

Scottish Parliamentary Contributory Pension Scheme

Report on the 2007/08 Audit



November 2008



Contents

Executive Summary	1
Introduction	3
Financial Statements	4
Governance	8
Looking forward	10

Executive Summary

Introduction

In 2007-08 we audited the financial statements of the Scottish Parliamentary Contributory Pension Fund (SPCPF). Our responsibilities also include looking at aspects of performance management and governance as considered appropriate. This report sets out our key findings.

Financial Statements

We have given an unqualified opinion on the financial statements of the SPCPF for 2007-08. We 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; and that contributions have been paid in line with Fund rules and the recommendation of the Actuary.

Financial position

The Scheme liabilities have been estimated by the Actuary at £21.0 million as at 31 March 2008 (2006-07: £23.4 million). The value of the related pension fund at that time is £19.7 million (2006-07: £18.5 million). The shortfall of assets in the Fund at 31 March 2008 is £1.3 million, a significant reduction from the £4.9 million shortfall at 31 March 2007.

Governance

SPCPF's corporate governance and control arrangements operated satisfactorily in the period under review as reflected in the Statement on Internal Control; we undertook a range of testing which confirmed the position. SPCB staff confirmed that they had made progress in addressing the recommendations arising from the internal audit review of arrangements reported as part of the 2006-07 audit. Also, during the year, we liaised with SPCB staff on their preparation for introducing new legislation for MSP's pensions.

Performance Management

As indicated in the approved audit plan, the audit approach involved aspects of performance audit, but these were dealt with under corporate governance and financial statements, with no specific performance audit work reported.

Looking Forward

We will continue to liaise on the implications of the proposed update to the statutory framework for the Scheme; the developments in the governance arrangements; and the updated accounting rules for pension schemes that become effective for 2008-09.

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

Murdoch McCamley CA,
Senior Audit Manager,
November 2008

Introduction

Scope of the Audit

1. This report summarises the findings from our 2007-08 audit of the Scottish Parliamentary Contributory Pension Fund (SPCPF), which is the Fund for the pensions of MSP's and Law Officers under the terms of the Scottish Parliamentary Pension Scheme (SPPS). For simplicity we adopt the abbreviation SPCPF in most circumstances in this report. The scope of the audit was set out in our Audit Plan, which was discussed and agreed with management and reviewed and approved by the Advisory Audit Board on 15 April 2008. The Audit Plan described the work we planned to carry out, the primary focus being an audit of the financial statements and provision of an opinion on whether they present a true and fair view of the financial position of SPCPF and its expenditure and receipts for the year. We also review aspects of the SPCPF's arrangements for governance and internal control.
2. This report to management sets out the findings on the completion of our audit as at October 2008. Any weaknesses outlined are only those which have come to our attention during the course of our normal audit work and are not necessarily all the weaknesses which may exist. It is the responsibility of management to determine the extent of the internal control system appropriate to the SPCPF. 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. The assistance and co-operation we received during the course of our audit is gratefully acknowledged. This report will be submitted to the Auditor General for Scotland and will be published on our website at www.audit-scotland.gov.uk.

Financial Statements

Our Responsibilities

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

they give a true and fair view of the financial transactions of the Fund for the year ended 31 March 2008 and of the amount and disposition at that date of its assets and liabilities, other than liabilities to pay benefits after the end of the Fund year;

they have been properly prepared in accordance with the Public Finance and Accountability (Scotland) Act 2000 and the Scotland Act 1998 (transitory and Transitional Provisions) (Scottish Parliamentary Pension Scheme) Order 1999 and directions made thereunder;

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; and

the Contributions payable to the Fund during the year ended 31 March 2008 have been paid in accordance with the Fund rules and the recommendation of the Actuary.

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

considering compliance with Scottish Public Finance Manual guidance;

considering the adequacy of the process put in place to obtain assurances on systems of internal control by the members of the Scottish Parliamentary Corporate Body (SPCB) in their role as Managers of the Fund; and

assessing whether disclosures in the Statement are consistent with the information emerging from our normal audit work.

Overall Conclusion

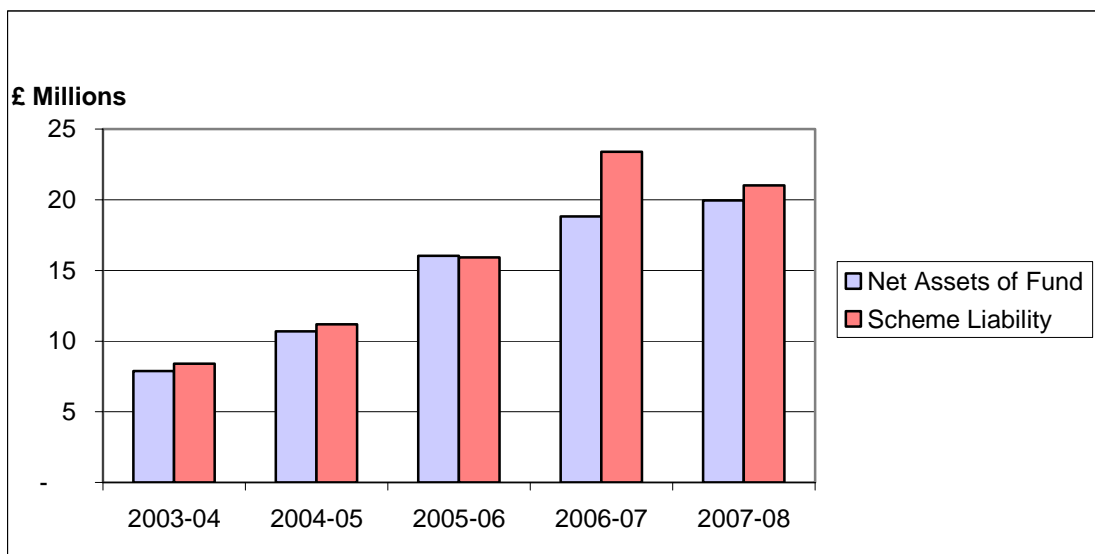
6. We have given an unqualified opinion on the financial statements of the SPCPF for 2007-08. We are able to conclude that the financial statements of the SPCPF give a true and fair view of the financial transactions of the Fund for the year ended 31 March 2008 and the disposition at that date of its assets and liabilities, other than liabilities to pay benefits after the end of the Fund year; 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; and that the Contributions payable to the Fund during the year ended 31 March 2008 have been paid in accordance with the Fund rules and the recommendation of the Actuary.

Financial Position

7. The Fund Account for the year records a total income for the financial year of £2.05 million (2006-07: £2.21 million), comprising contributions into the Fund, transfers into the fund from those joining the Scheme and other income. The main reason for the decrease was the reduction of £0.13 million in transfers into the Scheme. The expenditure for the financial year was £0.74 million, an increase of £0.57 million from 2006-07 expenditure of £0.17 million. The main increase related to transfers out of the Scheme of £0.40 million (2006-07: nil); benefits payable increased by £0.15 million to £0.22 million; administration expenditure and other payments increased by £0.02 million to £0.11 million. The net return on investments held by the Fund was a decrease of £0.19m (2006-07: £0.76 million increase). The overall effect of these movements was an increase in the net assets of the Fund of £1.12 million, taking the Fund value at the year end to £19.94 million, (2006-07: £2.79 million and £18.82 million). These figures include Additional Voluntary Contributions in year of £14 thousand (2006-07: £27 thousand) with a year end value of £270 thousand (2006:07 £282 thousand).
8. In line with the Accounts Direction the accounts exclude the Scheme's liability to pay future benefits. The Scheme liabilities, excluding liabilities associated with Additional Voluntary Contributions, have been estimated by the Actuary at £21.0 million as at 31 March 2008 (2006-07: £23.4 million). The value of the related pension fund at that time is £19.7 million. Exhibit 1 shows the shortfall of assets in the Fund (excluding Additional Voluntary Contributions) is £1.3 million, a significant reduction from the £4.9 million shortfall at 31 March 2007.

Exhibit 1

Scottish Parliamentary Contributory Pension Scheme: Comparison of Nets Assets and Fund Liability



Source: Audited Accounts 2003-04 to 2007-08

Scheme liabilities

9. The main factor in the improvement in the overall position of the Fund is the £2.4 million decrease in Scheme liabilities. This is analysed in note 16 to the accounts, which records increases in the costs of current service of £2.6 million (2006-07: £2.2 million) and the interest cost of scheme liabilities of £1.3 million (2006-07: £0.8 million); these increased costs of £3.9 million (2006-07: £3.0 million) are offset by an experience gain (change in actuarial assumptions) and net transfers totalling £6.3 million, resulting in the net decrease in Scheme liabilities of £2.4 million. (2006-07: £4.5 million experience loss and £3.0 million costs led to an increase in liabilities of £7.5 million).

10. The Actuary reports that a number of factors are responsible for the overall reduction in the Scheme liabilities. The main factor in the change between 2006-07 and 2007-08 is the increase in the percentage rate applied to estimated future pension payments to state them at their present value at the balance sheet date (the discount rate). The discount rate applied is linked to the rate of interest on corporate bonds; and this rose from 1.9% to 3.1% between 2006-07 and 2007-08. The higher the discount rate the lower the present value of the liabilities. The reduction in liabilities was offset, to an extent, by a change in the assumptions on the longevity of Scheme members, which increase future liabilities.

Annual charge

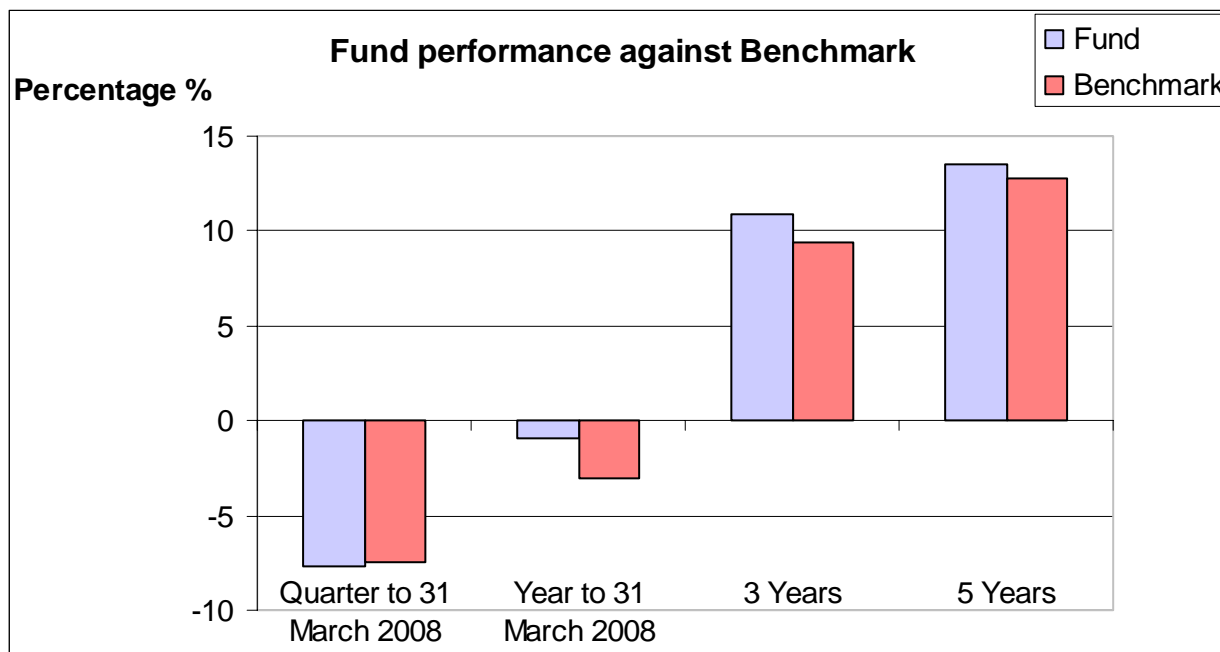
11. Although the change in the year-end liabilities of the Scheme is the most significant change over the year, it is also worthwhile commenting on the annual charge. The actuarial estimate of the annual cost for the year is £3.9 million, up from £3.0 million in 2006-07. This contrasts with the annual employers contributions from the Scottish Consolidated Fund of £1.5 million (2006-07 £1.5 million). The difference reflects the Actuary's assumption that the long term investment yield will be higher than the current market yield of 3.1%.

Investment performance

12. Baillie Gifford's Managed reported that the Managed Pension Fund decreased in value by 0.9% over the year to 31 March 2008 compared to a decrease of 3% for the target benchmark (Exhibit 2).

Exhibit 2

Baillie Gifford managed pension fund performance against benchmark



Source: Baillie Gifford

13. The 3 year performance was an increase of 10.9% per annum compared to the benchmark of an increase of 9.4% per annum. (The benchmark is the Combined Actuarial Performance Service (CAPS) median Balanced Pooled Fund over a rolling 3 year period).
14. Performance in the 6 months to 30 September 2008 has also been broadly in line with benchmark, being a drop of 10% in the price of units. The period from 31 March 2008 to the date at which the accounts were signed has been one of significant volatility in the value of investments. However, we agree with SPCB that it would not be appropriate to adjust the investment values in the accounts as a post balance sheet event; or to disclose the value at the date at which the accounts are signed. These investments are being held for the long term and the long term effect of asset values on the future contributions to the Scheme will be assessed as part of the actuarial valuation process.

Statement on Internal Control

15. A Statement on Internal Control was signed by the Presiding Officer on 31 October 2008. This set 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 Public Finance Manual guidance; that satisfactory processes have been put in place to obtain assurances on systems of internal control by the Presiding Officer and by the members of the SPCB in their role as Managers of the Fund; and that 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. Our responsibilities in relation to the communication of audit matters to those charged with governance are covered in International Standard on Auditing 260 and outcomes against the requirements of the Standard were recorded in a report to the SPCB and its Advisory Audit Board in draft on 1 October 2008 and issued formally to the Presiding Officer immediately prior to him signing the accounts. In this context, our audit had not identified any unadjusted errors that we needed to bring to attention.
18. In line with normal practice, issues were discussed and resolved with officers during the course of the audit of the financial statements. Otherwise, there are no matters of such significance that we wish to record them as part of this report.

Governance

Introduction

19. 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 the SPCPF's corporate governance as it relates to systems of internal control and the review of internal audit.

Overall Governance Arrangements

20. During our audit we updated and confirmed our understanding of the governance systems operating in relation to SPCPF. The Fund relies on SPCB systems and arrangements for aspects of the financial accounting and payroll; and aspects of these are in turn based on Scottish Government arrangements. Pension aspects and accounts preparation are carried out by SPPA under a Service Level Agreement. Baillie Gifford are Investment Managers.
21. Our understanding of arrangements builds on our reviews of systems and controls in previous years, any relevant findings of internal audit and our current year work. In the current year we carried out systems and controls work as necessary to support our audit of the financial statements of SPCPF. This mainly comprised examining pension transactions: contributions due and their transmittal to the investment managers; transfers in and out of the Scheme and benefits payable.
22. In relation to the broader aspects of the governance and control environment, Audit Scotland carry out annual work on systems and controls at the SPCB and the Scottish Government, including SPPA. The coverage includes the main accounting system (SEAS) and payroll; and also pension arrangements at the SPPA, who manage this aspect of the Scheme's operations on behalf of the SPCB. There are no matters we wish to bring to attention from this work. In addition, in relation to the investments held, Baillie Gifford prepared a statement on their internal control framework. KPMG, as reporting accountants, provided positive assurance on the statement. Overall therefore we are content that the governance arrangements are soundly based.

Internal Audit

23. 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. Audit Scotland have reviewed and place reliance on the internal audit services provided to the Scottish Parliamentary Corporate Body and the Scottish Government, including SPPA.
24. As part of the 2007-08 audit we followed up the internal audit review of governance arrangements, which was reported as part of the 2006-07 audit. We discussed progress on the 4 recommendations which had been accepted by SPCB. SPCB staff confirmed that the relevant agreed actions were in hand, for example, through agreeing a new Service Level Agreement with SPPA. However, as anticipated at the time of agreeing the recommendations, while it had been possible to make progress, not all the relevant arrangements had been finalised or brought to the SPCB (in their role as Managing Trustees) for approval. We also note that the future implementation of these recommendations will need to take account of the new arrangements that will flow from the introduction of the replacement scheme for MSPs pensions that is being put in place. We will continue to monitor progress as part of the 2008-09 audit.

Other aspects of governance

25. We also noted progress in providing training for the new SPCB members in their role and responsibilities as Managing Trustees; and are aware that a strategy for future training will be linked to governance structure and control environment that evolves under the new framework that is envisaged for the SPPS.
26. During the year, we liaised with SPCB staff on their preparation for introducing new legislation for MSP's pensions. In particular, we considered the potential implications for audit arrangements and Parliamentary accountability. As part of this, we prepared a report on behalf of the Auditor General for Scotland, confirming the appropriateness of charges on the Scottish Consolidated Fund included in the proposed legislation; confirmation was required by the Parliament's standing orders.

Looking forward

27. As part of our audit of the 2008-09 accounts we will follow up on developments in the governance arrangements. We will also continue to liaise on the implications of the proposed update to the statutory framework for the Scheme.
28. We will also consider and discuss with SPCB the implications of the revised pension SORP (Statement Of Recommended Practice, issued on behalf of the Accounting Standards Board (ASB)), which will apply for the 2008-09 accounts. Overall we do not anticipate major changes flowing from this – but the Auditor General will need to issue a new Accounts Direction; and there will be some other changes that may require some preparatory work, for example, the SORP requires a move to the use of bid price for valuing investments and SPCB may need to ensure the relevant information is available for 2008-09, with comparative figures, as appropriate.