

# Scottish Public Pensions Agency

2016/17 Annual Audit Report



 AUDIT SCOTLAND

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

September 2017

## Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



## About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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# Key messages

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## Audit of the 2016/17 financial statements

- 1** The financial statements of the Scottish Public Pensions Agency, NHS Pension Scheme (Scotland) and Scottish Teachers' Pension Scheme for 2016/17 all give true and fair views of the state of the financial position and the net expenditure for the year.
- 2** The expenditure and income in the financial statements was incurred or applied in accordance with applicable enactments and guidance.
- 3** The other information in the annual reports and accounts is consistent with the financial statements and prepared in accordance with legal requirements.

## Financial management

- 4** SPPA effectively managed the finances of the Agency and the Pension schemes.
- 5** Systems of internal control operated effectively in 2016/17.
- 6** There has been good engagement with the NFI exercise throughout the year.

## Financial sustainability

- 7** SPPA has effective short term financial planning arrangements in place for the Agency and the Pension schemes.
- 8** SPPA should work to complete a corporate plan and longer term financial strategy.

## Governance and transparency

- 9** SPPA has adequate governance arrangements in place, but these could be further strengthened.
- 10** Risk management processes have been improved in 2016/17.
- 11** There is scope for SPPA to enhance openness and transparency.

## Value for money

- 12** Successful implementation of PS Pensions remains a significant risk for the Agency and SPPA should continue to work to ensure effective management and scrutiny to allow successful delivery.
- 13** SPPA should develop an approach to workforce planning to ensure it has appropriate resources to meet the future needs of the business.

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# Introduction

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1. This report is a summary of our findings arising from the 2016/17 audit of Scottish Public Pensions Agency (SPPA), NHS Pension Scheme (Scotland) (NHSPSS) and Scottish Teachers' Pension Scheme (STPS).

2. The scope of our audit was set out in our Annual Audit Plan presented to the January 2017 meeting of the Audit and Risk Committee. This report comprises:

- an audit of the annual report and accounts for the Agency and the Pension schemes
- consideration of the wider dimensions set out in the [Code of Audit Practice 2016](#) as illustrated in [Exhibit 1](#).

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## Exhibit 1

### Audit dimensions



Source: Code of Audit Practice 2016

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3. The main elements of our audit work in 2016/17 have been:

- an interim audit of the Agency and Pension schemes' main financial systems and governance arrangements resulting in an interim report presented to the Audit and Risk Committee (ARC) in May 2017
- an audit of the Agency and Pension schemes' 2016/17 annual report and accounts including the issue of an independent auditor's report setting out our opinions.

4. SPPA is responsible for preparing financial statements for the Agency and Pension schemes that give a true and fair view, for the accuracy of the other information in the annual report and accounts, and for establishing effective arrangements for governance, propriety and regularity that enable the Agency to successfully deliver its objectives.

5. Our responsibilities as independent auditor are established by the Public Finance and Accountability (Scotland) Act 2000 and the [Code of Audit Practice 2016](#), supplementary guidance and, guided by the auditing profession's ethical guidance.

6. These responsibilities include giving independent opinions:

- on the financial statements, regularity, the remuneration and staff report, the performance report and the governance statement for the Agency
- on the financial statements, regularity, the report of the managers and the governance statement for the Pension schemes.

7. We also review and report on the arrangements within SPPA to manage its performance, regularity and use of resources. In doing this, we aim to support improvement and accountability.

8. Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.

9. The weaknesses or risks identified in this report are only those that have come to our attention during our normal audit work, and may not be all that exist. Also, our Annual Audit Report contains an action plan at [Appendix 1 \(page 22\)](#). It sets out specific recommendations, responsible officers and dates for implementation.

10. Communication in this report of matters arising from the audit of the annual report and accounts or of risks or of weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

11. As part of the requirement to provide fair and full disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2016/17 audit fee for the audit was set out in our Annual Audit Plan and as we did not carry out any work additional to our planned audit activity, the fee remains unchanged.

12. This report is addressed to both the board and the Auditor General for Scotland and will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).

13. We would like to thank all management and staff who have been involved in our work for their cooperation and assistance during the audit.

# Part 1

## Audit of 2016/17 financial statements



### Main judgements

**The financial statements of the Scottish Public Pensions Agency, NHS Pension Scheme (Scotland) and Scottish Teachers' Pension Scheme for 2016/17 all give true and fair views of the state of the financial position and the net expenditure for the year.**

**The expenditure and income in the financial statements was incurred or applied in accordance with applicable enactments and guidance.**

**The other information in the annual reports and accounts is consistent with the financial statements and prepared in accordance with legal requirements.**

### Unqualified audit opinions

14. The annual report and accounts for the Scottish Public Pension Agency (the Agency) for the year ended 31 March 2017 were approved by the Audit and Risk Committee on 25 July 2017. We reported, within our independent auditor's report:

- an unqualified opinion on the financial statements
- an unqualified opinion on regularity of expenditure and income
- an unqualified audit opinion on the remuneration and staff report, performance report and governance statement.

15. The annual report and accounts for the NHS Pension Scheme Scotland and the annual report and accounts for the Scottish Teachers' Pension Scheme (the Pension schemes) for the year ended 31 March 2017 were approved by the Audit and Risk Committee on 25 September 2017. We reported, within our independent auditor's report:

- an unqualified opinion on the financial statements
- an unqualified opinion on regularity of expenditure and income
- an unqualified audit opinion on the report of managers and governance statement.

16. Additionally, we are satisfied that there are no matters which we are required by the Auditor General to report by exception.

### Submission of annual report and accounts for audit

17. We received the unaudited financial statements for the Agency on 5 June 2017, in line with our agreed audit timetable.

The annual report and accounts are the principal means of accounting for the stewardship of resources and performance in the use of those resources.

18. We received the unaudited financial statements for the Pension schemes on 17 July 2017 in line with our agreed audit timetable.

19. The working papers provided with the unaudited financial statements for the Agency and Pension schemes were of a good standard and finance staff provided support to the audit team which helped ensure the final accounts audit process ran smoothly.

## Whole of government accounts

20. We are auditing the Pension schemes' consolidation packs for whole of government accounts. We anticipate submitting our assurance statement to the National Audit Office by the deadline of 30 September 2017.

## Risk of material misstatement

21. [Appendix 2 \(page 25\)](#) provides a description of those assessed risks of material misstatement that were identified during the planning process which had the greatest effect on the overall audit strategy, the allocation of resources to the audit and directing the efforts of the audit team. This covers both the Agency and Pension schemes.

## Materiality

22. Materiality defines the maximum error that we are prepared to accept and still conclude that our audit objective has been achieved. The assessment of what is material is a matter of professional judgement. It involves considering both the amount and nature of the misstatement.

23. Our initial assessment of materiality for the annual report and accounts was undertaken during the planning phase of the audit for the Agency and Pension schemes. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

24. On receipt of the annual report and accounts we reviewed our original materiality calculations and concluded that they remained appropriate. The materiality levels we applied during the audit are summarised in [Exhibit 2](#).

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## Exhibit 2

### Materiality values

Agency materiality level	Amount
<b>Overall materiality</b> – This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It was set at 1% of gross expenditure for the year ended 31 March 2017.	£0.180 m
<b>Performance materiality</b> – This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality, this would indicate that further audit procedures should be considered. Using our professional judgement we have calculated performance materiality at 75% of overall materiality.	£0.135 m
<b>Reporting threshold</b> – We are required to report to those charged with governance on all unadjusted misstatements in excess of the 'reporting threshold' amount. This has been calculated at approximately 5% of overall materiality.	£0.010 m



NHS Pension Scheme (Scotland) materiality level	Amount
<b>Overall materiality</b> – This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It was set at 1% of benefits paid for the year ended 31 March 2017.	£11.122 m
<b>Performance materiality</b> – This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality, this would indicate that further audit procedures should be considered. Using our professional judgement we have calculated performance materiality at 90% of overall materiality.	£10.010 m
<b>Reporting threshold</b> – We are required to report to those charged with governance on all unadjusted misstatements in excess of the 'reporting threshold' amount. This has been calculated at 1% of overall materiality.	£0.100 m

Scottish Teachers' Pension Scheme	Amount
<b>Overall materiality</b> – This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It was set at 1% of benefits paid for the year ended 31 March 2017.	£10.876 m
<b>Performance materiality</b> – This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality, this would indicate that further audit procedures should be considered. Using our professional judgement we have calculated performance materiality at 90% of overall materiality.	£9.788 m
<b>Reporting threshold</b> – We are required to report to those charged with governance on all unadjusted misstatements in excess of the 'reporting threshold' amount. This has been calculated at 1% of overall materiality.	£ 0.100 m

Source: Audit Scotland

## Evaluation of misstatements

25. There were no material adjustments to the unaudited financial statements of the Agency or the Pension schemes arising from our audit. All individual misstatements which exceeded our reporting threshold have been amended in the audited financial statements.

## Significant findings from the audits

26. International Standard on Auditing (UK and Ireland) 260 requires us to communicate significant findings from the audit to you. These are summarised in [Exhibit 3](#).

## Exhibit 3

### Significant findings from the audit of financial statements

Issue	Resolution
<p><b>1. Statement of financial position: Pension scheme net liabilities</b></p> <p>The NHSPSS and STPS are unfunded schemes. This means that the pension liabilities detailed in the statement of financial position are not matched by investments or other financial assets. The net liabilities of both schemes have increased significantly in 2016/17, due mainly to a change in discount rate set by HM Treasury. This has resulted in net liabilities of:</p> <ul style="list-style-type: none"> <li>• £59.7 billion for NHSPSS (2015/16 £44.8 billion)</li> <li>• £36.3 billion for STPS (2015/16 £28.7 billion).</li> </ul> <p>The accounts for both schemes are prepared on a going concern basis. We have concluded that this is appropriate as the Scottish Government provides funding through its budget process to meet pension payments as they fall due under the Pension schemes regulations.</p>	<p>We are satisfied that the use of the going concern basis is appropriate for the preparation of the Pension scheme accounts.</p>
<p><b>2. Actuarial methodology: Pension schemes</b></p> <p>The pension liabilities at 31 March 2017 for both schemes are based on a full actuarial valuation carried out using membership data as at 31 March 2015. This has then been 'rolled forward' to 31 March 2017 using the actuarial roll forward methodology.</p> <p>The actuary has identified some weaknesses with this methodology including the liabilities attributed to active members, deferred pensioners and pensioners may not reflect the actual membership in each category at the roll forward date.</p>	<p>The Accountable Officer has confirmed that they are content with the assumptions proposed by the actuary and the methodology used for the valuation.</p> <p>We are satisfied that the actuary's methodology, judgements and assumptions provide a sufficiently reliable estimate of the NHSPSS and STPS liabilities as at 31 March 2017.</p>

Source: Audit Scotland

## Other findings

27. Our audit identified a number of presentational and disclosure issues which were discussed with management for both the Agency and the Pension schemes. These were adjusted and reflected in the audited financial statements.

# Part 2

## Financial management



### Main judgements

**SPPA effectively managed the finances of the Agency and the Pension schemes.**

**Systems of internal control operated effectively in 2016/17.**

**There has been good engagement with the NFI exercise throughout the year.**

### Financial performance in 2016/17

28. The main financial objective for the Agency is to ensure that its financial outturn for the year is within the budget allocated by Scottish Ministers. The Agency reported an outturn of £19.05 million (including capital and non-cash expenditure) against its budget of £20.30 million, resulting in an underspend of £1.25 million. The financial performance against Departmental Expenditure Limits (DEL) is shown in [Exhibit 4](#).

29. The Agency's resource DEL was increased in year for funding for actuarial services which are historically transferred in year. The reduction in the Agency capital DEL is as a result of funding not being required due to delays in the PS Pensions Project, which is to develop a new integrated pension administration and payment system. The resource underspend also mainly relates to lower than expected spending on the PS Pensions Project.

30. The Pension schemes are funded through annually managed expenditure (AME). The AME budget covers the cost of pension payments to approximately 175,000 retired scheme members. The change between initial and final budget reflects that the HM Treasury discount rates for pensions were not known at the time of the initial budget. The accrued resources for the Pension schemes are covered by one limit of £3,300.3 million as detailed in the Budget (Scotland) Act 2016. The financial performance against AME is shown in [Exhibit 4](#). The total combined accrued resources totalled £3,281.6 million which is within the combined limit.

## Exhibit 4

### Performance against DEL/AME in 2016/17

Agency Performance	Initial budget £m	Final budget £m	Actual outturn £m	Overspend/ (underspend) £m
Resource DEL	16.80	18.20	17.29	(0.91)
Capital DEL	3.50	2.10	1.76	(0.34)
<b>Total DEL</b>	<b>20.30</b>	<b>20.30</b>	<b>19.05</b>	<b>(1.25)</b>

Pension scheme Performance	Initial budget £m	Final budget £m	Actual outturn £m	Overspend/ (underspend) £m
NHSPSS AME	2,182.5	2,092.0	2,097.4	5.4
STPS AME	1,259.1	1,208.3	1,184.2	(24.1)
<b>Overall Budget Limit</b>	<b>3,441.6</b>	<b>3,300.3</b>	<b>3,281.6</b>	<b>(18.7)</b>

Source: Scotland's Budget: Draft Budget 2017/18 (issued 15 Dec 2016) Spring Budget Revision 2016/17 (issued 2 Feb 2017)

## Internal controls

31. As part of our audit we identify and inspect the key internal controls in those accounting systems which we regard as significant for the production of the financial statements. Our objective is to gain assurance that the Agency and Pension schemes have systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

32. Our findings were included in an interim audit report presented to the Audit and Risk Committee on 5 May 2017. We concluded that the controls were operating effectively. No significant internal control weaknesses were identified during the audit which could 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 for the Agency and the Pension schemes.

## Budgetary processes

33. We also reviewed SPPA's budgetary processes and budget monitoring arrangements for the Agency and Pension schemes. From our review of budget monitoring reports, review of committee papers and attendance at committees we confirmed that senior management and members receive regular, timely and up to date financial information on the financial position.

34. We concluded that SPPA has effective budgetary monitoring and control arrangements that allow both non-executives and officers to carry out effective scrutiny of its finances.

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Financial management is about financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

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## Prevention and detection of fraud and irregularity

35. We assessed the SPPA's arrangements for the prevention and detection of fraud. Our audit work covered a number of areas such as whistleblowing and review of the counter fraud strategy.

36. We concluded that SPPA is proactive in promoting fraud awareness and had appropriate and adequate arrangements in place for fraud detection and prevention during 2016/17. We noted that the whistleblowing policy is due for review in 2017/18.

## National Fraud Initiative

37. The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise coordinated by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify 'matches' that might suggest the existence of fraud or error.

38. The matches investigated by SPPA related to the Pension schemes only. The matches identified:

- 2,659 matches for deceased pensioners. These were reviewed and 382 cases are currently under investigation
- 1,990 matches for deferred members (against deceased records). 1,500 matches have been investigated and the members' records have been updated on the system. It is expected that investigation of the remaining matches will be completed in the next couple of months
- 6,947 matches for re-entered employment. 1,163 of these cases have been identified as requiring further investigation.

39. SPPA have been proactive in investigating matches and progress is reported regularly at the Audit and Risk Committee. The matching process has identified overpayments totalling £68,000 which SPPA is actively pursuing.

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

40. We have reviewed the arrangements in place to maintain standards of conduct including the Civil Service and Members' Codes of Conduct. There are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.

41. Based on our review of the evidence we concluded that SPPA has appropriate arrangements in place for the prevention and detection of bribery and corruption. We are not aware of any specific issues that we need to bring to your attention.

# Part 3

## Financial sustainability



### Main judgements

**SPPA has effective short term financial planning arrangements in place for the Agency and the Pension schemes.**

**SPPA should work to complete a corporate plan and longer term financial strategy.**

### Financial planning

42. The Scottish Government published the 2017/18 draft budget in December 2016 and Budget Bill in February 2017 for the Agency and the Pension schemes. The Agency has a resource allocation of £18.3 million (resource £16.3 million and capital £2.0 million) which is £2 million (9.9 %) less than the initial 2016/17 budget allocation. As in previous years there is a shortfall between the budget provided and that required for the Agency. Contributions will be sought towards the £2.148 million cost of actuarial services from other portfolios with scheme member interests and the £0.314 million annual cost of the administration of fire fighters' pensions from the Scottish Government during 2017/18.

43. The budget position will be challenging for the Agency as there will be increased resource costs to complete work on the Guaranteed Minimum Pension reconciliation by the December 2018 deadline.

44. For 2017/18, the NHSPSS has an AME allocation of £2,966.9 million, which is £784.4 million (35.9%) more than the initial 2016/17 budget allocation. The STPS has an AME allocation of £1,554.6 million, which is £295.5 million (23.4%) more than the initial 2016/17 budget allocation.

45. The significant increases in AME funding for the Pension schemes reflect the change in HM Treasury discount rate used for post-employment benefits.

### 2016/17 financial position

46. The financial statements show that for the Pension schemes:

- NHSPSS has net liabilities of £59.7 billion, an increase of £14.9 billion
- STPS has net liabilities of £36.3 billion, an increase of £7.6 billion.

47. The increase in net liabilities mainly stems from the change in the financial assumptions used in the actuarial valuations, particularly the discount rate set by HM Treasury.

Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

## Medium to long term financial planning

48. We reviewed the financial planning systems and assessed how effective SPPA is in identifying and addressing risks to financial sustainability in the medium to long term.

49. We recognise that the Agency is mainly funded from the Scottish Government budget allocation (99% of income) and this is set annually by the Scottish Government. SPPA prepares rolling three year forecasts for its revenue and capital budgets. It also uses scenario planning to assess the impact of movements in key variables on business cases. SPPA does not yet prepare medium to long term financial plans (typically covering five to ten years).

50. In April 2016 the SPPA Corporate Board drafted a 2016/17 corporate plan which officers indicated would cover the years 2016-19. However this was not published. Instead, a one year business plan was prepared, but this did not cover the wider strategic objectives for SPPA. Officers plan to develop a new three year corporate plan covering the period to 2019/20. The plan is due to be presented to the Management Advisory Board by the end of 2017. This will include a medium term financial strategy.

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### Recommendation 1

**SPPA should work to complete a corporate plan which sets out its strategic objectives and how these will be delivered within funding allocations. This should include a longer term financial strategy, with clear links to its People Strategy and annual business plans.**

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# Part 4

## Governance and transparency



### Main judgements

**SPPA has adequate governance arrangements in place, but these could be further strengthened.**

**Risk management processes have been improved in 2016/17.**

**There is scope for SPPA to enhance openness and transparency.**

### Governance arrangements

51. The governance arrangements for SPPA are set out in its Framework Document 2012-2015 which has been extended to cover 2015/16 and 2016/17. Elements of the document are out of date. The Agency has advised that this will be reviewed in full in 2017/18.

#### Recommendation 2

**SPPA, together with its sponsor directorate, should review and update its Governance Framework Document to ensure it sets out a clear vision and direction for the Agency.**

52. The corporate governance framework within the SPPA is centred around the Management Advisory Board (MAB) (previously the Corporate Board until March 2017). The Board is SPPA's main forum for discussing strategic priorities and ensuring effective governance. The Board's responsibility is to support the Accountable Officer. It does not have a formal decision making or scrutiny role. It is supported in its role by the Audit and Risk Committee (ARC) which is a non-executive committee of the Board.

53. We reviewed the SPPA's governance arrangements. Our key findings are:

- Board members provide an appropriate level of scrutiny and challenge of strategic decisions
- Board members are generally provided with sufficiently detailed information to support them in their role, although in January 2017, we observed the need for more information to be provided to the ARC on the PS Pensions project. Since then SPPA has strengthened governance arrangements for the project; this has included holding extraordinary ARC meetings in February and September 2017 to provide additional information to members
- the Chair and other Board members understand their roles and responsibilities. Terms of reference for the MAB are in the process of being prepared and reviewed

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision-making and transparent reporting of financial and performance information.



- SPPA should consider formally assessing the performance of the Chair and Board members on a regular basis
- we noted that at the May 2017 MAB, non-executive directors agreed that they would complete register of interest forms annually.

54. In addition to annual declarations of interest for non-executive directors of the MAB, members of the ARC, Pension Boards and executive directors should also complete an annual declaration of interest form. Maintaining an up to date register of interests is an important means of demonstrating and ensuring openness and transparency in organisational decision making.

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### Recommendation 3

**All Board members should complete a declaration of interests at least annually and ensure that any changes in their interests are notified to the Agency.**

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55. The Pension Boards assist the Scheme Managers in the operational delivery of the Pension schemes in line with scheme regulations and the requirements of the Pension Regulator. External consultants have reviewed the governance arrangements and this report has recently been agreed by Scottish Ministers. An action plan will be taken forward in 2017/18.

56. We concluded that SPPA has adequate governance, decision making and scrutiny arrangements in place. These arrangements provide an appropriate framework for organisational decision making, but could be further strengthened.

### The annual governance statement

57. Under the Treasury's Financial Reporting Manual (FReM), SPPA must prepare an annual governance statement within the Annual Report and Accounts for the Agency and the Pension schemes. Guidance is set out within the Scottish Public Finance Manual (SPFM) for the content of the statement and provides assurances around the achievement of the organisation's strategic objectives.

58. The SPFM does not prescribe a format for the annual governance statement, but sets out minimum requirements for central government bodies. The process undertaken by management included conducting an assurance mapping exercise and working to an assurance plan that assessed the evidence underpinning the preparation of the governance statement.

59. We concluded that the 2016/17 annual governance statement for the Agency and Pension schemes complies with the guidance issued by the Scottish Ministers and based on our knowledge and work performed presents an accurate picture of governance arrangements.

### Internal audit

60. Internal audit provides SPPA and the Accountable Officer with independent assurance on SPPA's overall risk management, internal control and corporate governance processes and covers both the Agency and the Pension schemes.

61. The internal audit function is carried out by the Scottish Government's Internal Audit Directorate. We carried out a review of the adequacy of the internal audit function and concluded that it operates in accordance with the Public Sector Internal Audit Standards (PSIAS) and has sound documentation standards and reporting procedures in place.

62. To avoid duplication of effort we place reliance on the work of internal audit wherever possible. In 2016/17, we met regularly with internal audit to coordinate our work on the PS Pensions Project. We planned to place reliance on internal audit's work on Bank receipts and the collection process. Due to the revised timing of this work, we did not do so, but we will consider using it to support our 2017/18 audit work. We also considered other internal audit report findings and work as part of our wider dimension work.

## Risk management

63. SPPA has made changes to its risk management process following an external review carried out in July 2016. A new Risk Governance Group has been created. Its role is to ensure the risk environment is reviewed regularly and key risks are recorded in SPPA's risk registers. A non-executive member attends meetings of the group to provide scrutiny and challenge.

64. The corporate risk register was reviewed and it covers all key elements required to manage each risk including:

- the risk owner
- impact and likelihood
- risk rating
- risk target
- actions in place to manage and mitigate the risk.

65. We concluded that risk management processes are operating effectively and good progress has been made to embed these within SPPA's governance arrangements.

## Transparency

66. Transparency means that the stakeholders, including the general public, have access to understandable, relevant and timely information about how the SPPA is taking decisions and how it is using resources.

67. Minutes of the Management Advisory Board are published on the SPPA website. Board papers and Audit and Risk Committee agendas, minutes and papers are not published.

68. With increasing expectations for enhanced openness in the conduct of public business SPPA may wish to consider whether there are opportunities to further enhance transparency. For example, SPPA could consider making available Board and Audit and Risk Committee papers and minutes, where appropriate.

# Part 5

## Value for money



### Main judgements

**Successful implementation of PS Pensions remains a significant risk for the Agency and SPPA should continue to work to ensure effective management and scrutiny to allow successful delivery.**

**SPPA should develop an approach to workforce planning to ensure it has appropriate resources to meet the future needs of the business.**

### Best Value

69. Accountable officers have a specific 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 SPPA agree to undertake local work in this area.

### PS Pensions Project

70. In 2013, SPPA began a Business Transformation Programme 'One SPPA'. This covered a wide range of areas including:

- managing the introduction of the Public Sector Pensions Act (2013)
- providing administration support for police and fire fighters' pensions
- ensuring IT provision for this expanded role.

71. In October 2015, SPPA awarded a £5.6 million contract to deliver a bespoke unified pension administration and payment system for the Pension schemes, PS Pensions. The aims of the PS Pensions Project include; replacing a number of existing systems to improve business efficiency, to improve service quality for members, and make financial savings in the longer term.

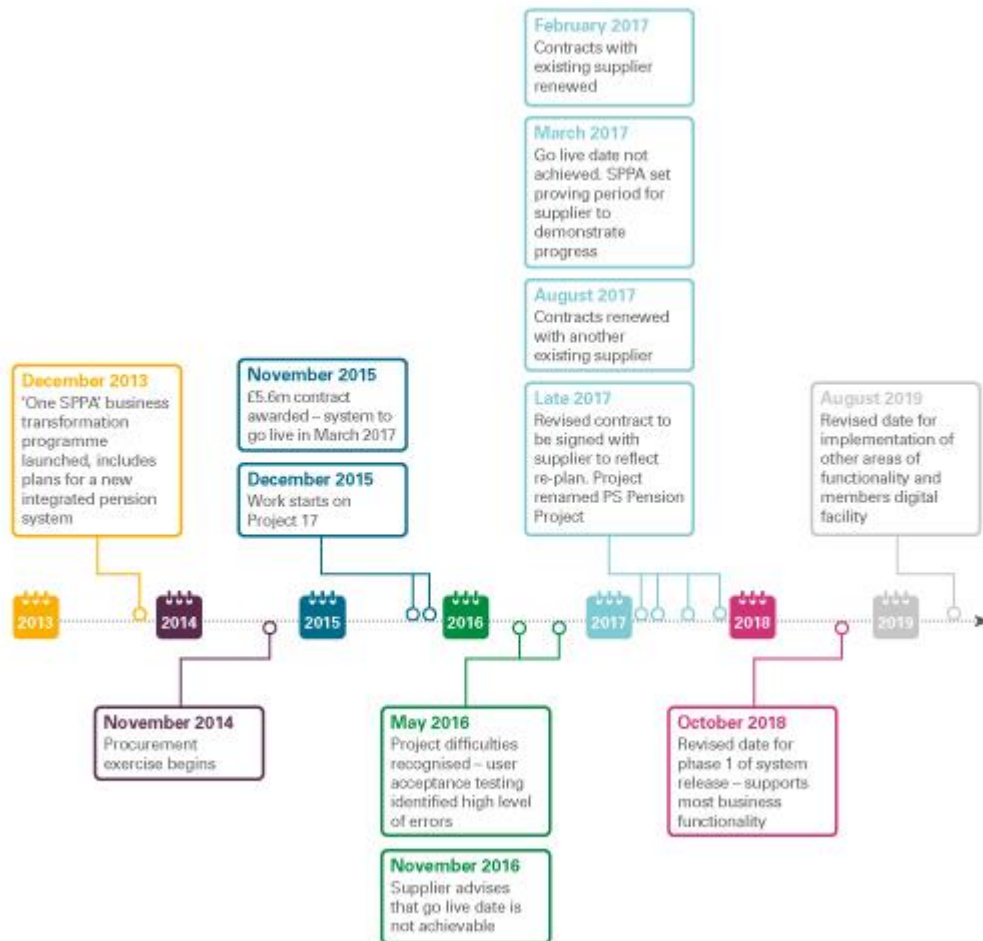
72. By mid 2016, a significant number of coding errors were identified through user acceptance testing. As a result of this, the then Chief Executive initiated a system health check carried out by the Scottish Government's Office of the Chief Information Officer. This health check was completed in late 2016 and identified that the project would not be completed by its March 2017 deadline and that a re-plan would be required. The health check identified areas of improvement for both SPPA and the supplier.

73. Throughout 2017, work has been carried out on re-planning the project and ensuring it remains viable. An additional health check was carried out in mid 2017. Both the revised business case and contract variation were scrutinised by the ARC and MAB in September 2017. There will be a partial implementation in October

Value for money is concerned with using resources effectively and continually improving services.

2018 which will support the majority of business operations, with subsequent releases leading to a full implementation by August 2019, see [Exhibit 5](#).

## Exhibit 5 PS Pensions Project



Source: Audit Scotland

74. The project delays have led to increased costs for the project as contracts with existing suppliers have had to be extended to ensure SPPA is able to continue to deliver services. The Agency has modelled the budget for the project over the next three years to take into account the additional areas of expense. Governance arrangements around the re-plan have been strengthened, with business case revisions subject to internal and external scrutiny through Project Board, ARC and MAB meetings.

75. Due to the size and scale of the PS Pensions Project it continues to present significant financial, reputational and service delivery risks to SPPA. The increase in the duration of the project and the fixed price contract creates a supply side risk. SPPA needs to closely manage the PS Pensions Project to ensure successful delivery of the project within its revised budget and in line with the new timetable for implementation.

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## Recommendation 4

**Successful implementation of PS Pensions remains a significant risk for the Agency and SPPA should continue to work to ensure effective management and scrutiny to allow successful delivery. Relationships with the supplier must be managed effectively to ensure the success of the project.**

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### Workforce planning

76. As reported in 2015/16, SPPA does not have a workforce plan in place and succession planning arrangements are unclear. Without an organisation wide plan, there is a risk that:

- changes to service delivery in one area may have unplanned or unintended effects on other areas of the business
- the leadership team cannot manage workforce changes to ensure that the organisation is making best use of its staff resources to achieve its objectives.

77. Development of a workforce plan, with appropriate succession planning for key posts, should be part of SPPA's arrangements to support business change. Service redesign may require different staff skills and resourcing models from those currently in place.

78. The Chief Executive is leading work to develop a Target Operating Model (TOM) for the Agency. This will guide:

- decisions on services which will be offered
- the required skills needed
- how the new IT system will support this work
- how the Agency is structured to deliver them.

79. Workforce planning will be a key element of this project.

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## Recommendation 5

**SPPA should develop an approach to workforce planning as part of its Target Operating Model to ensure it has appropriate resources to meet the future needs of the business.**

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### National performance audit reports

80. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2016/17, we published a number of reports which are of direct interest to the board. These are outlined in [Appendix 3 \(page 29\)](#) accompanying this report.

81. SPPA's Audit and Risk Committee periodically considers relevant Audit Scotland reports.

# Appendix 1

## Action plan 2016/17

### 2016/17 recommendations for improvement

Page no.	Issue/risk	Recommendation	Agreed management action/timing
15	<p><b>1. Corporate plan and financial strategy</b></p> <p>In April 2016 the SPPA Corporate Board drafted a 2016/17 corporate plan which was expected to cover the years 2016-19. However this was not published. A one year business plan was prepared, but this did not cover the wider strategic objectives for SPPA.</p> <p>We have been advised that a new three year corporate plan covering the period to 2019/20 will be developed. This will include a medium term financial strategy.</p> <p><b>Risk</b></p> <p>There is no formalised strategic level plan in place to demonstrate how SPPA will meet its strategic objectives and how finances will be managed in the medium to long term.</p>	<p>SPPA should work to complete a corporate plan which sets out its strategic objectives and how these will be delivered within funding allocations. This should include a longer term financial strategy, with clear links to its People Strategy and annual business plans.</p>	<p>Agreed. CEO 31/12/2017</p>
16	<p><b>2. Governance Framework Document</b></p> <p>The governance arrangements for SPPA are set out in its Framework Document 2012-2015 which has been extended to cover 2015/16 and 2016/17. Elements of the document are out of date. The Agency has advised that this will be reviewed in full in 2017/18.</p>	<p>SPPA, together with its sponsor directorate, should review and update its Governance Framework Document to ensure it sets out a clear vision and direction for the Agency.</p>	<p>Agreed. CEO 31/12/2017</p>



Page  
no.

Issue/risk

Recommendation

Agreed management  
action/timing

#### Risk

Without regular review of key governance documents, there is a risk that obligations to Scottish Ministers and stakeholders may not be fully met.

17

#### 3. Register of Interests

We noted that at the May 2017 MAB, non-executive directors agreed that they would complete register of interest forms annually.

In addition to annual declarations of interest for non-executive directors of the MAB, members of the ARC, Pension Boards and executive directors should also complete an annual declaration of interest form. Maintaining an up to date register of interests is an important means of demonstrating and ensuring openness and transparency in organisational decision making.

#### Risk

SPPA may not be able to demonstrate the probity of key organisational decisions.

All Board members should complete a declaration of interests at least annually and ensure that any changes in their interests are notified to the Agency.

Agreed. Register of interest forms were issued to all Pension Board members in April 2017 and to MAB members in June 2017. Note that at each meeting there is an Agenda item for 'Member declaration of changes to Register of Interests and declaration of any interest in business to be conducted'.

CEO

3/10/2017 – forms to be issued to executive directors.

30/4/2018 and annually thereafter – MAB, ARC and Pension Board members plus executive directors.

20/21

#### 4. PS Pensions Project

Due to the size and scale of the PS Pensions Project it continues to present significant financial, reputational and service delivery risks to SPPA. SPPA needs to closely manage the PS Pensions Project to ensure successful delivery of the project within its revised budget and in line with the new timetable for implementation.

The increase in the duration of the project and the fixed price contract creates a supply side risk.

Successful implementation of PS Pensions remains a significant risk for the Agency and SPPA should continue to work to ensure effective management and scrutiny to allow successful delivery.

Relationships with the supplier must be managed effectively to ensure the success of the project.

Revised corporate governance arrangements have been put in place and their effectiveness will be subject to on-going audit in accordance with agreed audit plans and timetables.

Head of Operations  
Transformation

Arrangements - completed.

Review – on-going to end of project, 31/8/2019.



Page  
no.

Issue/risk

Recommendation

Agreed management  
action/timing

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**Risk**

The project does not achieve its intended aims and there are further delays in its implementation. The supplier might determine that the contract is no longer commercially viable and may seek to end the contract and not continue with the project.

21

**5. Workforce plan**

Development of a workforce plan, with appropriate succession planning for key posts, should be part of SPPA's arrangements to support business change. Service redesign may require different staff skills and resourcing models from those currently in place.

Work is ongoing in relation to the Target Operating Model (TOM) which is looking at how SPPA sees itself in the longer term and is being led by the Chief Executive. This will guide decisions on services which will be offered, the required skills, how the new IT system will support this work and how the Agency is structured to deliver them. Workforce planning will be a key element of this project.

**Risk**

Without an overarching workforce plan, changes to service delivery in one area may have unplanned or unintended effects on other areas of the business and the leadership team cannot manage workforce changes to ensure that the organisation is making best use of its staff resources to achieve its objectives.

SPPA should develop an approach to workforce planning as part of its Target Operating Model to ensure it has appropriate resources to meet the future needs of the business.

The approach being taken to the preparation of the workforce plan is incremental. It is intended to issue drafts of new sections of the plan over the next 12 months as the TOM is developed and more research and analysis of the workforce is carried out.

CEO

Workforce plan - 31/10/2018.

Target Operating Model –  
31/3/2019.

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# Appendix 2

## Significant audit risks identified during planning

The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the annual report and accounts and those relating our wider responsibility under the [Code of Audit Practice 2016](#).

Audit Risk	Assurance procedure	Results and conclusions
<b>Risks of material misstatement in the financial statements</b>		
<p><b>1 Risk of management override of controls</b></p> <p>ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls in order to change the position disclosed in the financial statements.</p> <p>(Agency and Pension schemes)</p>	<p>Detailed testing of journal entries.</p> <p>Review of accounting estimates.</p> <p>Focused testing of accruals and prepayments.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p>	<p>Sample tested journals created during the year and at year end. No issues identified.</p> <p>Accounting estimates were reviewed and no issues identified.</p> <p>Focused testing on accruals and prepayments was carried out and no issues identified.</p> <p>There was no evidence of transactions outside the course of normal business.</p> <p>From work carried out in year, there was no evidence of management override of controls.</p>
<p><b>2 Risk of fraud over expenditure</b></p> <p>The Financial Reporting Council's Practice Note 10 (revised) requires auditors of public bodies to give consideration of the risk of fraud over expenditure. The extent of expenditure, for example, volume of benefits paid means that there is an inherent risk of fraud.</p> <p>(Agency and Pension schemes)</p>	<p>System review of Altair and Resourcelink focusing on key controls.</p> <p>Focused substantive testing on higher risk areas and more complex areas including new awards and deaths.</p>	<p>Carried out high level system review of Altair and Resourcelink payables, recalculation of new pension awards for NHSPSS and STPS and substantive testing of deaths. No fraud risks identified.</p> <p>Testing of Agency trade payables and non-current additions and disposals. No fraud risks identified.</p> <p>There were no fraud risks identified in relation to expenditure.</p>
<p><b>3 Risk of fraud over income</b></p> <p>SPPA receive a significant amount of income from contributions in addition to Scottish Government funding. The extent and complexity of income means that, in accordance with ISA240, there is an inherent risk of fraud.</p>	<p>System review of EPICOR focusing on key controls.</p> <p>Sample testing of contributions from other audited bodies (such as councils and health boards) to ensure consistency with SPPA records.</p> <p>Review of internal audit work on bank receipts and collection</p>	<p>Carried out high level system review of Epicor including checking contribution records. No fraud risks identified.</p> <p>Contribution records from audited bodies (Health boards and councils) were compared to Epicor records and no differences were identified.</p>

Audit Risk	Assurance procedure	Results and conclusions
(Pension schemes)	procedures.	<p>Due to timing we were unable to review the internal audit work on bank receipts and collection procedures.</p> <p>There were no fraud risks identified in relation to income.</p>
<p><b>4 Pension contributions</b></p> <p>Contributions income, as processed and recorded on EPICOR, is key in calculating scheme liabilities and current service costs. Robust procedures are required for reconciling income received to employers' annual returns to ensure that monies due from over 1,000 different employers are received timeously and in full. SPPA continue to develop the reconciliation process between EPICOR contributions and employers' annual returns.</p> <p>Failure to manage and reconcile contributions income effectively may impact on the schemes' liabilities and actuarial valuations.</p> <p>(Pension schemes)</p>	<p>Review the progress of reconciliations, with timescales and targets agreed.</p> <p>Review of reconciliations during the financial statements audit.</p> <p>Sample testing of contributions from other audited bodies to ensure consistency with SPPA records.</p>	<p>Reviewed the reconciliation process with both the finance and operations teams and were satisfied with the process and progress during the year.</p> <p>Contribution records from audited bodies (Health boards and councils) were compared to Epicor records and no differences were identified.</p> <p>Overall, the annual reconciliation process is well managed and the variances identified are in line with our understanding of contributions income and the annual returns process.</p>
<p><b>5 Information supporting scheme valuations</b></p> <p>The decisions taken by SPPA in relation to the schemes are heavily reliant on the work of the Government Actuary Department (GAD). The actuarial valuation methodology relies on significant judgements and assumptions in relation to financial, mortality and demographic factors.</p> <p>In addition, pension liabilities are based on extracts of members data incorporated in GAD's established roll forward methodology. SPPA needs to ensure that the implications of changes to membership profiles are completed timeously and in full to ensure that accurate information is transferred to GAD.</p> <p>There is a risk that the actuarial information for valuing the schemes could be affected by incomplete or inaccurate</p>	<p>Review the work of GAD focusing on reliability, professional competence and capability.</p> <p>Meet with GAD to discuss quality review processes to determine where reliance can be taken in relation to GAD's internal processes. In addition, review GAD's validation processes.</p> <p>Review reports to GAD supporting valuation data.</p> <p>Review PWC's report on assessing GAD's actuarial processes and assumptions.</p>	<p>Met with GAD and reviewed the internal quality and validation processes carried out by GAD and no issues were identified.</p> <p>We are satisfied that the work of GAD is carried out by competent and capable officers.</p> <p>The GAD reports were in agreement to supporting valuation data.</p> <p>PWC reviewed key actuarial assumptions used by GAD and found them to be reasonable.</p> <p>No significant issues were identified in relation to information supporting scheme valuations. We were satisfied with the assumptions and work carried out by GAD.</p>





















Audit Risk	Assurance procedure	Results and conclusions
<p>information, or the use of unreasonable judgements and assumptions.</p> <p>(Pension schemes)</p>		
<b>Risks identified from the auditor's wider responsibility under the Code of Audit Practice</b>		
<p><b>6 Financial sustainability and financial management</b></p> <p>SPPA do not currently have a long-term financial strategy. Developing and maintaining a long-term financial strategy will help set the context for annual budgets. It will also help clarify the financial sustainability of the organisation over an extended period and can help identify any problems with affordability at an early stage. A long-term financial strategy should have clear links to the Agency's strategic objectives, corporate plan, workforce plans and annual business plans.</p> <p>There is a risk that given the substantial changes in the organisation, decisions may be taken without a clear understanding of the financial implications beyond the current financial year and how they affect the overall financial sustainability of the Agency.</p>	<p>Review progress in the development of longer-term financial planning.</p>	<p>We noted that progress on the medium-longer term financial strategy has been delayed and we will review this further in 2017/18.</p> <p>We noted that this will be included in the new corporate plan which is expected to cover 2017/18 to 2019/20.</p>
<p><b>7 Workforce planning</b></p> <p>Workforce planning is a key element of assessing and shaping the future requirements and structure of the organisation's workforce. Without an effective organisation-wide workforce plan, there is a risk that workforce decisions may be uncoordinated leading to decisions in one area having unintended consequences in another.</p> <p>SPPA is currently developing a longer-term workforce plan and establishing a target operating model as part of its transformation programme 'One SPPA'.</p>	<p>We will monitor progress on workforce planning arrangements throughout the year.</p>	<p>We noted that the health check for PS Pensions Project reported that a target operating model would help support the work of SPPA.</p> <p>We noted that progress on the planned target operating model is being led by the new Chief Executive. This will incorporate work on workforce planning. This work has been delayed and we will review this further in 2017/18.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p><b>8 PS Pensions Project (previously Project 2017)</b></p> <p>The Agency's PS Pensions Project features as a key risk on its risk register. The project, with a budget of £5.6 million, aims to deliver a bespoke unified pension administration and payment system for the Pension scheme accounts and it is therefore central to the Agency's effective operation. The size and scale of PS Pensions Project means it has significant financial, reputational and service delivery risks.</p> <p>It is therefore critical that the Agency ensures PS Pensions Project is properly managed to ensure its successful delivery and that the public and users get the full benefits of the investment.</p>	<p>Review progress on the delivery of the system.</p> <p>Review the gateway review documentation and SPPA's actions to address any recommendations.</p> <p>Review the Scottish Government's ICT assurance report and SPPA's actions to address any recommendations.</p>	<p>As noted in the report, progress on the project has been delayed and the timescale for delivery of the system is now significantly longer than initially planned.</p> <p>ICT health checks have been carried out periodically by the Office of the Chief Information Officer and SPPA has made progress on its recommendations and taken necessary contingency actions.</p> <p>There is further work to be carried out to address the new recommendations issued in the second report in July 2017 and we will follow up on these in 2017/18.</p>

# Appendix 3

## Summary of national performance reports 2016/17



Apr			
May		Common Agricultural Policy Futures programme: an update	
Jun		South Ayrshire Council: Best Value audit report	 The National Fraud Initiative in Scotland
Jul		Audit of higher education in Scottish universities	 Supporting Scotland's economic growth
Aug		Maintaining Scotland's roads: a follow-up report	 Superfast broadband for Scotland: a progress update
			 Scotland's colleges 2016
Sept		Social work in Scotland	 Scotland's new financial powers
Oct		Angus Council: Best Value audit report	 NHS in Scotland 2016
Nov		How councils work – Roles and working relationships in councils	 Local government in Scotland: Financial overview 2015/16
Dec		Falkirk Council: Best Value audit report	 East Dunbartonshire Council: Best Value audit report
Jan			
Feb		Scotland's NHS workforce	
Mar		Local government in Scotland: Performance and challenges 2017	 i6: a review
			 Managing new financial powers: an update

### Central Government relevant reports

[Common Agricultural Policy Futures programme: an update](#) – May 2016

[The National Fraud Initiative in Scotland](#) – June 2016

[Scotland's new financial powers](#) – September 2016

[i6: a review](#) – March 2017

[Managing new financial powers: an update](#) – March 2017

# Scottish Public Pensions Agency

## 2016/17 Annual Audit Report

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