



Scottish Public Pensions Agency

Annual audit report 2014/15

October 2015

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This report has been prepared for the use of SPPA and no responsibility to any member or officer in their individual capacity or any third party is accepted.

This report will be published on our website after it has been considered by the audit committee. The information in this report may be used by Audit Scotland in any reporting to the Scottish Parliament.

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Key Messages

 Audit of financial statements	<ul style="list-style-type: none">• The independent auditor's reports on the 2014/15 financial statements for SPPA, NHSSSS and STSS are unqualified
 Financial management and sustainability	<ul style="list-style-type: none">• SPPA operated within limits set by the Scottish Government with a net underspend of £1.7m against a budget of £15.2m• NHSSSS is an unfunded pension scheme with £44.1 billion net liabilities, a year on year increase of 11.6% <p>STSS is an unfunded pension scheme with £29.4 billion net liabilities, a year on year increase of 8.5%</p>
 Governance and transparency	<ul style="list-style-type: none">• Overall we found that SPPA had sound governance arrangements in place• Systems of internal control operated effectively during 2014/15• Arrangements in relation to the prevention and detection of fraud and irregularities were satisfactory
 Outlook	<ul style="list-style-type: none">• SPPA has made good progress in establishing the new scheme governance arrangements and will need to ensure going forward that the arrangements work efficiently in practice• SPPA will continue to progress its significant business change programme including developing and implementing the necessary ICT and managerial systems

Introduction

1. This report is a summary of our findings arising from the 2014/15 audit of the Scottish Public Pensions Agency (SPPA), the NHS Superannuation Scheme (Scotland) (NHSSSS) and the Scottish Teachers' Superannuation Scheme (STSS).
2. The management of SPPA is responsible for:
 - preparing financial statements timeously which give a true and fair view of the Agency, NHSSSS and STSS as at 31 March 2015 and their expenditure and income for the year then ended, in accordance with the relevant financial reporting framework
 - ensuring the regularity of transactions, by putting in place appropriate systems of internal control
 - maintaining proper accounting records
 - preparing and publishing with their financial statements an annual governance statement and a remuneration report
 - preparing a consolidation pack (SPPA) and preparing Whole of Government Accounts returns (NHSSSS and STSS).
3. Our responsibility, as the external auditor of SPPA, NHSSSS and STSS is to undertake our audits in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.
4. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. This does not relieve management of their responsibility for the preparation of financial statements.
5. A number of reports, both local and national, have been issued by Audit Scotland during the course of the year. These reports are summarised at [appendix II](#) and [appendix III](#).
6. [Appendix IV](#) is an action plan setting out our recommendations to address the high level risks we have identified from the audit. We recognise that not all risks can be eliminated or even minimised. What is important is that SPPA understands its risks and has arrangements in place to manage these risks. The committee should ensure that they are satisfied with proposed actions and have a mechanism in place to assess progress and monitor outcomes.
7. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures; consequently, our comments should not be

Introduction

regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.

8. The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged.

Audit of the 2014/15 financial statements

Overview of the scope of the audit of the financial statements

9. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan presented to the Audit and Risk Committee on 7 April 2015.
10. As part of the requirement to provide full and fair disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2014/15 agreed fee for the audit was set out in the Annual Audit Plan and, as we did not carry out any work additional to our planned audit activity, the fee remains unchanged at £157,570 (£25,850 for SPPA; £64,170 for STSS and £67,550 for NHSSSS).
11. The concept of audit risk is of central importance to our audit approach. During the planning stage of our audit we identified a number of key audit risks which had the greatest effect on the audit strategy, resources and effort. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance.
12. [Appendix I](#) sets out the significant audit risks identified at the planning stage and how we addressed each risk in arriving at our opinion on the financial statements.

13. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

Materiality

14. Materiality can be defined as the maximum amount by which auditors believe the financial statements could be misstated and still not be expected to affect the decisions of users of financial statements. A misstatement or omission, which would not normally be regarded as material by amount, may be important for other qualitative reasons (for example an item contrary to law).
15. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.
16. We summarised our approach to materiality in our Annual Audit Plan. Based on the financial statements, we revised our planning materiality for 2014/15 for SPPA to £140,000 (1% of gross expenditure), NHSSSS £10.3m and STSS £10.5m (1% of benefits paid). Performance materiality of £105,000 for

Audit of the 2014/15 financial statements

SPPA, £9.3m for NHSSSS and £9.5m for STSS is determined to ensure that uncorrected and undetected audit differences do not exceed our planning materiality level. We report all misstatements greater than £7,500 for the SPPA and £250,000 for each of the Schemes.

Audit of the SPPA 2014/15 financial statements

Audit opinions

Financial Statements

- The financial statements of SPPA for 2014/15 give a true and fair view of the state of the body's affairs and of its net operating cost for the year
- We confirm that the financial statements have been properly prepared in accordance with the 2014/15 Government Reporting Manual (the FReM) and the requirements of the Public Finance and Accountability (Scotland) Act 2000 and directions

Regularity

- In all material respects, the expenditure and income in the financial statements were incurred or applied in accordance with relevant legislation and guidance issued by Scottish Ministers
- The sums paid out of the Scottish Consolidated Fund for the purpose of meeting the expenditure shown in the financial statements were applied in accordance with section 65 of the Scotland Act 1998

Other prescribed matters

- The remuneration report has been properly prepared in accordance with the requirements of the Public Finance and Accountability (Scotland) Act 2000 and directions
- The information in the Management Commentary is consistent with the financial statements

Submission of financial statements for audit

17. We received the unaudited SPPA financial statements on 8 June 2015, in accordance with the agreed timetable. The working papers were of a high standard and the staff provided good support to the audit team. We completed our on-site fieldwork on 25 June 2015.

Evaluation of misstatements

18. There were no misstatements identified during the audit. A number of presentational and monetary adjustments were identified within the financial statements during the course of our audit. These were discussed with relevant officers who agreed to amend the unaudited financial statements.

Significant findings from the audit

19. International Standard on Auditing 260 requires us to communicate to those charged with governance significant findings from the audit:

- The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and disclosures.
- Significant difficulties encountered during the audit.
- Significant matters arising from the audit that were discussed, or subject to correspondence with management.
- Written representations requested by the auditor.

- Other matters which in the auditor's professional judgment, are significant to the oversight of the financial reporting process.
20. During the course of the audit we identified one significant matter: SPPA acts as the Scheme Manager for the Police and Firefighters' pension schemes. SPPA has responsibility for processing pension payments for the schemes and under its Agency status SPPA has access to and utilises Scottish Government designated bank accounts in order to carry out its functions. Under current funding arrangements, pensions paid to members require to be reimbursed to SPPA by the Police Service of Scotland (PSoS) and the Scottish Fire and Rescue Service (SFRS). Amounts paid to HMRC by SPPA relating to police and fire pensions obligations follow similar reimbursement arrangements.
21. The account balances due at the year-end are included in SPPA's Statement of Financial Position and the temporary funding of these balances is included in the Statement of Cash Flows. PSoS and SFRS account for pensions expenditure and the related funding from the Scottish Government in their financial statements and this is therefore not included in SPPA's financial statements.
22. SPPA has included a new accounting policy setting out these arrangements. We are content that the accounting policy adopted is appropriate to SPPA's circumstances and that the

arrangements established with other areas of the Scottish Government for accounting for these transactions are satisfactory.

Future accounting and auditing developments

23. The financial statements are prepared in accordance with the FReM. Two significant revisions will apply from 2015/16:
 - Adoption of IFRS13 *Fair value measurement* for the first time – this also includes IAS 16 and IAS 38 adaptations.
 - Simplification and Streamlining Project – changes to the form and content of the annual report and accounts.
24. **International Financial Reporting Standards (IFRS)13 Fair value measurement:** Sets out the requirements for assets to be valued at fair value and is applied in full by the FReM only to assets that are not held for their service potential (i.e. investment properties and assets held for sale). It also applies to operational assets which are surplus to requirements where there are no restrictions on disposal which would prevent access to the market.
25. IFRS 13 does not apply to operational assets which are in use delivering front line services or back office functions, and surplus assets with restrictions on their disposal. These will be valued in accordance with the adaptations to IAS (International Accounting Standard) 16 *Property, plant and equipment*.
26. We will discuss any implications for SPPA with management in

due course.

27. **Restructuring of the annual report:** The 2015/16 FReM has been extensively re-written to require the annual report and accounts to include:
 - A performance report which will give a fair, balanced and understandable analysis of performance and will include an overview section and a performance analysis section.
 - An accountability report incorporating the following three main sections:
 - corporate governance report consisting of a directors' report, a statement of the Accountable Officer's responsibilities and a governance statement
 - remuneration and staff report which will cover a number of prescribed disclosures including remuneration policy, payments to directors, staff numbers and sickness absence rates
 - parliamentary and accountability report which will include information on the regularity of expenditure and the independent auditor's report
28. SPPA will need to consider the implications for its Annual Report and Accounts for next year. **Refer Action Plan no. 1**

Financial management and sustainability - SPPA

29. As an executive agency of the Scottish Government, the main financial objective for SPPA is to ensure that the financial outturn for the year is within the resource budget allocated by Scottish Ministers. The Scottish Government sets a resource budget for the year which originates from the spending review settlement and is subsequently approved by the Budget Bill. During the year, revisions are approved in the autumn and spring budget revisions. SPPA operated within the budget approved by the Scottish Parliament.

2014/15 financial performance

30. SPPA's budget increased from £12.5 million to £15.2 million in the spring budget revision. The Scottish Government gave this additional £2.7 million to fund: actuarial services for pension reform (£1.4 million); costs of the business transformation projects (£0.1 million); and funding for implementing the migration of pension administration for Scottish Fire and Police Services (£0.6 million). A further £0.6 million was transferred by the Scottish Government which was additional to requirements.
31. The final outturn against budget is £13.5 million. The underspend is due to a combination of factors which include: a lower than anticipated level of actuarial services, timing of spend associated with stakeholder communication on 2015

Pension Reform and the additional sum allocated but not required. The financial position of SPPA remains stable with the body operating within its available funding.

2014/15 financial position

32. At 31 March 2015, the statement of financial position shows a net asset position of £10.836 million, an increase in total equity of £4.469 million. The two main elements of this increase are the purchase of ICT systems (intangible assets) needed to deliver pensions reform; and the monies due to SPPA by the Police Service of Scotland and the Scottish Fire and Rescue Service as at the year end for pensions paid to members.

Financial management

33. As auditors we need to consider whether bodies have established adequate financial management arrangements. We do this by considering a number of factors, including whether:
- the Director of Finance has sufficient status to be able to deliver good financial management
 - standing financial instructions and standing orders are comprehensive, current and promoted within the body
 - reports monitoring performance against budgets are

Financial management and sustainability - SPPA

accurate and provided regularly to budget holders

- monitoring reports do not just contain financial data but are linked to information about performance
- members provide a good level of challenge and question budget holders on significant variances

34. On an annual basis, as part of the risk assessment stage of our audit, we review the financial control environment (including standing orders, financial regulations and scheme of delegation). We have concluded that SPPA's arrangements are satisfactory.
35. Based on our accumulated knowledge, review of board and committee papers and through our attendance at the Audit and Risk Committee we conclude that SPPA has strong financial management arrangements in place.

Workforce planning

36. The pension reform agenda together with the administration of the Police and Firefighters' pension schemes has continued to increase the Agency's workload. Procurement of the new integrated pension administration and payroll system is placing further demands on the workforce. Staff costs are expected to increase over the next year, with further growth in staff numbers to meet the challenging nature of these projects.
37. We recommended last year that SPPA should develop its workforce planning to ensure it has the capacity and skills to

deal effectively with its existing and future workload. As reported in last year's Annual Audit Report action plan, SPPA's review of workforce planning approach was deferred to 2015/16 to give senior management time to consider job grading options. The agreed target date for completion was 31 December 2015; the work plan is currently under development. Management's planned action is recorded on SPPA's audit recommendations tracker. The tracker is reported to the Audit and Risk Committee so progress can be monitored.

Outlook

38. The External Management Board agreed in April 2015 to roll forward the 2012-2015 corporate plan into 2015/16. A three year corporate plan covering the years 2016 to 2019 will be developed during 2015/16.
39. Scottish Ministers have agreed a resource budget for SPPA of £23.15 million for 2015/16. This comprises operating expenditure of £13.75 million and capital expenditure of £9.4 million. SPPA will be seeking additional funding of £2.966 million to cover additional actuarial costs, Fire and Police administration costs, and expenditure for a pension reform project. The substantial increase in capital funding over previous years is necessary to support the procurement of the new pension administration and payroll system.
40. In a period of reducing resources across the public sector as a whole, the challenge facing SPPA is to continue to maintain

Financial management and sustainability - SPPA

performance levels within available resources.

Audit of the Schemes 2014/15 financial statements

Audit opinions

Financial Statements

- The financial statements of NHSSSS and STSS for 2014/15 give a true and fair view of the state of affairs of the Schemes and of the net resource outturn and the net cash requirement for the year
- We confirm that the financial statements have been properly prepared in accordance with the 2014/15 Government Reporting Manual (the FReM) and the requirements of the Public Finance and Accountability (Scotland) Act 2000 and directions

Regularity

- In all material respects, the expenditure and income in the financial statements were incurred or applied in accordance with relevant legislation and guidance issued by Scottish Ministers
- The sums paid out of the Scottish Consolidated Fund for the purpose of meeting the expenditure shown in the financial statements were applied in accordance with section 65 of the Scotland Act 1998

Other prescribed matters

- The information in the Report of the Managers is consistent with the financial statements

Submission of financial statements for audit

41. We received the unaudited financial statements on 20 July 2015, in accordance with the agreed timetable. The working papers were of a high standard and the staff provided good support to the audit team. We completed our on-site fieldwork on 17 September 2015.

Evaluation of misstatements

42. There were no misstatements identified during the audit. A number of presentational and monetary adjustments were identified within the financial statements during the course of our audit. These were discussed with relevant officers who agreed to amend the unaudited financial statements.

Significant findings from the audit

43. During the course of the audit we identified one significant issue: Membership data as at 31 March 2012 for NHSSSS and STSS, rolled forward to 31 March 2015, forms the basis of the Statement by the Actuary. SPPA also provide the actuary with membership data as at 31 March 2015, to inform their valuation process. The membership data extracted from SPPA's pension administration and payroll systems as at 31 March 2015 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 2014/15, further work has been carried out by Agency staff to

demonstrate the reasonableness of the data supplied to the actuary. We are content that this provides us with the necessary assurance and are satisfied that data as at 31 March 2015 provided to the actuary was consistent with underlying records.

44. The following issues are brought to the attention of those charged with governance regarding the appropriateness of accounting policies or accounting estimates and judgements, the timing of transactions, the existence of material unusual transactions or the potential effect on the financial statements of any uncertainties.
45. **Actuarial methodology:** The pension liabilities as at 31 March 2015 are based on a complete extract of the members' data as at 31 March 2012 for NHSSSS and STSS, rolled forward to 31 March 2015. The actuary has previously identified that the roll forward methodology has some weaknesses, notably that 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.
46. Valuation methodology relies on judgement and assumptions for financial, demographic and mortality factors. SPPA require to ensure that they are content with the assumptions proposed

by the actuary. We received representations from the Accountable Officer that he is satisfied with key aspects of the methodology. We are satisfied that the roll forward valuation methodology together with the Actuary's judgements and assumptions provides a sufficiently reliable estimate of the NHSSSS and STSS liabilities as at 31 March 2015.

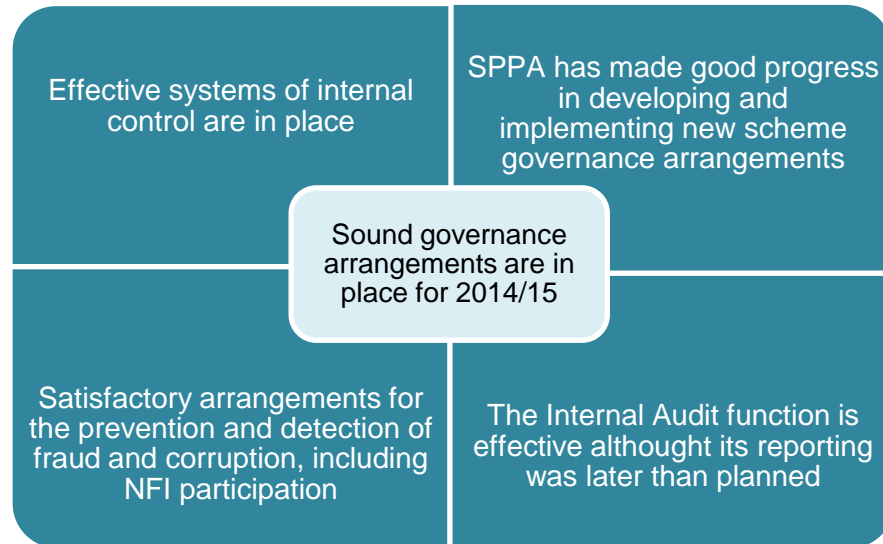
47. **Statements of financial position - net liabilities:** in common with some other public pension schemes, the NHSSSS and STSS are unfunded. The pension liabilities recorded in the financial statements are not matched by investments or other assets, and consequently the schemes show net liabilities of £44.1 billion and £29.4 billion respectively. The accounts of the schemes are prepared on a going concern basis given that funding to meet pension payments, as they fall due under the Schemes' regulations, is made available from the Scottish Government's budget. An appropriate disclosure note is included in the financial statements. We are satisfied that it is appropriate to prepare the accounts on a going concern basis.
48. The financial statements are prepared in accordance with the FReM. As noted at paragraph 24, two significant revisions to the FReM will apply from 2015/16:
- Adoption of IFRS13 *Fair value measurement* for the first time – this also includes IAS 16 and IAS 38 adaptations.
 - Simplification and Streamlining Project – changes to the form and content of the annual report and accounts.

49. The impact of these revisions to be applied from 2015/16 is unlikely to be significant to NHSSSS or STSS.

Financial management and sustainability - Schemes

50. The net expenditure for the year for NHSSSS was £2,176 million, compared to net expenditure of £1,499 million in 2013/14. This rise is due mainly to an increase in the pension financing cost along with a small increase in services costs.
51. The scheme liability has increased by £4.6 billion to £44.1 billion. The main reason for this increase is the change in financial assumptions over the year, largely brought about by a lower discount rate of 1.30% as set by HM Treasury (2013/14 1.80%).
52. The STSS's net expenditure for the year was £1,420 million, compared to net expenditure of £1,137 million in 2013/14. This movement is also due mainly to an increase in interest on scheme liabilities. The scheme liability has increased by £2.3 billion to £29.4 billion. This increase is due to the change in financial assumptions.
53. Accrued resources for the NHSSSS and the STSS are covered by one combined limit in the Budget (Scotland) Act 2014. In 2014/15 the combined accrued resource cost of £3,595.9 million for NHSSSS and STSS was within the combined limit of £3,617.3 million.
54. The budget figures have been set for 2015/16 at a combined figure of £3,537.0 million. The budget figures are accounting estimates for assessing the overall commitments in each scheme that will be need to be met through time. The direct cost falling on the Scottish public sector is the annual employer contributions.
55. The most recent actuarial valuations to assess the overall scheme commitments were carried out by the Government Actuary's Department (GAD) on behalf of the Scottish Government during 2014. These were based on scheme data as at 31st March 2012 and the results were published earlier in 2015. The valuations have been used to set employer contribution rates for the period from 1st April 2015 to 31st March 2019 and to establish an employer cost cap against which future scheme costs will be compared in future quadrennial valuations.
56. Future valuations will be used to inform future contribution rates to be paid into the Schemes by scheme employers and to compare scheme costs against the employer cost cap mechanism. The next valuation will be based on scheme data as at 31st March 2016 and will begin in 2016/17. Any changes arising from that valuation will apply from 1st April 2019.

Governance and transparency



Corporate governance

57. The Chief Executive is the Agency's Accountable Officer, answerable to the Scottish Government's Principal Accountable Officer and Scottish Ministers. The Chief Executive is supported by a management board of Executive and Non- Executive Directors.
58. The Chief Executive and the External Management Board (Corporate Board as from July 2015) are responsible for establishing arrangements for ensuring the proper conduct of the affairs of SPPA.

59. The Board is supported in its role by the Audit and Risk Committee. The Board and Audit and Risk Committee meet on a regular basis throughout the year to consider relevant matters. We have concluded that SPPA has effective overarching and supporting governance arrangements which provide an appropriate framework for robust organised decision making.
60. The Public Service Pensions Act 2013 required new governance arrangements to be established from 1 April 2015 for the pension schemes, to reinforce the importance of transparency and accountability. The Act required two new statutory governance bodies to operate for each scheme: a Scheme Advisory Board and a Pension Board.
 - The purpose of a Scheme Advisory Board is to provide advice to the Responsible Authority (Scottish Ministers), at the Responsible Authority's request, on the desirability of changes to the design of the scheme and the implication of other policy issues.
 - The role of a pension board is to assist the Scheme Manager (SPPA) in the operational delivery of the pension scheme in line with scheme regulations and expectations set by the Pensions Regulator.

Governance and transparency

61. SPPA has made good progress in developing and implementing these new governance arrangements. Members of the boards have been recruited and inaugural meetings have taken place. Up to four meetings are proposed; in due course, each board will decide the most appropriate frequency of its meetings. Formal training/awareness sessions have been provided to Pension Board Members.

Transparency

62. The Scottish Government's On Board guidance (<http://www.gov.scot/Publications/2015/04/9736/0>) for board members of public bodies was updated and reissued in April 2015. On Board states that boards should demonstrate high standards of corporate governance at all times including openness and transparency in decision making. It recommends boards should consider:

- Holding an annual open meeting
- Holding board meetings in public unless there is a good reason not to
- Publishing summary reports and/or minutes of meetings
- Inviting evidence from members of the public in relation to matters of public concern
- Consulting stakeholders and users on a wide range of issues
- Making corporate plans and the annual report widely

available.

63. On Board was intended specifically for Non Departmental Public Bodies but it contains principles which are applicable across the public sector and relevant to SPPA.
64. The Board and Audit and Risk Committee meetings are held in private and the papers for these meetings are not publicly available. Some elements of the business are considered private because of the confidential and sensitive nature of these areas; however there are some areas which could be made more accessible to the public.
65. The minutes of the Board meetings are published on SPPA's website after they have been approved at the following meeting. There is therefore a significant time lag before minutes are publicly available. The most recent minutes available are for February 2015. Minutes of the Audit and Risk Committee are not published.
66. Overall we concluded that SPPA is open and transparent in conducting its business, but that there is scope for it to review its arrangements for organisational decision making against the relevant best practice principles within the On Board guidance.
Refer Action Plan no. 2

Internal control

67. As part of our audit we reviewed the high level controls in a

Governance and transparency

number of financial systems fundamental to the preparation of the financial statements. Our objective was to obtain sufficient audit evidence to support our opinion on the financial statements. This audit work covered payroll; trade payables; trade receivables; EPICOR (income collection system); AXISe/Altair (pensions system for NHS and Teachers Schemes); and ResourceLink (system for paying pensions).

68. We have also taken assurance from the auditor of the Scottish Government central systems that are used by SPPA.
69. No material weaknesses in the accounting and internal control systems were identified during the audit which could adversely affect SPPA's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.
70. We reported our findings to the Audit and Risk Committee on 14 July 2015.

Internal audit

71. Internal audit provides SPPA and its Accountable Officer with independent assurance on the overall risk management, internal control and corporate governance processes. We are required by international auditing standards to make an assessment of internal audit to determine the extent to which we can place reliance on its work. To avoid duplication, we place reliance on internal audit work where possible.
72. Internal Audit is provided by the Scottish Government Internal Audit Division. Our review of internal audit concluded that the Internal Audit Division operates in accordance with the Public Sector Internal Audit Standards (PSIAS) and has sound documentation standards and reporting procedures in place.
73. The internal audit plan for 2014/15 was materially complete, although reporting of the two audits on which we planned to take assurance took place after the year end. For the schemes financial statements audits, we were able to place formal reliance on aspects of the work of internal audit in the following areas:
 - Overpayments
 - Annual allowances
74. SPPA's business transformation programme contains significant ICT elements, as ICT systems are critical to the agency's day to day operations and appropriate investment is required to ensure that they continue to fully support the Agency's business. A major milestone of this programme, delivered during 2014/15, was the upgrade of the core pension administration system to enable the delivery of the 2015 pension scheme reforms. This involved migration of pensions data from the original system (AXISe) to the upgraded system (Altair). We reviewed the arrangements to assure the accuracy

ICT audit

Governance and transparency

of the data migration. We found the approach to data cleansing and migration testing to be well-structured, leading to a successful upgrade with no data issues being identified.

75. An important element of the upgrade of the pension administration system was the implementation of a new server infrastructure, with increased resilience capabilities. As part of the pre-implementation activities, the recovery and failover capabilities of the new infrastructure were tested. It is good practice to ensure that live recovery procedures are tested on a regular basis to ensure that they work as expected. No recovery testing was performed in 2014/15 for either the NHS or Teachers pension schemes, which were migrated to the new system in September 2014. We note that testing took place at the end of September 2015; we will review the outcome as part of our 2015/16 audit planning and risk assessment.
76. The next significant ICT system change within the Business Transformation Programme is the full replacement of all the Agency's pension and payroll administration systems with a single fully integrated system in 2017. The award of the contract is currently pending and project plans are at an early stage of development.

Business change

77. SPPA's business transformation programme has a number of workstreams in place to address the challenges ahead and maintain the continuity and quality of pension services as the

changes to pension schemes are implemented. Through review of Business Transformation Board papers and discussion with the Director of Business Change we have concluded that appropriate governance arrangements are in place. SPPA received positive results in its latest Gateway Review of the programme and has responded well to the recommendations of the review.

Arrangements for the prevention and detection of fraud

78. We assessed the arrangements for the prevention and detection of fraud during the planning phase of our audit. This involved reviewing the counter fraud and whistle blowing policies and year end testing of journals and accounting estimates and judgements. Any frauds or losses are reported to the Audit and Risk Committee. The committee also reviews the Fraud Risk Register annually.
79. SPPA's arrangements in relation to the prevention and detection of fraud and irregularities were satisfactory and in line with Scottish Government's guidance. There were no instances of internal fraud or irregularity reported by SPPA in 2014/15.

National Fraud Initiative in Scotland

80. The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise led by Audit Scotland. It uses computerised techniques to compare information about individuals held by

Governance and transparency

different public bodies, and on different financial systems, to identify circumstances (data matches) that might suggest the existence of fraud or error.

81. Auditors are required to assess the arrangements that bodies have put in place to prevent and detect fraud, including how they approach the NFI exercise itself.
82. SPPA submitted datasets for the 2014/15 NFI exercise, and the matching process identified 5,188 'recommended' records for investigation. To date 2,466 matches have been investigated with SPPA recording 107 outcomes worth £263,257. Further work on the matches, including those relating to 'deferred members' requires to be carried out over the next 6 months.
83. The NFI has a high profile within SPPA with data matches actively investigated, and findings regularly reported to the Operations Management team and the Senior Management team. SPPA continues to be committed to NFI and is active in seeking opportunities to reduce errors through additional data matching processes. These include the twice yearly mortality screening exercise operating through NFI, and the introduction of the UK wide Government initiative 'Tell Us Once', an enhanced reporting service available via registrars, which will be available to SPPA later this year.

Arrangements for maintaining standards of conduct and the prevention and detection of corruption

84. SPPA has in place a range of measures designed to maintain standards of conduct including the Code of Conduct for members and Standards of Propriety for staff. There are also established procedures for preventing and detecting corruption including reviews of Standing Financial Instructions and Standing Orders via the 2012-2015 SPPA Framework Document.
85. SPPA non-executive members complete 'Register of Interests' forms which highlight where there may be a potential conflict of interest. This process is renewed annually. The process for executive directors and other senior members of staff is less clear. The Scottish Government Standards of Propriety guide highlights that staff in bands A-C are required to register their interests where there is the potential for a conflict of interest to arise e.g. business interests, shares, other financial interests etc. The Audit and Risk Committee has added "Register of Interests" as an agenda item at each meeting, to require the disclosure of any relevant interest by non executive members or SPPA senior staff attending the meeting.
86. Based on our review of the evidence we concluded that there are appropriate arrangements in place for the prevention and detection of corruption.

Best Value and Value for Money

National performance audit reports

87. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2014/15, a number of reports were issued which are of direct interest. These are outlined in [appendix III](#).
88. SPPA has processes in place to ensure that all relevant national performance reports are considered by the Audit and Risk Committee. Relevant reports are highlighted in the Director of Finance's report at each committee meeting.
89. **Scotland's public finances - a follow-up audit: Progress in meeting the challenges.** This report was published in June 2014 and commented that, in setting budgets, public bodies need to focus more on their priorities, making clearer connections between planned spending and the delivery and measurement of outcomes. It recommended that public bodies should develop long-term (5-10 year) financial strategies to direct and control their finances.
90. **Update on developing financial reporting:** This update report, published in March 2015, reviewed the principles of public financial management and provided an update on the actions the Scottish Government is taking to further develop

financial reporting. The report concludes that the Scottish Government and the public sector generally, have a good record of financial management and reporting. The Scottish Government has continued to improve and develop its financial reporting framework since Audit Scotland's last report on this area in July 2013. The report highlights that consolidated accounts for the whole of the Scottish public sector would help provide an overall picture of its financial position to strengthen understanding and transparency.

91. **Managing ICT contracts in central government: an update:** The update report published in June 2015 reviewed the Scottish Government's new assurance and oversight arrangements for central government ICT programmes. The report concluded that these arrangements have not been fully effective. SPPA's business transformation programme was one of the projects reviewed, as it has significant ICT elements. The report noted that SPPA did not have the resources in place at the start of the programme to collect baseline benefits realisation information, but that an officer has since been recruited and the relevant work is taking place. As we have noted at paragraph 77, SPPA has appropriate governance arrangements in place for the business transformation programme.

Best Value and Value for Money

92. **Financial capacity in public bodies:** Audit feedback through Annual Audit Reports in recent years indicates that reductions in staff numbers in public bodies may be affecting the capacity of back office functions, specifically finance. Consequently as part of the 2014/15 audit, Audit Scotland has collected information on financial capacity in all its audited bodies. This involved the completion of a questionnaire covering:
- Organisational structure and the role of the chief financial officer
 - Financial strategy and sustainability
 - Budget monitoring and reporting
 - Finance capacity within the organisation
 - Reporting
93. The aim of this baseline information collection is to provide the Accounts Commission and the Auditor General with a summary of key issues or themes in respect of financial capacity. This may be used to support the development of Audit Scotland's future performance audit programme.
94. We did not identify any financial capacity issues at SPPA.

Appendix I – Significant audit risks

The table below sets out the financial statement audit risks, how we addressed each risk and our judgement in arriving at our opinion on the financial statements.

Audit Risk (from Annual Audit Plan)	Assurance procedure	Results and conclusions
Risk of material misstatement		
<p>Management override of controls (Agency corporate risk)</p> <p>Auditing standards (ISA 240: “The auditor’s responsibility to consider fraud in an audit of financial statements”) require auditors to consider, on all audits, management’s ability to manipulate accounting records and prepare fraudulent or biased financial statements by overriding controls that otherwise appear to be operating effectively.</p>	<ul style="list-style-type: none"> • Detailed testing of journal entries and other adjustments to the financial statements. • Review the reasonableness of accounting estimates. • Evaluation of significant transactions that are outside the normal course of business. • Consider the results of controls testing and amend level of year end testing if appropriate. 	<p>We concluded from our audit testing that the 2014/15 journal entries, accounting estimates and judgements and significant transactions which we reviewed were appropriate.</p> <p>No issues were highlighted as a result of our controls testing and detailed substantive testing at the year end that indicate management override of controls affecting the outturn or year end position.</p>

Appendix I – Significant audit risks

Audit Risk (from Annual Audit Plan)	Assurance procedure	Results and conclusions
<p>Income recognition (Pension schemes risk)</p> <p>ISA 240: “The auditor’s responsibility to consider fraud in an audit of financial statements” presumes a risk of fraud in regard to revenue recognition in the financial statements. The volume and complexity of contribution income means there is an inherent risk of fraud in accordance with ISA 240.</p>	<ul style="list-style-type: none"> • Regular engagement with internal audit. • Review of internal audit progress reports, plans and reports. • Attendance at Audit and Risk Committee meetings. • Review of internal audit working papers where placing formal reliance on their work. 	<p>Our attendance at Audit and Risk Committee meetings, review of internal audit reports and detailed testing of contributions income did not highlight any issues.</p>
<p>Internal audit assurances (Agency corporate risk)</p> <p>Resourcing pressures may lead to planned internal audit work being delayed or postponed. Such delays would impact on the level of assurance provided by internal audit to the Audit and Risk Committee and Accountable Officer and on our ability to rely on internal audit’s work for financial statements assurance.</p>	<ul style="list-style-type: none"> • Regular engagement with internal audit. • Review of internal audit progress reports, plans and reports. • Attendance at Audit and Risk Committee meetings. • Review of internal audit working papers where placing formal reliance on their work. 	<p>Through attendance at Audit and Risk Committee meetings we noted that there were still internal audit resourcing pressures. Despite delays, all planned internal audit work was completed. We were able to place reliance on internal audit’s work on Overpayments and Annual Allowances.</p>

Appendix I – Significant audit risks

Audit Risk (from Annual Audit Plan)	Assurance procedure	Results and conclusions
<p>Governance assurances from Accountable Officer (Agency corporate risk)</p> <p>The SPPA Chief Executive announced his intention to retire at the end of the financial year (March 2015). A successor will be appointed in due course following an open recruitment process.</p> <p>The Chief Executive as Accountable Officer is responsible for establishing arrangements for ensuring the proper conduct of the affairs of SPPA and for monitoring the adequacy and effectiveness of these arrangements.</p> <p>Appropriate assurance arrangements will need to be established to support the new Accountable Officer in signing the governance statement and accounts.</p>	<ul style="list-style-type: none"> • Attendance at Audit and Risk Committee meetings. • Consider and review Governance Statement and assurance processes at early stage. • Regular engagement with key SPPA staff. • Review of External Management Board and Senior Management Team minutes and papers. 	<p>An interim Chief Executive was in place until June 2015. Ross Paterson was appointed as Chief Executive and Accountable Officer in June 2015.</p> <p>We confirmed through regular engagement with senior staff, attendance at Audit and Risk Committee meetings and a detailed review of Governance Statement assurances at an early stage of the audit that appropriate assurance arrangements were in place to support the new Accountable Officer.</p>

Appendix I – Significant audit risks

Audit Risk (from Annual Audit Plan)	Assurance procedure	Results and conclusions
<p>GAD valuation (Pension schemes risk)</p> <p>The decisions taken by SPPA with regard to the schemes are based on the work of GAD, which involves significant elements of estimation and professional judgement.</p> <p>The actuarial valuation methodology relies on judgement and assumptions in relation to financial, demographic and mortality factors. The valuation process also relies on the data provided by the Agency to GAD being accurate, complete, timely and verifiable.</p> <p>The actuarial input in valuing the Schemes could be affected by incomplete or inaccurate information, reliance on source data which is not fully validated or the use of unreasonable assumptions.</p>	<ul style="list-style-type: none"> • Assess the reliability, professional competence capability and objectivity of GAD as an expert on whom we place reliance. • Meeting with GAD. • Discuss GAD’s quality review processes to determine the level of assurances that can be taken from their internal processes. • Review of PwC report assessing GAD’s actuarial processes. • Review the reports supporting the valuation data submitted to GAD. • Review audit trail of discussions between the SPPA and the actuary. • Carry out analytical work on the actuarial output figures. 	<p>We met with GAD and discussed the 2012 valuation process; roll forward of 2012 data for 2014/15 accounts; and GAD’s quality review processes.</p> <p>We reviewed the GAD assumptions reports, and noted the minutes of the meeting between GAD and SPPA to discuss the proposed assumptions.</p> <p>We carried out audit work on the valuation data submitted to GAD by SPPA.</p> <p>We carried out analytical work on the actuarial output figures.</p> <p>We assessed the reliability, professional competence capability and objectivity of GAD as an expert on whom we place reliance and concluded that we could place reliance on their work.</p>
<p>Information to support scheme valuations (Pension schemes risk)</p> <p>To avoid the risk of actuarial valuations being materially incorrect, SPPA needs to ensure that the implications of changes to membership profiles are fully considered and up to date information is provided to the actuary.</p>	<ul style="list-style-type: none"> • Meeting with GAD. • Review and assessment of the information supplied to GAD. • Review of GAD’s validation processes. 	<p>We met with GAD; discussed and reviewed the information supplied to GAD and also reviewed evidence that supported the validation processes in place. No issues were noted that would have a material effect on the actuarial valuation.</p>

Appendix I – Significant audit risks

Audit Risk (from Annual Audit Plan)	Assurance procedure	Results and conclusions
<p>AXISe/Altair systems (Pension schemes risk)</p> <p>Pension award payments may be inaccurate due to errors arising as result of human error, a failure in internal controls or systems or fraud. The pension administration system in place at the SPPA for a number of years has been AXISe. As a result of system support being withdrawn by the software supplier together with the major changes required to the IT administration software to implement changes required by pension reform, it has been necessary to upgrade the system to Altair. We will need to ascertain if the key controls over Altair are the same as for AXISe, and test whether they operated effectively during 2014/15.</p> <p>For 2014/15 there is a further risk of error if the migration of data to the new system was incomplete and/or inaccurate.</p> <p>Errors could result in overpayments being borne by the Agency/Scottish Consolidated Fund.</p>	<ul style="list-style-type: none"> • Review of key controls. • Review of data migration processes to gain assurance over complete data transfer. • Review the work of QA and payroll staff, noting error rates and types, and target our awards testing accordingly. • Pension awards testing. • Review of outcomes from NFI/GROS and other initiatives. 	<p>No significant issues were identified in our testing of key controls in AXISe and Altair.</p> <p>No issues were highlighted by the ICT auditor’s review of the data migration process.</p> <p>We discussed and reviewed the QA work of payroll staff and targeted our awards testing accordingly. No errors were highlighted during the testing of pension awards.</p> <p>We reviewed the NFI outcomes, noting progress with the matches, and discussed other initiatives in development. SPPA is actively investigating NFI data matches. 107 errors totalling £263,257 have been identified.</p>

Appendix I – Significant audit risks

Audit Risk (from Annual Audit Plan)	Assurance procedure	Results and conclusions
<p>Pension contributions/ Epicor system (Pension schemes risk)</p> <p>Contributions income, as processed and recorded on EPICOR, is a primary determinant in the calculation of the Schemes' liabilities and current service costs.</p> <p>Robust procedures for reconciling contributions income received to employers' annual returns are essential to ensure that all monies due from employers are received.</p> <p>Reviews of aged debtor reports and carrying out reconciliations processes for control accounts are key internal controls and are also important procedures for ensuring completeness of contributions. We have previously reported that the aged debt report in EPICOR is not functioning correctly and at the time of the 2013/14 audit there was a difference in the debtor figure between EPICOR and the SEAS general ledger.</p> <p>It is essential that information provided to GAD is accurate and reliable; failure to manage contribution collections effectively may impact on the Schemes' liabilities and actuarial valuations.</p>	<ul style="list-style-type: none"> • Meetings with SPPA to monitor the process of reconciliations, with targets and timescales agreed. • Review of reconciliations during our audit of the Schemes' financial statements. • Review of aged debtor reports and reconciliation work carried out by SPPA. 	<p>We held meetings with Finance staff to discuss progress with contributions reconciliation processes. We reported an issue in our 'Review of Internal Controls 2014/15' presented to the Audit and Risk Committee in July 2015.</p> <p>From our review of EPICOR/SEAS debtors reports we noted that issues with the reconciliation processes for control accounts remain evident. The amounts involved are not material.</p> <p>Both issues are currently under review by SPPA staff.</p>

Appendix I – Significant audit risks

Audit Risk (from Annual Audit Plan)	Assurance procedure	Results and conclusions
<p>Implementing business transformation (Agency corporate risk)</p> <p>We have previously reported on the governance arrangements in place to address the challenges ahead. SPPA's Business Change Programme remains a complex and significant programme. There is a business and reputational risk if SPPA cannot maintain the continuity and quality of services while implementing the changes to pension schemes and SPPA systems required by pension reform.</p>	<ul style="list-style-type: none"> Monitoring of pension reform developments through review of committee papers, discussion with SPPA staff and media reports. Monitoring of the Business Change Programme governance and reporting arrangements through review of committee papers and discussion with SPPA staff. 	<p>Through discussion with the Director of Business Change and the Director of Policy; review of the Business Transformation Board papers and committee papers; and attendance at Audit and Risk Committees, we conclude that SPPA is maintaining the continuity and quality of its services whilst implementing the changes to pension schemes, governance arrangements and SPPA systems required by pension reform.</p>

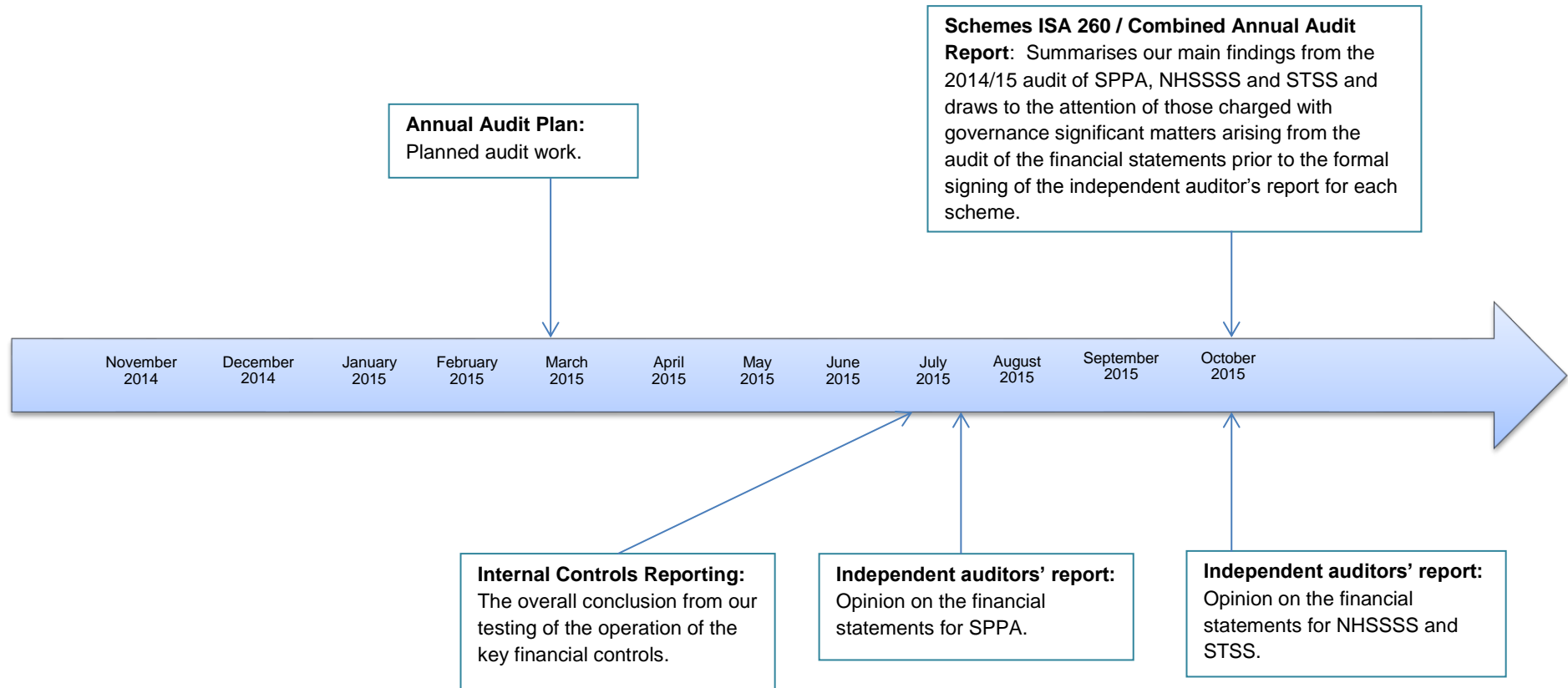
Appendix I – Significant audit risks

Audit Risk (from Annual Audit Plan)	Assurance procedure	Results and conclusions
<p>New governance arrangements for pension schemes (Pension schemes risk)</p> <p>The Public Service Pensions Act 2013 requires new governance arrangements to be established from 1 April 2015 for the pension schemes, to reinforce the importance of transparency and accountability.</p> <p>The Act requires two new statutory governance bodies to operate for each scheme: Scheme Advisory Boards and Pension Boards. These arrangements are being developed by SPPA. SPPA will need to ensure that the members recruited to these boards have a good understanding of pension scheme governance and administration, with training provided as appropriate.</p>	<ul style="list-style-type: none"> Review of the proposed arrangements against the requirements of the legislation 	<p>We met with the Director of Policy to discuss the new pension scheme governance arrangements.</p> <p>In line with the Act, a Scheme Advisory Board and a Pension Board have been established for each scheme.</p> <p>Scheme Advisory Board and Pension Board Members have been recruited and inaugural meetings have taken place. Up to four meetings a year are envisaged; in due course, each board will decide the most appropriate frequency of its meetings. Formal training/awareness sessions have been provided to Pension Board Members.</p> <p>SPPA has made good progress in developing and implementing the new arrangements.</p>

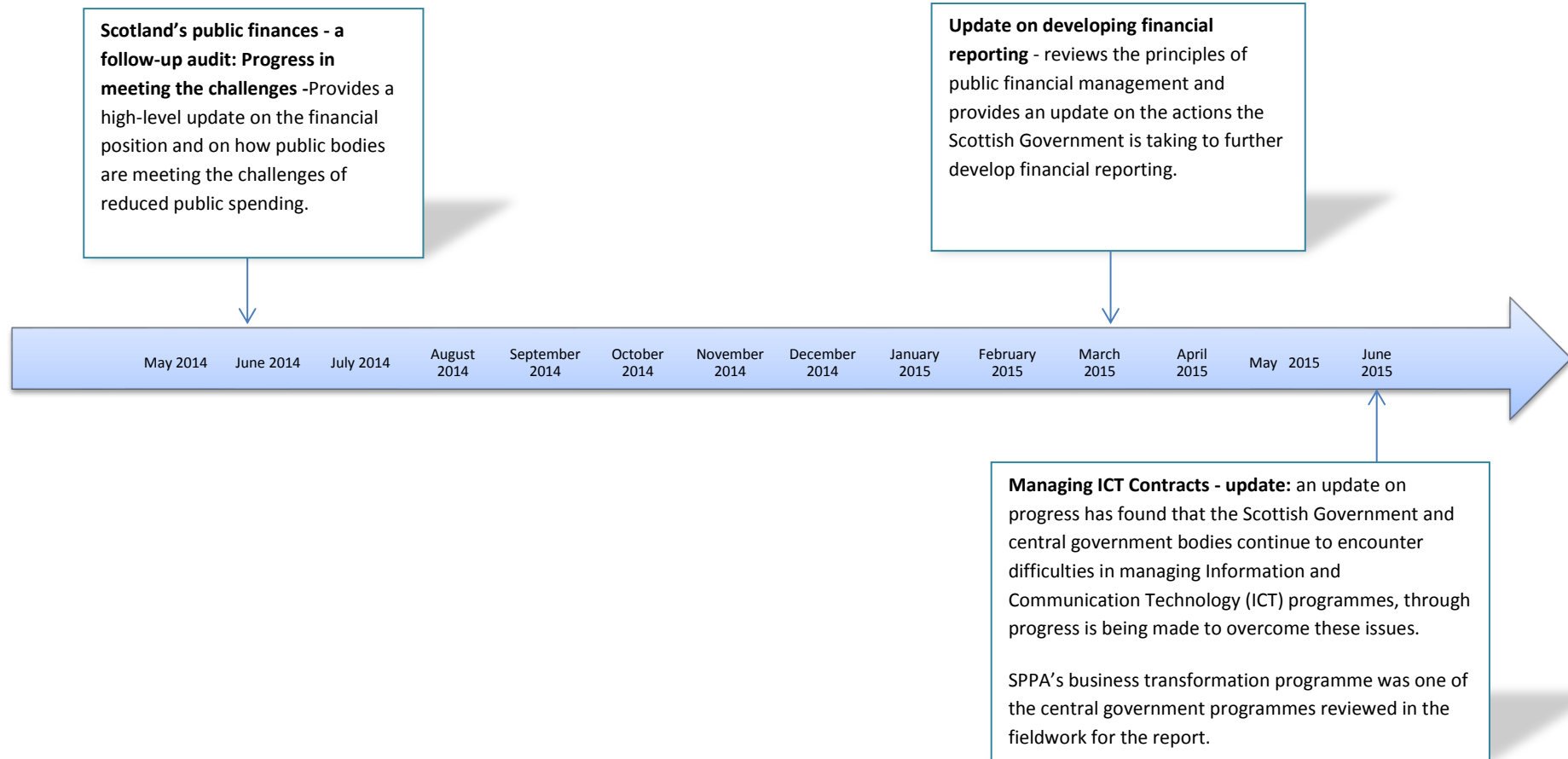
Appendix I – Significant audit risks

Audit Risk (from Annual Audit Plan)	Assurance procedure	Results and conclusions
<p>Workforce and Succession Planning (Agency corporate risk)</p> <p>As previously reported, the Agency has no overarching workforce plan in place. The significant changes arising from pension reform may result in workforce pressures for the Agency; development of a workforce plan with appropriate succession planning for key posts should assist effective management of these changes.</p> <p>In terms of key posts that affect governance arrangements, the Chief Executive leaves at the end of March and several members of the Audit and Risk Committee reach the end of their appointment this year.</p>	<ul style="list-style-type: none"> • Review and monitoring of KPIs for indications of workload affecting performance. • Attendance at Audit and Risk Committee meetings. • Regular engagement with key SPPA staff. • Review of External Management Board and Senior Management Team minutes and papers. • Follow up of the action plan recommendation from 2013/14 Annual Audit Report. 	<p>No indicators of poor performance highlighted by our review of KPIs, discussion with SPPA staff or through attendance at Audit and Risk Committee meetings.</p> <p>Progress against the action plan recommendation from our 2013/14 Annual Audit Report is monitored through the SPPA audit recommendations tracker, which is reported to the Audit and Risk Committee.</p> <p>SPPA’s review of its workforce planning approach is due to be completed by 31 December 2015.</p>

Appendix II – Summary of local audit reports 2014/15



Appendix III – Summary of national reports 2014/15



Appendix IV – Action plan

Para/ page	Issue/risk/recommendation	Management action/response	Responsible officer	Target date
Financial audit issues				
No.1 28/9	<p>Revisions to the Government Financial Reporting Manual (FReM)</p> <p>The 2015/16 FReM requires significant changes to the disclosures within the 2015/16 Annual Report and Accounts. A performance report will be required, along with an accountability report comprising a corporate governance report; remuneration and staff report; and a parliamentary and accountability report. Arrangements should be put in place to develop these disclosures (and retain any supporting documents as audit working papers).</p> <p>Risk:</p> <p>SPPA may not accord with best practice in annual reporting if it does not comply with the FReM.</p> <p>Recommendation:</p> <p>SPPA should consider the new FReM disclosure requirements and ensure that these are included in the 2015/16 Annual Report and Accounts, adjusting the timetable for preparation if necessary.</p>	Agreed. HM Treasury make periodic revisions to FReM which will be monitored until 2015-16 year end.	Director of Finance	March 2016

Appendix IV – Action plan

Para/ page	Issue/risk/recommendation	Management action/response	Responsible officer	Target date
Wider audit issues				
No.2 66/18	<p>Transparency and accountability</p> <p>The Scottish Government has updated its guidance for board members of public bodies which contains important principles which are relevant to SPPA. The Agency holds its board and committee meetings in private and the papers are not publicly available. Minutes are published on the website after they have been approved at the following meeting, which means a time lag before they are published. There are some areas of board and committee business which would not necessarily be considered confidential and which could be made more accessible to the public.</p> <p>Risk:</p> <p>SPPA may not be able to demonstrate it is sufficiently open and transparent.</p> <p>Recommendation:</p> <p>SPPA should review its current arrangements for openness and transparency of organisational decision making against relevant best practice.</p>	<p>Agreed. The issue was discussed both at the Audit & Risk Committee and at the Corporate Board, held in Oct 15.</p> <p>SPPA is establishing a Secretariat to service the needs of the boards and committee meetings operating within the Agency and key appointments will now be made over the coming months. Clear policies, and the associated processes and required resources, will be needed as part of a wider review of the transparency and accountability agenda in SPPA. In particular, ensuring appropriate publication of committee minutes and adherence to Freedom of Information legislation demands careful consideration and will be a key role of the new Secretariat when formed.</p>	Director of Corporate Services	Audit & Risk Committee meeting April 2016