about the error and how it arose, that the error is corrected at an appropriate point and that the organisations concerned learn from the incident and take action to avoid it happening again.

32. While the error in the published 2011/12 accounts was unwelcome, we were content that SPPA and GAD responded appropriately once it was identified, by acting to correct the error

and avoid a re-occurrence. GAD has outlined a number of improvements to its processes which it is making through time, and SPPA should ensure that it is monitoring the implementation of these - seeking further information and assurance from its actuary where necessary.

Refer Action Plan No. 1

Valuation of scheme liabilities

33. The actuarial valuations prepared by GAD are the most significant input to the scheme accounts. They determine the pension liability in the balance sheet and the accrued pension costs reported in the revenue account.

34. In October 2011 HM Treasury suspended all unfunded pension scheme valuations pending decisions by the UK Government on pension reform proposals. This suspension has now been removed and the next full actuarial and funding valuation of the schemes is due as at 31 March 2012. It is expected the results of this valuation will be ready in time for the 2013/14 financial statements. Pension liabilities for both schemes for 2012/13 were, nonetheless, valued using the methodology applied to a full valuation as outlined in the actuarial reports.

35. Employer contribution rates are based on previously published full valuations - the 2004 valuation in the case of NHSSS and the 2005 valuation in the case of STSS. The Financial statements of both NHSSS and STSS included disclosure of the circumstances of the suspension of the valuations and the impact on employer contribution rates.

36. We were satisfied that the valuations of NHSSS and STSS were fairly stated and that details of the circumstances surrounding the delay in carrying out full valuations and the impact on employer contribution rates were appropriately disclosed.

Actuarial Methodology

37. The pension liabilities as at 31 March 2013 were based on a complete extract of the members' data as at 31 March 2008 for NHSSS and as at 31 March 2009 for STSS. The 2010/11 accounts relied on the assumption that the schemes' population will remain stable in terms of the profile of the membership of each category of member over these roll forward periods. For the 2011/12 accounts, a revised roll forward methodology, which is far less reliant on an assumption of stability, was introduced. In the opinion of the Actuary, the revised methodology is likely to produce a more reliable estimate of the liabilities as at 31 March 2012. This revised methodology was also used for the 2012/13 accounts.

38. The actuary has identified that the revised method has some weaknesses, notably, although the total liability should be reasonably reliable, the liabilities attributed to active members, deferred pensioners and pensioners may not reflect the actual membership in each category at the roll forward date. Also, in times of significant change in scheme membership, material experience gains and losses will not be recognised until further data becomes available.

39. Valuation methodology relies on judgement and assumptions for financial, demographic and mortality factors. We were satisfied that the methodology provided a reliable estimate of the NHSSS and STSS liabilities as at 31 March 2013.

Adjustments to Premature Retirement Provision

40. The NHSSS premature retirement provision was revalued at 31 March 2012 using new factors provided by GAD. During this exercise coding errors in pension records were identified which resulted in an understatement of the premature retirement provision for prior years. During 2012/13, the review of NHSSS pension records continued and further coding errors were highlighted impacting on the premature retirement provision. The premature retirement provision and the general fund liability increased by a further £3.2 million during 2012/13 as a result of the adjustment.

41. The STSS premature retirement provision was also reviewed in 2012/13 and similar coding errors were identified. This resulted in the premature retirement provision and the general fund liability increasing by £0.7million.

42. These adjustments were not material and were therefore made in year and affected the 2012/13 financial statements only. We were satisfied that appropriate adjustments were made in the financial statements. We also noted that these reviews are now complete and therefore no further adjustments will be necessary in future years.

Membership Data

43. Membership data as at 31 March 2008 for NHSSS and 31 March 2009 for STSS, together with the data as at 31 March 2013 forms the basis of the Actuary's statement. The membership data extracted from SPPA's Pension Administration and Payroll systems as at 31 March 2013 and provided to the actuary was not retained for audit purposes. To enable us to confirm that the actuarial valuations were appropriately informed by data for 2012/13, further work was carried out by SPPA staff to demonstrate the reasonableness of the data supplied to the actuary. We were content that this provided us with the necessary assurance. However, the Agency should ensure that it retains all information provided to support actuarial valuations for audit purposes.

Refer Action Plan No. 2

Outlook

44. There are no significant changes to the 2012/13 FReM that are expected to have an impact on the 2013/14 annual financial statements for either the Schemes or the Agency itself.

45. It has been agreed that following the creation of single Police and Fire and Rescue services for Scotland, responsibility for the administration of police and fire pension schemes will transfer to the Agency from 1 April 2015. Detailed accounting arrangements will require to be developed, and will most likely lead to the requirement for SPPA to produce further sets of accounts for these schemes from 2015/16.

SPPA Financial position

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

47. We 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.

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

Financial results

Annual outturn

49. Net operating costs during 2011/12 were £12.032 million and capital expenditure was £5.165 million. Cash funding of £14.489 million was received from the Scottish Consolidated Fund.

50. SPPA operated within limits set by the Scottish Government with a net underspend of £0.2 million against a budget of £17.1 million. Unplanned impairment costs arising from the purchase and revaluation of Tweedbank were offset by underspends in other operating costs.

Financial position

51. SPPA's statement of financial position shows a net asset position of £8.0 million as at 31 March 2013 which compares to a net asset position of £5.3 million the previous year. This increase largely reflects the acquisition of the Tweedbank property and the amortisation of IT software during the year.

Financial planning to support priority setting and cost reductions

52. The Scottish Government Draft Budget 2014-15 sets out SPPA's spending plans up to 2016. SPPA have received a modest budget increase to their running costs in both 2014/15 and 2015/16 to meet the additional costs associated with the implementation of Pension Reform. The Capital budget has also increased to enable SPPA to take forward the implementation of new IT systems to make the pension casework administration and management system fit for purpose and to replace current systems with a new integrated pension and payroll system.

Exhibit 1: SPPA's funding allocations 2013-2016

	2013/14 Budget £ million	2014/15 Draft Budget £ million	2015/16 Plans £ million
Running costs	11.9	12.5	13.0
Capital	1.1	2.8	12.2
Total	**13.0**	**15.3**	**25.2**

Outlook

2013/14 budget

53. Scottish Ministers have agreed a resource budget for the SPPA of £13.0 million for 2013/14. This comprises operating expenditure of £11.9 million and capital expenditure of £1.1 million. This represents an increase of £1 million or 8.33% from 2012/13.

54. Over the next couple of years, SPPA will continue to face the significant challenge of Pension Reform Agenda. The SPPA will have to ensure they have the necessary IT systems and business processes in place to meet the statutory deadline of April 2015 for the implementation of new pension schemes.

Schemes' Financial position

55. The pension schemes are funded from Annually Managed Expenditure, funded separately by Treasury from the Departmental Expenditure Limit settlement and, as such, variations in the scheme expenditure do not have to be balanced by adjustments elsewhere in the Scottish Budget. Budgets are subject to regular revision to meet the requirements of HM Treasury, the Office of Budget Responsibility and the Scottish Government.

56. 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.

Financial results 2012/13 - NHSSS

Annual outturn

57. The NHSSS's net expenditure for the year was £1,398 million, compared to net expenditure of £1,603 million in 2011/12. This movement is due mainly to an increase in contributions receivable together with a decrease in interest on scheme liabilities. The scheme liability has increased by £3.8 billion to £29.1 billion. This increase is due largely to a lower discount rate of 2.35% as set by HM Treasury, (2011/12 2.8%) but is also due to changes in actuarial assumptions, and experience gains/ (losses) on the scheme liability.

Financial results 2012/13 - STSS

Annual outturn

58. The STSS' net expenditure for the year was £1,152 million, compared to net expenditure of £1,375 million in 2011/12 (restated).This movement is due mainly to a decrease in interest on scheme liabilities. The scheme liability has increased by £2.2 billion to £24 billion. This increase is due largely to the lower discount rate, changes in actuarial assumptions, and experience gains/ (losses) on the scheme liability.

59. Accrued resources for the NHSSS and the STSS are covered by one limit in the Budget (Scotland) Act 2011. In 2012/13 the combined accrued resources of the NHSSS and the STSS of £2,550 million fell within the combined limit of £2,633.8 million.

Outlook

60. The budget figures originally set for 2013/14 have altered following the Autumn Budget Revision and are now at a combined figure of £2,667.6 million. Draft budget figures have been agreed for 2014/15 (£2,687.4 million) and there are planned figures for 2015/16 (£2,781.6

million). These increasing budgets reflect the expected increases in the cost of accruing members' pensionable service as a consequence of forecast reductions in the discount rate supplied by Treasury together with forecast increases in income.

Pensions reform

61. Some changes brought about by the Hutton review of public sector pension schemes have already been implemented. The government announced that employee contributions for some of the larger unfunded schemes should increase by an average of 3.2% of pay by April 2014. The first increment was applied from 1 April 2012 with the second annual increment of increases taking place in April 2013. In addition legislation took effect on 1 April 2012 by introducing tiered employee contribution rates for Teachers.

62. Partnership negotiations have taken place during the year to design the new schemes that are required by the longer term pension reforms. Agreement to the reformed scheme designs is expected during 2013/14 and planning for the transition to the new schemes has begun. The time available to achieve full implementation by the statutory deadline of April 2015 will be very challenging, but good progress has been made to date.

    As changes to pension schemes are implemented this will have a consequential impact on the overall cost of the schemes and how these are shared between employers, employees and the UK and Scottish Governments. Full actuarial valuations are expected to conclude in 2014 in line with HM Treasury directions and will be used to set future contribution levels. It will be necessary to manage the financial consequences of schemes against a backdrop of continuing restraints in overall government spending.

Governance and accountability

63. 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.

64. 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.

65. Consistent with the wider scope of public audit, we 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.

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

Corporate governance

Overall effectiveness

67. We found that overall, corporate governance arrangements operated effectively during 2012/13. Substantial assurance on the standards of governance applied across the SPPA can be provided as a result of processes and committees in place, and the work undertaken by Internal Audit. Reasonable assurance can be taken from the results of corporate systems reviews undertaken by Scottish Government colleagues.

Processes and committees

68. 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 five non-executive directors and the other members of the Senior Management Team (SMT). The main scrutiny process of SPPA is led by the Audit and Risk committee (A&RC) comprising three non-executive directors. They provide robust and professional challenge to the SPPA management on SPPA performance. The Board and the A&RC each meet four times annually.

69. The SMT comprises the directors of SPPA and is chaired by the Chief Executive. The SMT meets fortnightly as part of the SPPA's formal monitoring and accountability processes.

70. A new Director of Finance was appointed in June 2013, following the retirement of the previous postholder. The SMT has been strengthened by the addition of a Director of Business Change Programme, recognising the change agenda currently facing the organisation.

Internal control

71. While we concentrate on significant systems and key controls in support of the opinion on the financial statements, our wider responsibilities require us to consider the financial systems and controls of audited bodies as a whole. The extent of this work is informed by our assessment of risk and the activities of internal audit.

72. Overall the systems of internal control were operating effectively during 2012/13. This enabled us to take the planned assurance on these systems for the audit of the financial statements. There were no major findings from our review of internal control systems; however, we identified a small number of control weaknesses where improvements could be made to existing arrangements. Management have responded positively to our findings.

73. As part of our risk assessment and planning process, the Scottish Government external audit team reviewed and assessed the Scottish Government's Internal Audit Division (IAD) who also acts as the SPPA's internal auditors. The team concluded overall that internal audit complies with the Government's Internal Audit Manual. The review identified some areas for monitoring and/or improvement in the management and governance arrangements for the internal audit function, however the findings were mainly around resourcing. As a result of their assessment we were able to take assurance from the work of internal audit. We placed reliance on internal audit and carried out a comprehensive review of their working papers in the following areas:

- Payroll Preparation/Payment Time Lag
- Compliance Testing of Teachers and NHSS Awards
- Anti-Fraud Measures
- Benefit Statements
- Validation of SPPA Performance Targets.

74. In their annual report for 2012/13, internal audit were able to provide substantial assurance in respect of SPPA's risk management, controls and governance arrangements. Assurance provided in relation to the Scottish Government's corporate systems used by the SPPA was assessed as reasonable. This was less than the substantial assurance provided in both 2010/11 and 2011/12. This change was a result of a number of control issues identified during internal audit's work at the Scottish Government during the year.

75. While actions are being taken forward to address the specific control issues, the reduction in the overall assurance assessment indicates a risk that internal control standards are falling. It is important that the overall position is subject to close monitoring.

Refer Action Point 3

Governance statement

76. In 2012/13 SPPA, NHSSS and STSS included governance statements in each set of annual accounts as required. In accordance with Scottish Government guidance, these included description and assessment of the essential components of corporate governance and details of any significant risk-related matters arising during the period. The overstatement of the pension liabilities of STSS as a result of actuarial error was highlighted appropriately in the STSS statement. There were no other significant exceptions reported in the governance statement. Arrangements to prepare the statements were satisfactory.

Prevention and detection of fraud and irregularities

77. SPPA is responsible for establishing arrangements to prevent and detect fraud and other irregularity. We review and report on these arrangements.

78. The SPPA has appropriate arrangements in place to help prevent and detect fraud and irregularities which follow Scottish Government's guidance. The SPPA's Fraud Policy and Whistleblowing Policy are available to all staff via the intranet. The SPPA communicates its Code of Conduct to staff via their contracts of employment and the Staff Handbook. Standards of conduct and the Disciplinary Policy are available on the intranet and reminders are issued to staff periodically or when changes are made. Adequate arrangements are in place to help prevent and detect fraud and irregularities.

NFI in Scotland

79. SPPA participates in the National Fraud Initiative (NFI). This is a counter-fraud exercise that uses computerised techniques to compare information about individuals held by different public bodies to identify circumstances that might suggest the existence of fraud or error (matches). Where matches are identified public bodies are expected to investigate these, and if fraud and error has taken place, to stop payments and attempt to recover the amounts involved. The exercise also provides assurance on the effectiveness of arrangements and helps deter fraud.

80. The value of overpayments identified by SPPA through the NFI exercise has fallen significantly over the course of the past four exercises as issues are identified and addressed. In this year's exercise a total of 6,633 cases (2010/11 5,749) were identified, and of these 2,678 (2010/11 1,574) have been highlighted as recommended for further investigation. Of the data matches processed in respect of death information, 37 cases were identified with overpayments totalling £79k. 1,305 NHSSS re-employment cases have been processed, highlighting overpayments of £23k. 360 STSS re-employment cases have yet to be investigated. SPPA is clearly committed to the NFI exercise and progress to date has been satisfactory. We will continue to review progress on the STSS re-employment matches.

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

81. 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. We consider whether bodies have adequate arrangements in place.

82. SPPA has adequate arrangements in place to help ensure appropriate standards of conduct and to help prevent and detect bribery and corruption. We are not aware of any specific issues that we need to identify in this report. The SPPA's Bribery Policy is published on the intranet. Staff have been made aware of the actions that they should take if they suspect bribery or fraud. A Register of Board Members' Interests is maintained by the Chief Executive's office and is available for public inspection. Arrangements are in place for Board Members to confirm their position annually.

Outlook

83. The current environment of significant change and increasing expectations is one in which the organisation's governance and accountability arrangements will be tested. In addition to the operational challenges facing the SPPA, the UK Government's 2013 Public Service Reform Act requires a number of significant changes to be made to the schemes' governance arrangements. During 2013/14 the SPPA will set out plans for establishing the necessary pension boards with wider stakeholder representation for both schemes. The scale and ambition of the pension reform agenda will involve a fundamental redesign of the way the schemes are structured, financed and governed, and this change will present significant challenges for the SPPA.

84. The extent of the change agenda facing the Agency will present significant challenges to the organisation's capacity. Changes required include the implementation of increases in employee contributions, the establishment of new pension schemes from 1 April 2015, new responsibilities for the administration of police and fire schemes and associated changes to IT and managerial systems. Planned increases in the available budget will help provide some additional capacity, but ensuring that effective programme and project management and good oversight arrangements are in place will be critical for the Agency.

Best Value, use of resources and performance

85. Audited bodies have responsibility to ensure that arrangements have been made to secure best value. The Auditor General may require that we consider whether accountable officers have put in place appropriate arrangements to satisfy their corresponding duty of best value. Where such requirements are not specified we may, in conjunction with audited bodies, agree to undertake local work in this area.

86. As part of their statutory responsibilities, the Auditor General may procure, through Audit Scotland, examinations of the use of resources by audited bodies and publish reports or guidance. We 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.

87. During the course of our audit appointment we also consider and report on progress made by audited bodies in implementing the recommendations arising from reviews in earlier years. We may also consider the use of resources in services or functions, where the need for this is identified through local audit risk assessments.

88. This section includes a commentary on the best value and performance management arrangements within SPPA. We also summarise headline performance measures used by SPPA, highlight any relevant national reports and comment on the body's response to these.

Management arrangements

Best Value

89. Scottish Government guidance for accountable officers on best value in public services requires a systematic approach to self-evaluation and continuous improvement. The guidance identifies the themes 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.

90. The SPPA's approach to Best Value is described in the Governance Statement. This highlights that Best Value principles are embedded in the SPPA's planning, governance and business decision arrangements; and are communicated to staff through commitment, leadership and staff participation in the business planning process. It also highlights the SPPA's participation in a pension's industry benchmarking group and the Scottish Government's benchmarking of corporate services.

91. Structures for ensuring best value continued during 2012/13 with notable developments. These included consolidating the development of its member web interface allowing scheme members to access their pension benefit statements on line, and the successful continuation of data cleansing activities. In addition the SPPA was granted the award of gold status from Investors in People Scotland as an indication of the SPPA's commitment to staff investment and delivery of its business objectives.

92. The SPPA continues to develop its systems in order to improve the efficiency and effectiveness of the service provided to its stakeholders. The SPPA plans to develop further its website to enable employers to record contributions payable and other data on line. Efficiencies are also expected through a planned review of the SPPA's financial processes and a review of its membership data quality, and the processes used to update membership data.

Overview of reported performance in 2012/13

93. The SPPA's operational performance is formally reviewed by the EMB and SMT on a regular basis. The SPPA reported that it had met 9 of its 11 key performance targets set for 2012/13. The 2 targets that the SPPA failed to meet were relating to the issue of pension benefit statements and the collection of scheme contributions within the period prescribed by legislation; both of these fell short of the targets by a very small margin. High levels of customer satisfaction were also reported.

94. Performance at a directorate level continued to be mixed with Policy and Corporate Services missing a greater proportion of targets than other directorates. However some of the targets set are outwith the control of the directorates, this being largely due to poor definition of the targets, through third party influence or the challenges of pension reform.

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 are detailed in Exhibit 1.

Exhibit 1: A selection of National performance reports 2012/13

- Managing early departures from the Scottish public sector (May 2013)
- Developing Financial Reporting in Scotland (July 2013)

Source: www.audit-scotland.gov.uk

Managing Early Departures from the Scottish Public Sector

96. *Managing early departure from the Scottish public sector* was published in May 2013 and aims to remind public organisations of the principles of good practice in managing early departures.

The SPPA agreed 13 exit packages during 2012/13 with an average cost to the SPPA of £31,846.

97. Key messages delivered in the report include:

- Scotland's public bodies need to be more consistent in how they manage schemes allowing staff to take early retirements and redundancies, and be clearer about the costs and benefits
- early release schemes can provide significant savings, and most public bodies generally follow good practice, but there are striking differences between the schemes, and a marked inconsistency in how much bodies tell the public about the costs and expected savings. The report makes a number of recommendations to help public bodies improve this
- almost 14,000 employees took such packages between 2010 and 2012 – around one in 40 of all public sector staff – at a cost of more than £500 million.

98. The implications of this report have been reviewed in detail by the Senior Management Team (SMT) and particular attention given to the recommendations.

Developing Financial Reporting in Scotland

99. Our performance audit report on *Developing Financial Reporting in Scotland* (July 2013) highlighted that the Scottish Government's financial reporting framework has continued to evolve since devolution, reflecting developments in recognised good practice. However, the changing financial environment suggests that this would be a good time for the Scottish Government to review, in discussion with the Scottish Parliament, the current arrangements. There is scope for the Scottish Government to further develop its financial reporting to make it more transparent and comprehensive.

100. The report highlighted that there is scope to further develop existing financial reporting in the accounts, supplementing this with additional analysis as necessary. It recognised that the public reporting of financial information can take a number of forms, including audited accounts, budget documents and supporting materials, published plans and statements to Parliament. Good financial reporting involves getting the right balance between these different methods, and ensuring that overall financial reporting meets users' needs.

101. The report included an estimate of the aggregate pension liabilities associated with the five devolved public sector schemes: Teachers, NHS, Police, Fire and Local Government. It illustrated how an understanding of the size and valuation of pension liabilities was important to considering the overall financial position of the devolved public sector, and raised the potential for the development of consolidated public accounts incorporating these.

Arrangements to consider national performance reports

102. In line with best practice, national reports are considered by the Senior Management Team and presented to the EMB and ARC where these are considered to be relevant to the business of the SPPA.

Appendix A: audit reports

External audit reports and audit opinions issued for 2012/13

Title of report or opinion	Date of issue	Date presented to Audit and Risk Committee
Annual Audit Plan - SPPA, NHSSS, STSS	9 April 2013	16 April 2013
Review of internal controls key financial controls assurance report	13 June 2013	16 July 2013
Report on financial statements to those charged with governance - SPPA	9 July 2013	16 July 2013
Audit opinion on the 2012/13 financial statements - SPPA	22 August 2013	16 July 2013
Report on financial statements to those charged with governance - Schemes	1 October 2013	8 October 2013
Audit opinion on the 2012/13 financial statements - Schemes	29 October 2013	8 October 2013

Appendix B: action plan

Key Risk Areas and Planned Management Action

Action Point	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1.	**Actuarial processes** Following the identification of a significant error in the valuation of the 2011/12 STSS liability GAD has outlined a number of improvements to its processes which it is making through time. SPPA should ensure that it is monitoring the implementation of these. ***Risk: There is a risk of future actuarial error if required improvements to processes are not implemented or not effectively implemented.***	Written update requested from George Russell, Deputy Government Actuary in October 2013. Reply emailed to members of EMB on 19 November 2013.	Chief Executive	Completed
2.	**Membership data** Membership data extracted from SPPA's Pension Administration and Payroll systems for actuarial calculations was not retained for audit purposes. SPPA staff had to undertake additional work to demonstrate the reasonableness of the data supplied to the actuary. ***Risk. Failure to retain an adequately documented audit trail to support the financial statements may result in costly extra work or difficulties in giving a clear audit opinion.***	Specific reference to retention of source membership reports to be included in 2013/14 final accounts checklist for Schemes. Reminders to be issued to relevant staff.	Director of Finance/Director of Operations	March 2014

Action Point	Risk Identified	Planned Management Action	Responsible Officer	Target Date
3.	**IA assurance** Internal audit assurance provided in relation to the Scottish Government's corporate systems used by the SPPA was less than the level of assurance provided in previous years. This may indicate a risk that the overall effectiveness of controls over SPPA is declining. It is important that the overall position is subject to close monitoring. ***Risk - The overall effectiveness of control is less than required.***	Internal Audit to provide an interim report on SGs corporate systems to the Audit & Risk Committee (ARC) on 15 July 2014. The extent to which the Agency is aware of the outcome of audits of corporate SG systems and processes is to be discussed at the next ARC on 7 February 2014, and consideration given to whether there is scope to receive regular reports on any SG ARC issues which might impact on the Agency.	Director of Finance Director of Finance	15 July 2014 7 February 2014