

Scottish Public Pensions Agency (SPPA)

Report on the 2005-06 Audit

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



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Executive Summary

Introduction

In 2005-06 we audited the financial statements of the Scottish Public Pensions Agency (SPPA) and looked at aspects of performance management and governance. This report sets out our key findings.

Financial Statements

We have given an unqualified opinion on the financial statements of the Agency for 2005-06.

The financial statements disclose net operating costs of £8,094k for 2005-06. SPPA operated within its budget allocation for the year.

At the planning stage we identified fifteen main audit risks. These informed our audit procedures in respect of the Agency.

Governance

SPPA's corporate governance and control arrangements operated satisfactorily in the period under review as reflected in the Statement on Internal Control. We have also found the work of the internal audit service to be satisfactory and continue to place formal reliance on its work.

Performance Management

During 2005-06 we completed a baseline analysis of SPPA's management arrangements for achieving Best Value. We found that SPPA's procedures were generally under development and that progress towards achieving Best Value was being made.

We also carried out an overview of the Agency's management arrangements in relation to the requirements of the Scottish Executive's Efficient Government Initiative. SPPA has committed itself to delivering £635k in savings from running costs over the three year period from 2005-06 to 2007-08.

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

Bill Convery CPFA, Assistant Director, 9 October 2006



Introduction

Scope of the Audit

1. This report summarises the findings from our 2005-06 audit of SPPA. The scope of the audit was set out in our Audit Risk Analysis and Plan (ARAP), which was submitted to the Audit Committee on 8 March 2006. This plan described the work we planned to carry out on financial statements, governance and performance.
2. This report to management sets out our findings from the review carried out. The weaknesses outlined are only those which have come to our attention during the course of our normal audit work and are not necessarily, therefore, all the weaknesses which may exist. Although we include a number of specific recommendations in this report to strengthen internal control, it is the responsibility of management to determine the extent of the internal control system appropriate to SPPA. We would stress, however, that an effective internal control system is an essential part of the efficient management of any organisation.
3. The contents of this report have been agreed with relevant officers to confirm factual accuracy.
4. This is the final year of a five year audit appointment. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officers and members of the Agency during the course of our appointment. This report will be submitted to the Auditor General for Scotland and will be published on our website at www.audit-scotland.gov.uk.
5. We note that Audit Scotland has been appointed as external auditors of the Agency for the period 2006/07 to 2010/11. In compliance with International Standards on Auditing and general good practice we will rotate some staff who have worked on this audit for a number of years.

Outcome on Risks Identified in the Audit Risk Analysis and Plan

6. SPPA shares its financial systems and corporate governance arrangements with the Scottish Teachers Pension Scheme (STPS) and the NHS Pension Scheme, Scotland (NHSPS). At the planning stage we identified fifteen main audit risks which informed our audit procedures in respect of the Agency and the two Pension Scheme Resource Accounts.



Prior Period Follow Up

7. Two issues were identified in our Report on the 2004-05 Audit. We are satisfied that the Audit Committee Terms of Reference have been updated to reflect the amendments suggested in our Report and the relevant extracts from the Scottish Public Finance Manual (SPFM) have been distributed to Audit Committee members in response to our second recommendation.

Management Action

8. Audit recommendations, together with management comments, on those areas where further improvements could be achieved are included in the action plan at Appendix A of this report.



Financial Statements

Our Responsibilities

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

- they give a true and fair view, in accordance with the Public Finance and Accountability (Scotland) Act 2000 and directions made thereunder by the Scottish Ministers, of the state of affairs of the Scottish Public Pensions Agency as at 31 March 2006 and the net cost of operations, recognised gains and losses and cash flows for the year then ended;
- they and the part of the Remuneration Report to be audited have been properly prepared in accordance with the Public Finance and Accountability (Scotland) Act 2000 and directions made thereunder by the Scottish Ministers;
- in all material respects the expenditure and receipts shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers, the Budget (Scotland) Act covering the financial year and sections 4 to 7 of the Public Finance and Accountability (Scotland) Act 2000; and
- in all material respects the sums paid out of the Scottish Consolidated Fund for the purpose of meeting the expenditure shown were applied in accordance with section 65 of the Scotland Act 1998.

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

- considering compliance with Scottish Executive guidance;
- considering the adequacy of the process put in place by the Accountable Officer to obtain assurances on systems of internal control; and
- assessing whether disclosures in the Statement are not inconsistent with the information emerging from our normal audit work.

Overall Conclusion

11. We have given an unqualified opinion on the financial statements of SPPA for 2005-06. We are able to conclude that the financial statements of SPPA give a true and fair view of the financial position for the period from 1 April 2005 to 31 March 2006 and that, in all material respects, the expenditure and receipts shown in the accounts were incurred or applied in accordance with applicable enactments and relevant guidance.



12. Following discussion with the Administration Finance Manager, a target date of 12 June 2006 was agreed for the provision of the accounts for audit. However, our audit start date was delayed by over two weeks to allow additional time for the accounts to be prepared.

Financial Performance

13. SPPA's income and expenditure account for the year records gross expenditure of £8,142k and income of £48k resulting in a net operating cost for the year of £8,094k.
14. The Annual Report to the financial statements identifies that the Agency is committed to reducing its expenditure in real terms from 2004-05 to 2007-08. Income has continued to decrease as the re-instatement of mis-sold pensions nears completion.

Statement on Internal Control

15. The Statement on Internal Control was signed by the Chief Executive on 27 September 2006. This Statement sets out the arrangements operated for risk identification and review, management of identified risks and assurance of effectiveness.
16. We are satisfied that the Statement complies with Scottish Executive guidance, the process put in place by the Accountable Officer to obtain assurances on systems of internal control is adequate and the contents of the Statement are not inconsistent with the information emerging from our normal audit work.

ISA 260: Communication of Audit Matters to Those Charged with Governance

17. My responsibilities in relation to the communication of audit matters to those charged with governance are covered in International Standard on Auditing 260. As part of the audit process we identified a number of adjustments to the draft account that were required:
 - reduction in wages and salaries by £22k; and
 - reduction in rent by £10k.
18. In addition there were a small number of further minor adjustments. There are no material unadjusted misstatements in the account and there are no significant judgements to be brought to attention.



Issues Arising

19. We would like to draw attention to the following issues arising from our audit of the financial statements:

Draft Account

- A draft account was submitted to audit after a two week delay to allow Finance additional time for account preparation. The account was incomplete in a number of regards and this caused inefficiencies in the audit process.

Action point 1

Capitalisation of NHS Payroll Project Costs

- A review of the invoices which comprised additions to Resourcelink in respect of the NHS Payroll Project identified costs incurred on development work including consultancy services and project management costs, writing/ testing software and meetings. These costs should have been analysed to ensure they were correctly treated as capital or revenue.

Action Point 2



Governance

Introduction

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

- general governance arrangements;
- systems of internal control; and
- review of internal audit.

Overall Conclusion

21. During our audit we reviewed aspects of the governance systems operating at SPPA. In general, on the basis of this work, we are content that they are soundly based.

General Governance Arrangements

22. Our 2004-05 audit included a review of SPPA's audit committee arrangements and procedures for preventing and detecting fraud and corruption. We followed up these reviews in the current year and confirmed that these arrangements are satisfactory. No frauds were identified by SPPA in 2005-06.

Systems of Internal Control

23. We carried out an assessment of systems and controls in relation to payroll, income and non-payroll expenditure. There are no significant points to highlight in this report.

Review of Internal Audit

24. SPPA recognises that internal audit is a key element of the internal control system set up by management. A strong internal audit function is necessary to ensure the continuing effectiveness of the internal control system that has been established. To maximise the reliance that external audit can place on internal audit and to avoid duplication of effort, the adequacy of internal audit is assessed each year.

25. Internal audit services are provided by the Scottish Executive Audit Unit (SEAU). Our colleagues responsible for the audit of the Scottish Executive completed a full review of the internal audit function



provided by the SEAU, in accordance with International Auditing Standard 610, during 2004-05. This review concluded that the internal audit service operated in accordance with Government Internal Audit Standards in adopting a risk based audit approach in planning and undertaking their work. This audit also identified some areas for improvement. During 2005-06, our colleagues assessed the SEAU's progress in implementing the agreed action plan resulting from the work done in 2004-05 and the extent to which reliance could be placed on the work of internal audit for 2005-06. This follow up review confirmed that the SEAU continues to comply with Government Internal Audit Standards and identified that the SEAU had made some progress in implementing recommendations from the 2004-05 review. This satisfactory evaluation of the internal audit service allows us to place reliance on a number of aspects of the SEAU's work during 2005-06.

26. Specific to our audit of the Agency, we planned to place formal reliance on the work of internal audit, in terms of International Standard on Auditing 610, in relation to administration cost expenditure. We reviewed the internal audit working paper file and report to support this work. None of the observations and related risks precluded planned assurance from being taken for our financial statements audit.
27. On 19 September 2006 the Head of Internal Audit provided the Chief Executive with substantial assurance on the effectiveness of controls governing administration cost expenditure within the SPPA.



Performance Management

Introduction

28. This section covers our assessment of the way in which SPPA secures value for money in the use of its resources. This year we focussed on two main areas:

- Efficient Government; and
- Best Value.

Efficient Government

29. The Efficient Government initiative is a five year programme with the aim of reducing waste, bureaucracy and duplication in Scotland's public sector. The primary objective is to deliver the same services with less money or to enable frontline services to deliver more or better services with the same money. The Efficient Government Plan sets targets to achieve £745 million (rising to £900 million) of cash-releasing savings and £300 million (rising to £600 million) of time-releasing savings, by 2007-08.

30. SPPA has committed to achieving cash releasing savings of £635k over the three year period from 2005-06 to 2007-08. Savings will be generated from reducing staff numbers for core activities and bringing the NHS payroll function in-house.

31. During 2005-06 Audit Scotland completed a management arrangements diagnostic on Efficient Government activities across a number of Central Government organisations including SPPA. It aimed at providing baseline information on arrangements across a range of Efficient Government related topics.

32. Overall we concluded that, at the time of our audit in March 2006, systems to monitor the expected savings were adequate. However, since this date, the implementation timetable for bringing the NHS payroll function in-house has been delayed until January 2007 which is likely to impact on the savings generated over the three year period.

33. Information gathered from the baseline exercise is being analysed and feedback to individual bodies on emerging themes and sector comparisons will be provided in due course.



Best Value

34. There is no statutory duty of Best Value in the wider public sector in Scotland (the Scottish Executive and its Executive Agencies, Executive NDPBs, and the NHS). Instead, the Scottish Executive issued high level guidance in May 2003, followed by more detailed draft secondary guidance in August 2003. This duty can be described as:
- to make arrangements to secure continuous improvement in performance (while maintaining an appropriate balance between quality and cost);
 - to have regard to economy, efficiency and effectiveness, and the equal opportunity requirements; and
 - to contribute to the achievement of sustainable development.
35. In May 2005, Ministers decided that they would not bring forward legislation which extends Best Value in the wider public sector. However, as Ministers do wish to encourage and embed the principles of Best Value across the wider public sector, revised guidance was issued in May 2006.
36. For 2005-06 Audit Scotland reviewed how well advanced arrangements are in place by public bodies across the central government sector to demonstrate Best Value, and to identify areas of good practice. As part of this review we completed a Best Value analysis to establish baseline information on the management arrangements in place within SPPA. The overall aim of this analysis was to establish the organisation's arrangements for taking forward the Best Value agenda and demonstrating continuous improvement.
37. Overall, we assessed SPPA's arrangements to secure Best Value as being under development but indicating progress. We note that key performance targets are identified in the three year corporate plan. The corporate plan is supported by five annual directorate business plans. We also note that the Agency has established an Environmental Group which includes staff representatives from across the Agency.
38. The results from the review across the wider public sector are currently being analysed. The outcomes from this exercise will be reported to individual bodies in due course.



National Studies

39. Reports published by the Auditor General for Scotland, which may be of interest to the Agency, are summarised at Appendix B.

Public Sector Pension Schemes in Scotland

40. In June 2006, the Central Government team within the Performance Audit division of Audit Scotland published a report on the six main public sector pension schemes in Scotland. The largest pension scheme examined covers local government. The other five main schemes, including the STPS and the NHSPS, are unfunded. The main messages from this report include:

- the combined funding shortfall and unfunded liabilities of these six pension schemes in Scotland may be as high as £53 billion;
- greater life expectancy is increasing the value of pension liabilities, as pensions will need to be paid for a longer time; and
- the value of pension liabilities is also increasing because of accounting changes.

Relocation of Scottish Executive Departments, Agencies and NDPBs

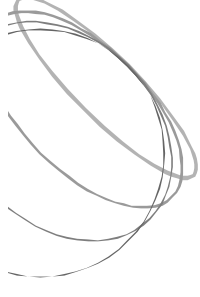
41. The Central Government team within the Performance Audit division of Audit Scotland has recently published on behalf of the Auditor General a study entitled "Relocation of Scottish Executive Departments, agencies and NDPBs". The study analysed the benefits and efficiencies of relocating government departments to new areas of Scotland.
42. Key findings in the report include that:
- there is some limited evidence of efficiency gains from relocation, such as lower staff turnover and reductions in sick leave in specific relocations, but wider benefits have not so far been measured
 - the estimated cost per job for the relocation of individual organisations range between a saving of £33,000 per job and a cost of £45,000 per job
 - the Executive does not have explicit targets for relocation and it has not identified areas of the country expected to benefit from its policy
 - In some cases, new or revised criteria to identify potential sites for relocation were introduced late in the review process.



43. SPPA was one of the organisations surveyed and details were provided in Appendix 3: Case study narratives. The key points made were that :
- The organisation was unable to provide detailed evidence in relation to several aspects of the review, primarily due to the elapsed time since the events
 - There have been improvements in staff turnover and sick absence levels

Appendix A: Action Plan: Recommendations for Further Improvements

Action Point	Para. No	Issue, Risk and Audit Recommendation	Importance	Management Response	Responsible Officer	Target Date
1	18	<p>Draft Account</p> <p>A draft account was submitted to audit after a two week delay to allow Finance additional time for account preparation. The first draft account had not been subject to a formal management review process. As a result the accounts did not sum or cross reference correctly and a number of posting errors and disclosure omissions were identified. This caused inefficiencies in the audit process.</p> <p><i>We recommend that a full, independent management review process is introduced prior to submitting the draft account to audit.</i></p>	High	<p>Accepted. The Accounts were held up because of staff shortages in the team, the Administration Finance Manager being off on holiday and in the middle of exams. We also gave Audit Scotland an incomplete set of accounts so they could start their audit work as we were already two weeks late in submitting our accounts. As you are aware the team only consists of a B2 and A3 so we will probably go for a later submission date in 2006-2007 so this does not clash with the Administration Finance Manager's</p>	David Weir	02/10/2006



Action Point	Para. No	Issue, Risk and Audit Recommendation	Importance	Management Response	Responsible Officer	Target Date
2	18	<p>Capitalisation of NHS Payroll Project Costs</p> <p>Fixed assets are determined in accordance with FRS 15 Tangible Fixed Assets and/ or SSAP 13 Accounting for Research and Development. Additional guidance, specific to application in the public sector, is contained in the Government Financial Reporting Manual (FRM). FRS 15 includes guidance on the capitalisation of costs incurred in the early stages of a project to acquire or create a tangible fixed asset and on subsequent expenditure in relation to an existing asset.</p> <p>A review of the invoices which comprised additions to Resourcelink in respect of the NHS Payroll Project (£148k) identified costs incurred on development work including consultancy services and project management costs, writing/ testing software and meetings.</p> <p><i>Given the uncertainties associated with the capitalisation of expenditure of this nature, we suggest that in the future the Agency considers analysing the costs to ensure they are correctly treated as capital or revenue expenditure.</i></p>	Medium	<p>exams.</p> <p>Agreed. The Agency has classified its expenditure in accordance with its interpretation of all relevant guidance. In reaching these interpretations the Agency has consulted widely with colleagues across the Executive and other Agencies who have had experience of dealing with the same issue. The Agency will therefore re-assess the basis for these decisions in the light of any new evidence received.</p>	Neville Mackay	02/10/2006

Appendix B: Auditor General for Scotland published reports

Auditor General for Scotland

Relocation of Scottish Executive departments, agencies and NDPBs (published 21/9/2006)

1,653 posts have been transferred from Edinburgh and a further 1,164 posts have been created outside the city. Audit Scotland found that most of the reviews arose from the creation or restructuring of organisations, or from breaks in property leases. Only two of 38 reviews were the result of potential efficiency improvements identified by the organisations in their business plans. In most cases, it was not clear whether relocation would deliver wider policy objectives.

Accounts Commission and Auditor General for Scotland

Public sector pension schemes in Scotland (published 20/06/2006)

The six main public sector pension schemes in Scotland will provide retirement benefits to about 950,000 people. Nearly one in five people living in Scotland has some entitlement to a public sector pension.

Accounts Commission and Auditor General for Scotland

No hiding place: the National Fraud Initiative in Scotland (published 17/05/2006)

Scotland's councils have worked with other public bodies to identify £15m worth of fraud and errors in a national detection exercise.

Auditor General for Scotland

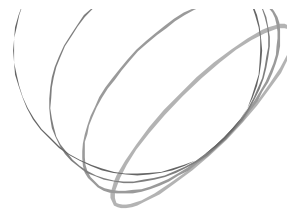
Leadership development. How Government Works (published 17/11/2005)

Scotland's public sector has good examples of investment in leadership but many individual organisations do not have clear policies and most are unable to link the spending to improvements in their performance. Public bodies need to do more to track the £5m they invest each year in leadership development and make sure it results in better managed organisations and better public services, says Audit Scotland.

Auditor General for Scotland

Scottish Executive: supporting new initiatives. How Government Works (published 10/11/2005)

Last year the Scottish Executive launched new initiatives amounting to £1.4 billion. The management of these projects is generally sound, but making changes could help to improve control of the funding and allow better assessment of whether the money is helping to achieve policy aims.



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