

Scottish Teachers' Superannuation Scheme NHS Superannuation Scheme (Scotland)

Report on the 2006/07 Audit



November 2007





Contents

Executive Summary	2	Governance	10
Introduction	4	Looking Forward	13
Financial Statements	5	Appendix A: Action Plan	14
Performance Management	9		



Executive Summary

Introduction

In 2006/07 we audited the financial statements of the Scottish Teachers' Superannuation Scheme and the NHS Superannuation Scheme (Scotland) and we looked at aspects of performance management and governance. This report sets out our key findings. Both schemes are administered by the Scottish Public Pensions Agency (SPPA).

Financial Position

During financial year 2006/07, the Scottish Teachers' Superannuation Scheme recorded income of £447.2 million from operating activities and had received financing of £120.3 million from the Scottish Government. The Scottish Teachers' Superannuation Scheme recorded net outgoings of £551.5 million. The balance sheet moved from an opening position of £14.6 billion to a closing balance of £18.7 billion.

During financial year 2006/07, the NHS Superannuation Scheme (Scotland) recorded income of £804.1 million from operating activities and had excess receipts over expenditure of £294.9 million from the Scottish Government. The NHS Superannuation Scheme (Scotland) recorded net outgoings of £1.0 billion. The balance sheet moved from an opening position of £16.2 billion to a closing balance of £21.9 billion.

Changes in actuarial assumptions, in particular the change in the Treasury discount rate from 2.8% to 1.8% on 31 March 2007, are the main cause of the increase in pension liabilities of both schemes. The Scottish Teachers' Superannuation Scheme and the NHS Superannuation Scheme (Scotland) operated within the combined budget provided by the Scottish Government.

Financial Statements

We have given an unqualified opinion on the accounts and have concluded that the financial statements of the Scottish Teachers' Superannuation Scheme and the NHS Superannuation Scheme (Scotland) for the year ending 31 March 2007 give a true and fair view of the state of affairs.

We have also concluded that in all material respects, the expenditure and receipts shown in the financial statements were incurred or applied in accordance with applicable enactments and relevant guidance, issued by Scottish Ministers.

Performance Management

During 2006/07 Internal Audit were only able to provide limited assurance on the systems currently in place for providing accurate reporting against key performance targets. The Scottish Public Pensions Agency is currently implementing Internal Audit's recommendations and we will follow-up progress made.



Governance

Corporate Governance is concerned with the structures and process for decision making, accountability, control and behaviour at the upper levels of an organisation. The establishment and operation of an efficient and effective internal audit function forms a key element of effective governance and stewardship. The Scottish Teachers' Superannuation Scheme and the NHS Superannuation Scheme (Scotland) internal audit service is provided by the Scottish Government Internal Audit Division. We reviewed internal audit and concluded that they continue to comply with Government Internal Audit Standards. We were able to place general reliance on their work.

In our audit plan we identified information and computer technology as a priority area for 2006/07. We completed, and reported separately on, a review of computer services. We also conducted a 'Your Business@Risk' survey. Both ICT reviews revealed examples of good practice and areas for improvement.

Audit Scotland
30 November 2007



Introduction

1. This report summarises the findings from our 2006/07 audit of the Scottish Teachers' Superannuation Scheme and the NHS Superannuation Scheme (Scotland). The scope of the audit was set out in our Audit Plan, which was presented to the Audit Committee on 6 March 2007. This plan described the work we planned to carry out on financial statements, performance and governance.
2. Appendix A of this report sets out the key risks highlighted in this report and the action planned by management to address them.
3. This is the first 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 Scottish Public Pensions Agency during the course of our audit. This report will be submitted to the Auditor General for Scotland and will be published on our website, www.audit-scotland.gov.uk.



Financial Statements

4. In this section we summarise key outcomes from our audit of the Scottish Teachers' Superannuation Scheme and the NHS Superannuation Scheme (Scotland) financial statements for 2006/07, and comment on the key financial management and accounting issues faced.

Our Responsibilities

5. We audit the financial statements and give an opinion on whether:
 - they give a true and fair view of the financial position of the Scottish Teachers' Superannuation Scheme and the NHS Superannuation Scheme (Scotland) and their expenditure and income for the period in question.
 - whether they have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements, and
 - the regularity of the expenditure and receipts.
6. We also review the statements on internal control by:
 - considering the adequacy of the process put in place by the Chief Executive as accountable officer to obtain assurances on systems of internal control; and
 - assessing whether disclosures in the statements are consistent with our knowledge of the Scottish Teachers' Superannuation Scheme and the NHS Superannuation Scheme (Scotland).

Overall Conclusion

7. We have given an unqualified opinion on the financial statements of the Scottish Teachers' Superannuation Scheme and the NHS Superannuation Scheme (Scotland) for 2006/07.

Financial Position

2006/07 outturn

8. The Scottish Teachers' Superannuation Scheme had net outgoings for the year of £551.5 million, a decrease of 34.8% (£295.1 million) from 2005/06 (£846.6 million). As a result of changes in benefits to the Scottish Teachers' Superannuation Scheme, members may choose to 'commute' part of their pension and receive a higher lump sum instead. The Government Actuary's Department has estimated that the effect of this change is to reduce the pension liability. Consequently £340.0 million has been credited to the operating cost statement as a negative past service cost.



9. The liabilities of the Scottish Teachers' Superannuation Scheme have increased by £4.1 billion (28.4%) from £14.6 billion to £18.7 billion. The increase in the liability for the prior period was £2.2 billion (18%). Changes in actuarial assumptions as a result of discount rate changes (£3.4 billion), in particular the change in the Treasury discount rate from 2.8% to 1.8% on 31 March 2007, are the single largest contributory factor to the increase in liability (2005/06 £1.7 billion).
10. The NHS Superannuation Scheme (Scotland) had net outgoings for the year of £1.0 billion, an increase of 10.3% (£95.4 million) from 2005/06 (£926.8 million).
11. The liabilities of the NHS Superannuation Scheme (Scotland) have increased by £5.7 billion (35.3%) from £16.2 billion to £21.9 billion. Changes in actuarial assumptions as a result of discount rate changes to the Treasury discount rate referred to in paragraph 9 above (£4.4 billion) are the single largest contributory factor to the increase in liability (2005/06 £2.3 billion).
12. In summary the FRS17 liability in the two schemes has risen as follows since first being introduced in 2003/04:

	2003/04 £ billion	2004/05 £ billion	2005/06 £ billion	2006/07 £ billion
STSS	10.7	12.4	14.6	18.7
NHSS (S)	11.6	12.7	16.2	21.9

Issues Arising from the Audit

13. We reported the following issues to the Audit Committee on 26 October 2007. A separate management letter will cover our recommendations in relation to minor findings.

Scottish Teachers' Superannuation Scheme

14. As required by auditing standard ISA260 a number of issues were reported to the audit committee on 26 October 2006. There are no further matters specifically relating to the Scottish Teachers' Superannuation Scheme.



NHS Superannuation Scheme (Scotland)

15. **Family Benefit Payments:** - Family Benefits total £17.5m. As part our normal testing we investigated a sample of family benefit payments. Of the sample of nine, there was insufficient information available on the Electronic Document Management system to confirm the accuracy of the payment calculation for six transactions. We were unable to obtain supporting documentation to fully explain how payments were calculated. These payments were made by Paymaster, prior to the transfer of the Payments function in-house and the documentation inherited by the Scottish Public Pensions Agency was insufficiently detailed to enable Agency staff to completely and accurately explain how the amounts were calculated. With the assistance of Agency staff, and with reference to key documents held electronically, we were able to agree the calculations for the six cases to amounts sufficiently close to the sums paid to provide assurance that their was no material error.

Refer Action Point No. 1

16. **Numbers for Members with Preserved Rights:** - The statistics for Members with Preserved Rights are derived from the Northgate system and passed to the Government Actuary's Department (GAD) as part of the information for their Actuarial Assessment. This year the data was extracted from the Northgate system and 'cleansed' of inappropriate entries. The original number fell from 63,984 to 57,580. However, this is still substantially higher (54%) than the 2005/06 figure of 37,377. The Scottish Public Pensions Agency considers that the revised approach produces more accurate figures.

Refer Action Point No. 2

17. **Agenda for Change information:** - A debtor of £35 million was included in the Scheme's accounts in for contributions receivable relating to the Agenda for Change pay increases in the Health bodies. The Scottish Public Pensions Agency did not have procedures in place to collect this information during 2006/07 and Audit Scotland collected the majority of the information from the audited bodies to allow a debtor figure to be established.

Refer Action Plan No. 3

18. **Early retirement receipts debtor:** - The early retirement receipts debtor of £2.6 million could not be independently confirmed. The amount had not yet been recharged to the Scottish Government, and therefore not been received, at the time of our review.

Refer Action Plan No. 4



19. **Adjustment in respect of Paymaster reporting difficulties:** - An adjustment of £4 million was made on the trial balance for amounts which could not be completely analysed due to Paymaster reporting difficulties. A similar adjustment (£2.3 million) was made in 2005/06.

Refer Action Plan No. 5

20. **Full Actuarial Valuation:** - A full actuarial valuation was due to be carried out as at 31 March 2004. This is currently being carried out by GAD and is expected to be completed by the end of December 2007. The previous full GAD valuation (as at 31 March 1999) was not signed off until July 2005.

Refer Action Plan No. 6

Both Schemes

21. **Supervisory checks on transfers in/out:** - Our audit was unable to confirm that B1 and B2 supervisory checks were operating in a number of areas of the Agency's work across the full 2006/07 financial year. We were therefore unable to rely on management controls to the extent that we would have wished. We note that the coverage of these checks has improved since last year.

Refer Action Point No. 7

Statement on Internal Control

22. The Statements on Internal Control provided by the Scottish Teachers' Superannuation Scheme and the NHS Superannuation Scheme (Scotland) Accountable Officer reflected the main findings from both external and internal audit work. These statements recorded management's responsibility for maintaining a sound system of internal control, and set out the approach to this.
23. The Statements on Internal Control for both Schemes reflected the limited assurances given by Internal Audit on the systems underpinning performance reporting and awards and payments and the action taken by the Scottish Public Pensions Agency to address the issues raised by Internal Audit.

Regularity Assertion

24. The Public Finance and Accountability (Scotland) Act 2000 imposes a responsibility on auditors that requires us to certify that, in all material respects, the expenditure and receipts shown in the accounts was incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers. We have been able to address the requirements of the regularity assertion through a range of procedures, including written assurances from the Accountable Officer as to his view on adherence to enactments and guidance. No significant issues were identified for disclosure.



Performance Management

25. Public audit is more wide-ranging than in the private sector and covers the examination of, and reporting on, performance and value for money issues. As part of our audit we are required to plan reviews of aspects of the arrangements to manage performance, as they relate to economy, efficiency and effectiveness in the use of resources.
26. Accountable officers also have a duty to ensure the resources of their organisation are used economically, efficiently and effectively. These arrangements were extended in April 2002 to include a duty to ensure 'best value' in the use of resources.
27. During 2006/07 Scottish Government Internal Audit reviewed the validation of performance against key targets in the 2005/06 Scottish Public Pensions Agency Annual Report. Internal Audit was only able to provide limited assurance on the systems underpinning performance reporting. We note that the Agency has started implementing Internal Audit's recommendations to improve performance reporting and will follow-up progress.



Governance

28. This section sets out our main findings arising from our review of the Scottish Teachers' Superannuation Scheme and the NHS Superannuation Scheme (Scotland) governance arrangements. This year we reviewed:
- internal audit; and
 - aspects of information and communications technology (ICT).
29. We also discharged our responsibilities as they relate to prevention and detection of fraud and irregularity; standards of conduct; and the organisation's financial position (see paragraphs 8-11).

Review of Internal audit

30. The establishment and operation of an effective internal audit function forms a key element of effective governance and stewardship. We therefore seek to rely on the work of internal audit wherever possible. As part of our risk assessment and planning process for the 2006/07 audit, we assessed whether we could place reliance on the internal audit of the Scottish Teachers' Superannuation Scheme and the NHS Superannuation Scheme (Scotland) which is provided by the Scottish Government Internal Audit Division. We planned to place reliance on the work of internal audit work for
- Scottish Teachers Superannuation Scheme and NHS Superannuation Scheme (Scotland) Awards and Payments
 - NHS Superannuation Scheme (Scotland) Payroll Migration
 - Scottish Public Pensions Agency Validation of Agency Performance
 - Scottish Public Pensions Agency Pension Reform Project.
31. Audit Scotland's Scottish Government team reviewed the work of the Division in general and we reviewed the work carried out on the Scottish Teachers' Superannuation Scheme and the NHS Superannuation Scheme (Scotland). We were in agreement with the findings of their reports. We concluded that the internal audit service operates in accordance with the Government Internal Audit Manual and therefore placed reliance on the areas covered by these audit reviews in coming to our conclusions.
32. We note that Internal Audit have provided limited assurance on the effectiveness of operations and controls designed to minimise risks in relation to awards and payments for both the Scottish Teachers'



Superannuation Scheme and the NHS Superannuation Scheme (Scotland). The Scottish Public Pensions Agency has made reference to this in their Statement on Internal Control and has accepted Internal Audit's recommendations. We will follow up the Agency's progress against these.

Information and Communication Technology

Computer services review

33. As part of our risk based assessment, we identified Information and Communication Technology (ICT) as a priority area for review in 2006/07. Management were asked to complete a Computer Service Review Client Questionnaire (CSR-CQ) and we reported our detailed findings from this exercise separately in our report issued in September 2007.
34. The seven key areas covered by the review were: ICT strategy, organisational structure, installation management, service delivery, asset protection and security, business continuity/contingency and data networking.
35. We noticed several examples of good practice:
 - installing good access and environmental controls in the key computer room;
 - undertaking the Scottish Government's COBRA security assessments to highlight system risks;
 - implementing an over-arching training and development strategy and undertaking annual staff appraisals;
 - participating in an information governance survey to gauge levels of awareness amongst staff; and
 - implementing the Government Secure Intranet (GSI) SCOTS network provided by the Scottish Government.
36. Areas for improvement included:
 - formally signing up to a service level agreement (SLA) with the Scottish Government's ISIS department for the SCOTS network;
 - establishing clear roles, responsibilities and monitoring of information security between the Scottish Government and SPPA; and
 - driving Business Continuity Management throughout SPPA;



Your Business @Risk Survey

37. Your Business @ Risk (YB@R) is a web-based survey that helps auditors and public sector organisations to focus on the business risks associated with information and communications technology (ICT). The Graham Committee report on the Standards of Conduct in Public Life and the Standards Commission for Scotland endorsed this type of tool and recommended that they be used throughout the whole of the public sector.
38. The ICT user survey identified additional areas of good practice and knowledge of awareness in topics that staff were reminded of on a regular basis, such as:
- monitoring of internet and email use through awareness of the user acceptance policy and aware mis-use may be treated as a disciplinary offence; and
 - knowing where to obtain help regarding computer problems and advice on handling sensitive information.
39. Areas for improvement included:
- business continuity management protocols;
 - information security management including policy, guidance and key responsibilities;
 - anti-fraud strategy and procedures;
 - data protection policy, guidance and their responsibilities under the Data Protection Act;
 - understanding actions to take regarding IT virus protection;
 - whether installing and copying software on computers is permitted; and
 - whether all computer equipment is clearly security marked and departments keep an up to date record of all its assets.



Looking Forward

40. The Scottish Teachers' Superannuation Scheme and the NHS Superannuation Scheme (Scotland) face a number of challenges in 2007/08, which include:

- **Financial Strategy** - There may be a financial impact arising from changes in strategic direction in line with adjustments to national priorities and the Spending Review.
- **New Pension Administration System** – A contractor has now been appointed to deliver the new IT system for the administration of pensions. The system is currently undergoing testing with the intention that the Scottish Teachers' Superannuation Scheme will 'go-live' early in 2008. The NHS Superannuation Scheme (Scotland) is expected to follow two to three months later. Subsequently, electronic access will be made available to members and employers. We will monitor the project management arrangements in place to deliver this ambitious project.
- **Pension reform** – Reforms to both the Scottish Teachers' Superannuation Scheme and the NHS Superannuation Scheme (Scotland) are planned as part of wider ranging reforms to occupational pensions. Members and employers have been consulted on proposed changes to the schemes and reforms to the Scottish Teachers' Superannuation Scheme were effected 1 April 2007. Reforms to the NHS Superannuation Scheme (Scotland) are planned to take effect on 1 April 2008.
- **Best Value** - As part of the 2007/08 audit we will be reviewing the progress that the Scottish Public Pensions Agency has made in strengthening its arrangements for securing Best Value since our baseline review work in 2005/06. Over the next year we will also be developing and refining our approach to the audit of public bodies' arrangements to secure economy, efficiency and effectiveness in the use of resources, as this is one of our key objectives as auditors, set out within the new Code of Audit Practice approved by the Auditor General. This will inform our ongoing work to develop an approach to the audit of Best Value across the Scottish public sector. We intend to consult with both clients and stakeholders at key stages of these initiatives.
- **Efficient Government** - The achievement of future Efficient Government targets represents a challenge for the organisation.
- **Performance Management** – The Scottish Public Pensions Agency needs to improve its arrangements for collecting data underlying performance reporting. Implementation of internal audit's recommendations made in 2006/07 should help accomplish this.

Appendix A: Action Plan

Key Issues and Planned Management Action

Action Point	Issue Identified	Planned Action	Responsible Officer	Target Date
1	<p>Family Benefit Payments</p> <p>We were unable to obtain supporting documentation to fully explain how payments were calculated for six out of our sample of nine payments. These payments were made by Paymaster, prior to the transfer of the Payments function in-house and the documentation inherited by SPPA was insufficiently detailed to enable SPPA staff to completely and accurately explain how the amounts were calculated. With the assistance of Agency staff, and with reference to key documents held electronically, we were able to agree the calculations for the six cases to amounts sufficiently close to the sums paid to provide assurance that there was no material error.</p> <p>There is a risk that inaccurate payments may be made without detection if complete and accurate records of all calculations are not retained.</p> <p><i>We recommend that SPPA reviews the documentation held in support of Family Benefit payments made from 2007/08 onwards and ensures that there is a complete and accurate audit trail in support of each payment.</i></p>	<p>Agree. Supporting documentation is now stored on EDM and will be stored on AXISE. The calculation of Family Benefit is by necessity carried out on SPPA's pensions admin systems. Details of the award will be per those systems.</p>	<p>Ian Clapperton, Director of Operations</p>	<p>In place since February 2007.</p>

Action Point	Issue Identified	Planned Action	Responsible Officer	Target Date
2	<p>Numbers for Members with Preserved Rights</p> <p>Previously the statistics for Members with Preserved Rights were derived from the Northgate system and passed to GAD as part of the information for their Actuarial Assessment. This year the data was extracted from the Northgate system and 'cleansed' of inappropriate entries. The original number fell from 63,984 to 57,580. However, this is still substantially higher (54%) than the 2005/06 figure of 37,377. SPPA considers that its revised approach produces more accurate figures.</p> <p>There is a risk that scheme liabilities could be mis-stated if the number of members with preserved rights is not accurately recorded.</p> <p><i>We recommend that procedures for the review of the statistics are established by SPPA and that GAD are consulted about the accuracy levels required.</i></p>	<p>Agree. This will be considered as part of the introduction of AXISE. The ongoing data cleanse exercise will also have an impact on the accuracy of these statistics.</p>	<p>Pam Lane, Director of IT Ian Clapperton, Director of Operations</p>	<p>April 2008</p>
3	<p>Agenda for Change information</p> <p>A debtor of £35 million was included in the Scheme's accounts in for contributions receivable in respect of Agenda for Change pay increases in the Health bodies. The Agency did not have procedures in place to collect this information during 2006/07 and Audit Scotland collected the majority of the information from the audited bodies to allow a debtor figure to be established.</p> <p>There is a risk that the agenda for change accrual is</p>	<p>Agree. SPPA will attempt to gather this information from Health Boards. This will only be possible where Health Boards are able and willing to provide this information and where time allows.</p> <p>SPPA are also in discussions with Health Boards on how they present members data.</p>	<p>Mark Cockburn, Finance Manager</p>	<p>July 2008</p>

Action Point	Issue Identified	Planned Action	Responsible Officer	Target Date
	<p>not reflected accurately in the accounts</p> <p><i>We recommend that the Agency establishes appropriate procedures to identify any accrual as at 31 March 2008.</i></p>			
4	<p>Early retirement receipts debtor</p> <p>The early retirement receipts debtor of £2.6 million could not be independently confirmed. The amount has not yet been recharged to the Scottish Government and therefore not yet been received.</p> <p>There is a risk that the amount included as a debtor in the Scheme's accounts could be mis-stated if the amount is not agreed with the Scottish Government.</p> <p><i>We recommend that SPPA ensures that early retirement recharges are raised timeously and any year end debtor amounts are agreed with the Scottish Government.</i></p>	<p>Agree. Work is ongoing to develop reports and clean up the payroll data migrated from Paymaster.</p>	<p>Mark Cockburn, Finance Manager Ian Clapperton, Director of Operations</p>	July 2008
5	<p>Adjustment in respect of Paymaster reporting difficulties</p> <p>An adjustment of £4 million was made on the trial balance due to Paymaster reporting difficulties. Although a similar adjustment (£2.3 million) was made in 2005/06. It is concerning that the amount has increased in 2006/07.</p> <p>There is a risk that pensions expenditure could be incorrectly analysed in the accounts if payments are not completely and accurately analysed in the accounting records.</p>	<p>Agree. Work is ongoing to develop reports and clean up the payroll data migrated from Paymaster.</p>	<p>Mark Cockburn, Finance Manager Ian Clapperton, Director of Operations</p>	July 2008

Action Point	Issue Identified	Planned Action	Responsible Officer	Target Date
	<p><i>Although we recognise that NHS pensions are no longer being made by Paymaster, we recommend that SPPA ensures that payments made through the new Resourcelink system are completely and accurately analysed.</i></p>			
6	<p>Full Actuarial Valuation</p> <p>A full actuarial valuation was due to be carried out as at 31 March 2004. This is currently being carried out by GAD but had not been completed at the time of the 2006/07 audit. The previous full GAD valuation (as at 31 March 1999) was not signed off until July 2005.</p> <p>If full scheme valuations are not carried out timeously in accordance with stated accounting policies, there is an increased risk that scheme liabilities may be mis-stated.</p> <p><i>We recommend that SPPA liaises with GAD with a view to reducing the time taken to complete full scheme valuations.</i></p>	<p>GAD has advised that the current delay is well within the norm for the lag in publication of funding valuations.</p> <p>SPPA will discuss the possibility of annual data reconciliations and biennial interim valuations with GAD</p>	Ian Clapperton, Director of Operations	2009

Action Point	Issue Identified	Planned Action	Responsible Officer	Target Date
7	<p>Supervisory checks on transfers in/out:</p> <p>Our audit was unable to confirm that B1 and B2 supervisory checks were operating in a number of areas of SPPA's work across the full 2006/07 financial year. We were therefore unable to rely on management controls to the extent that we would have wished. We note that the coverage of these checks has improved since last year.</p> <p>Without supervisory checks there is a risk that transfers are incorrectly processed.</p> <p><i>We recommend that a complete system of supervisory checks is implemented and appropriately evidenced as soon as possible to ensure a sufficient level of management control.</i></p>	<p>Agree. Checks are in place and we are reviewing standards and coverage.</p>	<p>Ian Clapperton, Director of Operations</p>	<p>April 2008</p>