

# HM Inspectorate of Education

## Report on the 2005-06 Audit

6 February 2007



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# Executive Summary

## Introduction

In 2005-06 we audited the financial statements of HM Inspectorate of Education (HMIE) 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 HMIE for 2005/06. HMIE's Operating Cost Statement shows a net operating cost for the year of £13.4 million, an increase of £1.8 million compared to the previous year. Staff costs increased by £1.2 million, reflecting the first full year's costs of the new 'Services for Children' Unit. The Management Commentary to the financial statements identifies that rent and rates, telecoms and publications expenditure all recorded increases, reflecting the first full years cost of occupying the new premises in Livingston and Clydebank.

## Governance

HMIE's corporate governance and control arrangements operated satisfactorily in the period under review as reflected in the Statement on Internal Control. We do however note that this statement, whilst presented in the spirit of guidance given in the Scottish Public Finance Manual (SPFM), does not comply in detail with the pro-forma given in the SPFM and recommend that disclosures in this statement be brought more closely in line with SPFM guidance in future years in order to ensure greater clarity and consistency with other Scottish central government bodies.

We have also found the work of the internal audit service of the Scottish Executive to be satisfactory and continue to place formal reliance on their work as appropriate.

## Performance Management

During 2005-06, we undertook an overview of HMIE's management arrangements for achieving Best Value and formed a preliminary view that these arrangements are well developed overall.

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

Peter Tait CPFA, Assistant Director



# Introduction

## Scope of the Audit

1. This report summarises the findings from our 2005-06 audit of HMIE. The scope of the audit was set out in our Audit Planning Memorandum, which was agreed with HMIE in 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 HMIE. We would stress, however, that an effective internal control system is an essential part of the efficient management of any organisation. The contents of this report have been agreed with relevant officers to confirm factual accuracy.
3. This is the final year of a five year audit appointment although the audit will continue to be delivered by Audit Scotland, albeit by a different audit team bringing a fresh perspective to the audit which, we are sure will add value to HMIE. Over the last five years HMIE has experienced considerable change and pressures with many additional responsibilities and burdens placed upon it and it is to the credit of HMIE staff that, in the context of such change, we have seen considerable improvements in the quality of the draft financial statements submitted for audit.
4. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officers and members of HMIE during the course of our appointment.
5. This report will be submitted to the Auditor General for Scotland and will be published on our website at [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).

## Outcome on Risks Identified in the Audit Risk Analysis and Plan

6. A key feature of our audit approach is the need to form a comprehensive understanding of the client's business in order to appreciate the risks arising from that business and affecting the achievement of its objectives. Three risks were identified at the planning stage and the outcome of the audit work on each of the risks is summarised at Appendix A.



## Prior Period Follow Up

7. In following up matters arising from the 2004-05 audit we found that there were none which remain unresolved or where management action is outstanding. However, we would highlight the following issues that need to be kept under review:
  - the Self certification of travel and subsistence claims;
  - the use of 'call-off contracts' for the procurement of educational consultancy and research services.
8. The self certification of claims remains an area that, as external auditors, we wish to mention again but accept that the nature and extent of internal control in this area is predicated on Scottish Executive corporate procedures and processes outwith the direct control of HMIE. However we are content that HMIE management are vigilant to the risks and sensitivity associated with expenditure in this area and continue to review and monitor internal controls in this area.
9. We have highlighted the procurement issue again because we believe it is important that HMIE keep sight of the inherent risks (in terms of internal control and procurement value for money) associated with any business area where there are a limited number of suppliers. For 2005-06, we concluded that HMIE practice is reasonable given the nature of the market for educational consultancy and research services.

## Management Action

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



# Financial Statements

## Our Responsibilities

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

- the financial statements give a true and fair view, in accordance with the Public Finance and Accountability (Scotland) Act 2000 and the directions made thereunder by the Scottish Ministers, of the state of affairs of the agency as at 31 March 2006 and the net cost of operations, recognised gains and losses and cash flows for the year then ended
- The financial statements 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 the 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.

12. 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
- assessing whether disclosures in the Statement are not inconsistent with the information emerging from our normal audit work.

## Overall Conclusion

13. We have given an unqualified opinion on the financial statements of HMIE for 2005-06. We are able to conclude that the financial statements of HMIE 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.

14. The Accounts Direction issued by Scottish Ministers stipulate that HMIE's financial statements comply with the Government's Financial Reporting Manual (FRoM). The 2005-06 financial statements should have been included in each audited body's annual report. This requirement has not been met by



HMIE for the 2005-06 year partly due to the HMIE annual report being produced by the end of June, in keeping with the education sector business cycle, and partly due to the timing of the audit. Achieving the publication of the financial statements as part of the Annual Report will represent a challenge for HMIE and the new audit team. We encourage HMIE to liaise closely with the incoming audit team in order to accelerate the financial statements preparation and audit process in order to meet FReM requirements.

## Financial Performance

15. HMIE's Operating Cost Statement shows a net operating cost for the year of £13.4 million, an increase of £1.8 million compared to the previous year. Staff costs increased by £1.2 million, reflecting the first full year's costs of the new Services for Children Unit. The Management Commentary to the financial statements identifies that rent and rates, telecoms and publications expenditure all recorded increases, reflecting the first full years cost of occupying the new premises in Livingston and Clydebank, investment in Blackberries and the production of a number of keynote publications.

## Statement on Internal Control

16. A draft Statement on Internal Control was presented to the Audit Committee on 14 September 2006 and signed by the Chief Executive on 27 September 2006. This set out the arrangements operation for risk identification and review, management of identified risks and assurance of effectiveness.
17. During 2005-06, the Scottish Executive Guidance was updated to include, among other points, references to the Scottish Public Finance Manual and the organisation's processes for continuous improvement and development. We do however note that this statement, whilst presented in the spirit of guidance given in the Scottish Public Finance Manual (SPFM), does not comply in detail with the pro-forma given in the SPFM and recommend that disclosures in this statement be brought more closely in line with SPFM guidance in future years in order to ensure greater clarity and consistency with other Scottish central government bodies. We have also found the work of the internal audit service of the Scottish Executive to be satisfactory and continue to place formal reliance on their work as appropriate and are grateful to colleagues in the internal audit service for enabling us to maintain good working relationships and the mutual sharing of information and views in order to minimise the audit burden on HMIE.
18. We are satisfied that 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

19. My 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 reported in a letter to the Accountable Officer on 1 September 2006.
20. As part of the audit process we identified two accounting adjustments that were required:
- Overstatement of expenditure by £91k due to double counting of notional audit fee and personnel costs
  - Understatement of income and expenditure by £4k due to netting off of an expense relating to consultancy services from SFEU against SFEU income

## Issues Arising

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

### *Accounting entries processed outwith HMIE*

22. A debit balance of £33,000 was identified on HMIE's creditors listing, which related to a transaction processed by SE staff. This highlights the need for HMIE to ensure that bookkeeping activity initiated outwith the organisation is satisfactorily evidenced and explained to the satisfaction of HMIE finance staff

**Action point 1**

### *Payroll Overpayment*

23. During testing of payroll, we identified an overpayment where an employee employed on a fees basis had been paid the same month's fees twice. The overpayment had already been identified by HMIE and arrangements made to recover the overpayment. This case highlights the importance of liaising with the SE payroll section to ensure that payroll information is actioned timeously and accurately.

**Action point 2**

### *Re-employment of retired/ former staff*

24. During testing of payroll, we noted that a number of retired/ former employees had been re-employed on a part time basis. There are certain risks associated with this practice and HMIE should remain vigilant to the risks and ensure that appropriate controls are in place.

**Action point 3**



# Governance

## Introduction

25. 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 HMIE's corporate governance as it relates to:

- fraud prevention and detection arrangements
- systems of internal control
- review of internal audit.

## Overall Conclusion

26. During our audit we reviewed the governance systems operating at HMIE. In general, we are content that they are soundly based.

## Fraud Prevention and Detection Arrangements

27. HMIE's arrangements for preventing and detecting fraud and corruption were assessed during the audit and found to be satisfactory. No internal frauds were identified by HMIE in 2005-06. During testing of expenditure, we identified an instance of fraudulent misuse, by an unrelated third party, of a GPC card issued to an employee of HMIE. The matter had been properly reported and investigated in accordance with the prescribed procedures, and full reimbursement made by the card provider. Nevertheless, this incident highlights the need to ensure that adequate security arrangements and controls over the use of GPC cards are maintained.

## Systems of Internal Control

### *Reliance on Internal Audit and the external auditor of the Scottish Executive*

28. As part of our audit, we placed reliance on the work undertaken by internal audit (see Review of Internal Audit below).



29. We also placed reliance upon work undertaken by the central Scottish Executive auditor in the following areas:

- The operation of the main accounting system (SEAS)
- Payment of creditors and accounts payable
- Cash and banking systems
- The central aspects of the operation of the Britannia fixed asset system
- The central aspects of payroll
- Review of the internal audit function

30. During our interim audit we reviewed and tested the operation of key system controls for payments and payroll starters and leavers and found that these appeared to be operating satisfactorily.

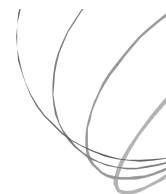
## Review of Internal Audit

31. HMIE 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 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.

32. Internal audit is provided by the Audit and Accountancy Services Division (AASD) which is part of the Scottish Executive Financial and Central Services Division. From our review of internal audit arrangements we are pleased to confirm that we are placing reliance on their work in a number of areas during 2005-06, as was anticipated in our audit plans. We are grateful to internal audit colleagues for enabling us to maintain good working relationships and the mutual sharing of information and views in order to minimise the audit burden on HMIE.

33. We planned to place formal reliance on the work of internal audit, in terms of International Standard on Auditing 610 on the reviews of:

- Human resources and staff governance arrangements
- Performance management measurement and validation
- Assurance to the Accountable Officer to support disclosures contained in the statement on internal control included in the financial statements



34. We reviewed the reports and are satisfied that none of the observations and related risks precludes planned assurance from being taken for our financial statements audit.
  
35. The Audit Services report to Audit Committee members on 9 May 2006 concludes that the overall opinion is that the governance and internal control within HMIE continues to provide substantial assurance that material risks to the achievement of objectives are identified and adequately managed.



# Performance Management

## Introduction

36. This section covers our assessment of the way in which HMIE secures value for money in the use of its resources. This year we focussed on Best Value.

## Best Value

37. There is no statutory duty of Best Value in the wider public sector in Scotland. 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.

38. In May 2005, Ministers decided that they would not bring forward legislation which extends Best Value in the wider public sector. However, Ministers do wish to encourage and embed the principles of Best Value across the wider public sector and revised guidance was issued in May 2006.

39. During 2005-06 Audit Scotland carried out a review to establish the arrangements in place across the central government and NHS sectors which support best value and continuous improvement, 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 HMIE. The overall aim of this analysis was to establish the organisation's arrangements for taking forward the Best Value agenda and demonstrating continuous improvement.

40. As part of the 2005-06 audit, we undertook an overview of HMIE's management arrangements for achieving Best Value and formed a preliminary view that these arrangements are well developed. The results of the national review across the wider public sector will be issued to audited bodies in 2007.

## National Studies

41. A list of relevant reports issued by the Auditor General is shown at Appendix C.

# Appendix A: Outcome on Risks Identified in the Audit Planning Memorandum

Risk	Planned audit action	Outcome
<p><b>1. Relocation</b> Since HMIE's programme of relocating offices is ongoing there is a generic risk that unexpected costs may arise.</p>	<p>We will review relocation costs in 2005-06 as well as new arrangements for facilities management costs and select a sample of transactions for detailed testing as appropriate.</p>	<p>Analytical and detailed audit testing was satisfactorily completed.</p>
<p><b>2. Associate assessors and seconded staff</b> Previous years audit findings have indicated that HMIE's use of seconded staff and associate assessors may result in errors or inconsistencies with respect to contractual arrangements and remuneration.</p>	<p>We will review developments in this area and select a sample of seconded staff / associate assessors contracts for detailed testing as appropriate.</p>	<p>Analytical and detailed audit testing was satisfactorily completed.</p>
<p><b>3. IT Developments (FLINT)</b> Significant IT developments (of which FLINT is the largest) at HMIE will impact on the levels of capital expenditure as well as having a consequential impact on related revenue expenditure. Generic audit risks arise in these circumstances relating to project management (ie the risk that projects may be late and / or over budget) and financial accounting (ie the risk that revenue items of expenditure have been capitalised and vice versa).</p>	<p>We will review project documentation for all significant IT projects and, taking account of where each project is in the system development lifecycle, compare project delivery (in terms of time and costs) with initial project plans. In addition we will review financial transactions relating to IT developments and select a sample for detailed testing paying particular regard to accounting treatment.</p>	<p>Audit testing was satisfactorily completed.</p>

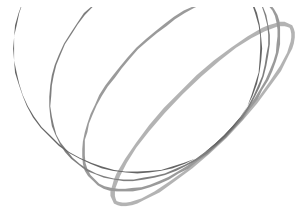
# Appendix B: Action Plan: Recommendations for Further Improvements

Action Point	Para. No	Issue, Risk and Audit Recommendation	Management Response	Responsible Officer	Target Date
1	22	<p><b>Accounting entries processed outwith HMIE</b></p> <p>During creditors testing we identified a debit balance of £33,000 on HMIE's creditors listing. This relates to a 2003-04 invoice from Dumfries and Galloway Council which it appears was originally posted to HMIE's accounts payable but later reversed out. Journal entries were made by SE staff however due to staff changes etc. HMIE have been unable to obtain an explanation for these entries or sufficient information to correct the debit balance.</p> <p><i>HMIE should work with the relevant SE branches to ensure that bookkeeping activity initiated outwith HMIE is satisfactorily evidenced and explained to the satisfaction of HMIE finance staff.</i></p>	<p>We will continue to work with SE colleagues to ensure that bookkeeping activity initiated outwith HMIE is evidenced and explained to our satisfaction. Monthly checks will include scrutiny of all such activity.</p>	<p>Morna Cochrane</p>	<p>Ongoing</p>



Action Point	Para. No	Issue, Risk and Audit Recommendation	Management Response	Responsible Officer	Target Date
2	23	<p><b>Payroll overpayment</b></p> <p>During payroll testing we identified an overpayment where an employee employed on a fees basis had been paid the same month's fees twice (December 2005 pay). The overpayment had already been identified by HMIE and arrangements made to recover the overpayment.</p> <p><i>HMIE should continue to liaise with the SE payroll section to ensure that payroll information is processed accurately and timeously.</i></p>	<p>Payments for fee paid staff will in future be routed through HMIE finance before they go to SE payroll. A check will be established to ensure all fees are paid accurately in future.</p>	Morna Cochrane	February 2007
3	24	<p><b>Re-employment of retired/ former staff</b></p> <p>HMIE employs a number of retired/ former staff on a part time basis. We noted one case where an employee whose full time employment ended in June 2005 was re-employed in July 2005 on a part time basis at a daily rate of pay equivalent to 64% higher than his daily pay rate as a full time salaried employee.</p> <p><i>HMIE should review the nature and extent of its re-employment of retired/ former staff in receipt of occupational pension and should remain vigilant to the risks of irregular transactions and to the need to ensure value for money.</i></p>	<p>A detailed policy statement will be developed that sets out HMIE's approach to the re-employment of retired/former staff and we will review our practice on a regular basis.</p>	Kevin Mills	January 2007





# Appendix C: Auditor General for Scotland published reports

Auditor General for Scotland

*The Efficient Government Initiative: a progress report (published 19/12/2006)*

The report on the Efficient Government Initiative has found a commitment to improve efficiency, but says the Executive needs to do more to provide assurance on the levels of savings and their impact on service delivery.

Accounts Commission and Auditor General for Scotland

*Community planning: an initial review (published 16/06/2006)*

Community planning partnerships have made progress but need to do more to show how their work is improving public services. The report also says that their complex remit makes it difficult for them to achieve their aims and calls on the Executive to support community planning more effectively.

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

*Scottish Further Education Funding Council: A progress report (published 26/01/2006)*

The Scottish Further and Higher Education Funding Council (Funding Council) is making progress on a number of fronts, according to a report published today by the Auditor General for Scotland.

Auditor General for Scotland

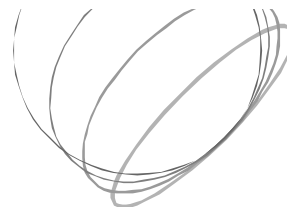
*Leadership development. How Government Works (published 17/11/2005)*

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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