

Scottish Government

Report on the 2009/10 audit



 AUDIT SCOTLAND

October 2010



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 Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

Contents

Key messages	2	Performance	19
Introduction	4	Looking Forward	22
Financial Statements	6	Appendix A: Forward Action Plan	23
Use of Resources	9	Appendix B: Section 22(3) Report	24
Governance and Accountability	15		

Key messages

In 2009/10 we looked at the key strategic and financial risks being faced by the Scottish Government. We audited the financial statements and we also reviewed the use of resources and 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 Scottish Government for 2009/10. The financial statements give a true and fair view of the Scottish Government financial position. The audit opinion records that the expenditure and receipts shown in the financial statements were incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers. The signed accounts were laid in the Scottish Parliament and published on 30 September 2010. This was a significant achievement, particularly in the first full year of application of International Financial Reporting Standards (IFRS).

Report by Auditor General for Scotland under Section 22(3) of the Public Finance and Accountability (Scotland) Act 2000

The Auditor General has prepared a report on the accounts under sub-section 22(3) of the Public Finance and Accountability (Scotland) Act 2000. In March 2010, the Auditor General briefed the Parliament's Public Audit Committee (PAC) on how the accounts could be used to inform Parliament's budget scrutiny and how Audit Scotland could assist this process by providing an analysis of variations between outturn and budget. The 2008/09 accounts formed the basis of the analysis provided. The PAC welcomed this approach, and agreed that a similar analysis for the 2009/10 accounts would be useful. This report provides that analysis and is intended to help inform scrutiny of the 2011/12 spending plans and also the 2010/11 autumn and spring budget revisions.

Financial position and use of resources

The final outturn for 2009/10 was £31,877 million against the Scottish Parliament approved budget of £32,130 million, representing an underspend of £253 million or just under 1%. All Portfolios remained within their Budget Act limit. The Scottish Government underspend against the Departmental Expenditure Limit (DEL) of £29 billion, as reported in the Scottish Government's Consolidated Annual Accounts, amounted to £136 million. This represents a significant achievement in aligning expenditure against overall budgets.

Scotland's economy is in recession and the public sector is under the greatest financial pressure since devolution ten years ago. It will be very challenging to maintain current levels of public services and meet new demands when resources are tight. It remains unclear what impact the current recession will have beyond 2010/11. The UK Government's Comprehensive Spending Review was published on 20 October and shows significant reductions in the Scottish Government's budget over the Spending Review horizon. Two per cent efficiency savings will not be sufficient beyond 2011 to bridge the gap between public spending and the budget available. In the current economic climate difficult decisions will have to be made across the public sector about priority spending programmes.

Although the Scottish Government has managed its budget well in recent years, the current financial situation will require new approaches to deal with the unprecedented challenge facing the public sector.

Governance and accountability

Corporate Governance is concerned with the structures and process for decision making, accountability, control and behaviour at the upper levels of an organisation. Overall the corporate governance and control arrangements for the Scottish Government operated satisfactorily during the year.

As part of our audit we reviewed the high level controls in all of the Scottish Government's central systems that impact on the financial statements. Our overall conclusion was that key controls were operating effectively and that the Scottish Government has adequate systems of internal control in place. Some control weaknesses were identified in the payroll and travel and subsistence systems. Travel and subsistence control weaknesses have already been fully addressed and encouraging progress is being made in payroll.

We reviewed the Internal Audit Division and concluded that it continues to comply with Government Internal Audit Standards. We are concerned, however, that resources will be insufficient in the future to meet audit plans and we intend to monitor developments during 2010/11.

Significant progress has been made in addressing previously identified weaknesses in the Scottish Government Rural Payments Inspection Directorate's key controls and preparation of accounts detailing the Scottish element of expenditure funded by the European Agriculture Guarantee Fund and the European Agricultural Fund for Rural Development. However weaknesses in the Agricultural Fund inspection regime have given rise to potential penalties being imposed by the European Union. The consolidated accounts, therefore, include a provision of £52 million in respect of this and other potential EU disallowance.

Performance

The Scottish Government's vision and strategic direction is set out in the National Performance Framework (NPF). As of August 2010, improved performance is being reported in 3 out of 11 purpose targets within the Framework, while performance is being maintained in a further 3. Reported performance is declining for 5 purpose targets and it is likely that the current economic climate is having an adverse impact on 2 of these; GDP growth and labour participation. Of the 40 national indicators where a performance assessment is provided, performance is improving in 21, being maintained in 11 and declining in 8.

Looking forward

The final part of our report notes some key risk areas for the Scottish Government going forward. In particular, the Scottish Government faces significant financial pressure over the next four years (the Comprehensive Spending Review horizon) to achieve financial balance. We will continue to monitor financial planning arrangements and the Scottish Government's financial position.

The assistance and co-operation given to us by officials and non-executives of the Scottish Government during our audit is gratefully acknowledged.

Introduction

1. This report summarises the findings from our 2009/10 audit of the Scottish Government. The scope of the audit was set out in our Audit Plan prepared in accordance with the Code of Audit Practice, and was presented to the Scottish Government Audit Committee (SGAC) on 8 March 2010. This plan set out our analysis of the key business risks facing the organisation and described the work we planned to carry out on financial statements, performance and governance.
2. We have issued a range of reports during the year, and we briefly comment on the key issues raised in these reports. Each report sets out our detailed findings and recommendations and records the agreed response. Appendix A sets out the key recommendations highlighted in this report and the action planned by management to address them.
3. Best value duties apply across the public sector and are a formal duty on all accountable officers. Audit Scotland has adopted a generic framework for the audit of best value across the public sector and this has been further developed during 2009/10. There is now a bank of best value toolkits which, although primarily designed for audit use, are available to all public bodies for reference.

Exhibit 1: Framework for a best value audit of a public body



4. The Scottish Government is currently refreshing its 2006 Best Value Guidance for Public Bodies. This is due for issue later in 2010, and will provide clearer guidance to public bodies on securing continuous improvement in performance, with due regard to the balance between cost and quality.

5. Another building block for our assessment of best value is the national study programme carried out by Audit Scotland on behalf of both the Auditor General for Scotland and the Accounts Commission. Where these have a bearing on the activities, risks or performance of the Scottish Government, we make reference to these reports in this document. Full copies of the study reports can be obtained from Audit Scotland's website, www.audit-scotland.gov.uk.
6. We do not make an overall best value judgement because we do not yet have enough evidence to conclude on all relevant areas. Our intention is to build up the corporate assessment over time.
7. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officials and non-executives of the Scottish Government during the course of our audit. This report will be submitted to the Auditor General for Scotland and will be published on our website.

Financial Statements

8. In this section we summarise key outcomes from our audit of the Scottish Government consolidated financial statements for 2009/10, and the accounting issues arising. The financial statements are an essential means by which the organisation accounts for its stewardship of the resources available to it and its financial performance in the use of those resources.

Our responsibilities

9. 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 Government and its expenditure and income for the period in question
 - whether they were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements
 - the consistency of some of the information published with the financial statements with the financial statements themselves
 - the regularity of expenditure and receipts.
10. We also review the statement on internal control by:
- considering the adequacy of the process put in place by the Permanent Secretary as Principal Accountable Officer to obtain assurances on systems of internal control
 - assessing whether disclosures in the statement are consistent with our knowledge of the Scottish Government.

Overall conclusion

11. The Auditor General for Scotland issued an unqualified auditor's report on 17 September.
12. The unaudited schedules for the core accounts and the consolidated account were submitted in line with agreed plans. The good standard of the supporting papers and the timely responses from Finance staff allowed us to conclude our audit within the agreed timetable and provide our opinion to the Scottish Government Audit Committee (SGAC) on 14 September. The Scottish Government has made significant improvements in both the timing and quality of unaudited accounts. The 2009/10 consolidated accounts were signed-off earlier than in 2008/09 and an unqualified audit certificate has been issued in each of the five years since 2005/06.
13. A small number of adjustments for financial misstatements were made to the unaudited consolidated accounts. The accounts were not adjusted to correct other financial misstatements which, individually and cumulatively, were not sufficiently material to impact on the audit opinion.

International financial reporting standards (IFRS)

14. Government departments and other public sector bodies prepared their accounts in accordance with International Financial Reporting Standards (IFRS) for the first time in financial year 2009/10. The Scottish Government transition arrangements to IFRS required bodies to prepare IFRS shadow accounts for 2008/09, including revised opening balances as at 1 April 2008.
15. Overall, the conversion to IFRS was achieved very successfully across the Scottish Government and other central government bodies and represents a significant achievement. The contribution of Accountancy Services in providing advice and support through this complex exercise was invaluable.

Issues arising from the audit

16. As required by auditing standards, we presented to SGAC and the Principal Accountable Officer our International Standards on Auditing (ISA) 260 report on 14 September. This report identifies areas worthy of note and any material unadjusted errors within the financial statements.
17. The financial statements of the Scottish Government consolidate the accounts of the core Scottish Government, the Crown Office and Procurator Fiscal Service, executive agencies and health boards. A number of issues arose from the audits of agencies and health boards which have been reported to these bodies by their auditors. Those that are considered significant or material to the consolidated accounts are highlighted below, along with issues arising from the audit of the core accounts.
18. **European Agricultural Guarantee Fund and European Agricultural Fund for Rural Development** - The Scottish Government Rural Payments Inspections Directorate, part of the Rural Affairs and Environment Portfolio, is responsible for the preparation of accounts detailing the Scottish element of expenditure funded by the European Agricultural Guarantee Fund and European Agricultural Fund for Rural Development. In previous years we have drawn attention to major weaknesses in the Directorate's key controls and accounts preparation processes.
19. While significant progress has been made in addressing these areas, particularly the accounts preparation process, weaknesses in the European Agricultural Guarantee Fund inspection regime have given rise to potential penalties being imposed by the European Union. The consolidated accounts, therefore, include a provision of £52 million for this and other potential EU disallowance. Provisions by their nature are uncertain and any difference between the value provided for and the future disallowance when it crystallises may have a significant impact on the future financial position. We are satisfied, however, that the provision included within the financial statements is reasonable, based on available information at this time. The EU has yet to inform the Scottish Government of the total disallowances it is seeking to levy.

20. **NHS Equal pay claims** - All territorial health boards and some special health boards have disclosed unquantified contingent liabilities within their accounts for claims made under the Equal Pay Act 1970, under the pay arrangements that preceded Agenda for Change. Developments in case law in England over the past year have slowed the progress of claims and led to a reduction in the number of claims going forward. The NHS Central Legal Office considers that claims still do not provide sufficient detail about the comparator jobs to allow an estimate to be made of the likelihood of the success of the claims or of any financial impact that they may have. Given the developments during the year and the comprehensive disclosure within the financial statements, auditors agreed that the emphasis of matter paragraph included within the 2008/09 audit opinion of many boards was not required for 2009/10.

Regularity

21. 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 were incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers. No significant issues were identified for disclosure.

Whole of Government Accounts

22. The Whole of Government Accounts programme (WGA) led by HM Treasury continues to progress towards production of accounts covering the whole of the UK public sector, consolidating the accounts of about 1,300 bodies from central government, the health service, local government and public corporations. The first year of publication of WGA will be for financial year 2009/10, which HM Treasury will deliver no later than 31 December 2011, although they hope to publish earlier. The Scottish Government is in the process of providing data to HM Treasury relating to the 2009/10 financial statements.

Scottish Consolidated Fund Annual Accounts and Non Domestic Rating White Paper Account

23. We have given unqualified opinions on the 2009/10 financial statements of both the Scottish Consolidated Fund and the Non Domestic Rating financial statements for the year ended 31 March 2010.

Auditor General Report on Accounts

24. The accounts for the year ended 31 March 2010 are not qualified. 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. The Auditor General has prepared a report on the accounts. A copy of that report, and the background to its preparation, is included at Appendix B.

Use of Resources

25. Sound management and use of resources (people, money and assets) to deliver strategic objectives is a key feature of best value. This section sets out our main findings from a review of the Scottish Government's:

- financial position and financial management
- management of people, assets and procurement
- management and use of information and communications technology (ICT).

Financial Position

Outturn 2009/10

26. The Budget (Scotland) Act 2009, as amended by the spring and autumn revisions, prescribes both the financial limits on the use of resources by the Portfolios of the Scottish Government and how these resources can be used. The final approved budget for 2009/10 was £32,130 million. The net outturn for the year was £31,877 million, resulting in an overall underspend of £253 million (2008/09 £254 million). Resource was underspent by £314 million, with an overspend on capital of £61 million against respective budgets. The Scottish Government met all Portfolio expenditure limits prescribed in the Budget (Scotland) Act 2009. This represents a significant achievement, especially given that this was the first year of IFRS. The net outturn by Portfolio is highlighted in Exhibit 2.

Exhibit 2 – Performance against Budget 2009/10

Portfolio	Resource Outturn	Capital Outturn	Total Outturn	Budget	Variance
	£m	£m	£m	£m	£m
Office of the First Minister	254	1	255	263	(8)
Finance and Sustainable Growth	2,764	533	3,297	3,369	(72)
Health and Wellbeing	11,661	795	12,456	12,542	(86)
Local Government	10,378	0	10,378	10,380	(2)
Education and Lifelong Learning	2,759	103	2,862	2,925	(63)
Justice	1,620	134	1,754	1,772	(18)
Rural Affairs and the Environment	479	1	480	482	(2)
Crown Office and Procurator Fiscal Service	113	6	119	120	(1)
Administration	261	15	276	277	(1)
Total	30,289	1,588	31,877	32,130	(253)

Scotland's public finances and financial sustainability

27. The Auditor General's report on *Scotland's public finances*, published in November 2009, contained an overview of the financial environment in Scotland and the pressures and challenges facing the public sector. The aim of this report was to help to inform the debate on the future of public finances in Scotland. The key messages from this report were:

Extract from Auditor General's report *Scotland's public finances*

The public sector is coming under the greatest financial pressure since devolution.

- Scotland's economy is in recession and the public sector is under the greatest financial pressure since devolution ten years ago. It will be very challenging to maintain current levels of public services and meet new demands when resources are tight.
- The Scottish Government and the wider public sector need to work together to develop better activity, cost and performance information. This information is needed to enable informed choices to be made between competing priorities, and to encourage greater efficiency and productivity.

The Scottish Government faces significant challenges in balancing the budget while also delivering on its commitments and meeting increasing demands for public services.

- It remains unclear what impact the current recession will have beyond 2010/11. The Scottish budget is likely to reduce in real terms but the full extent of this is not yet known.
- In many cases, the public sector uses income from various sources to pay for services. Income levels anticipated before the recession are unlikely to be realised, reducing the amount available to spend.
- The Scottish public sector faces significant challenges in balancing its budget while also delivering on its commitments. Changes in Scotland's population and rising unemployment rates will increase demand for public services.
- The Scottish Parliament has an important role in scrutinising the government's spending plans. Better information linking spending to costs, activities and service performance, and a rolling programme of performance reviews, would support the Scottish Parliament in fulfilling this role.

28. The Independent Budget Review was commissioned in February 2010 to conduct a review of public expenditure in Scotland. Its purpose was to inform public and Parliamentary debate in advance of the next UK Comprehensive Spending Review, which will cover the four years 2011/12, 2012/13, 2013/14 and 2014/15. The review was published in July and considered the challenges and choices which exist in a significantly constrained public spending environment.
29. Whilst there are numerous conclusions and recommendations within the report, the panel concluded that the developing response to future challenges needs to be set in a more strategic, longer term framework, and Parliament must provide the essential leadership in shaping the future of public service delivery. The panel also concluded that there is a need to move towards a more outcomes-based approach to public service management and to improve the quality of data and information across the public sector to ensure that resources are applied to full benefit.

30. Within the Scottish Government the Finance Directorate has continued to contribute to a range of activities in response to the macro economic climate.

2010/11 budget and future spending plans

31. The UK Government's Comprehensive Spending Review was published on 20 October. The Scottish Government's Draft Budget for 2011/12, together with the proposed spending plans for the Spending Review period (2012/13 to 2014/15), will be published in mid-November. The UK Government's Comprehensive Spending Review shows significant reductions in the Scottish Government's budget over the coming years with the total DEL budget for 2014/15 recorded as £28.4billion. The settlement overall is extremely challenging with significant reductions in the Capital budget available to the Scottish Government.

Financial management

32. Overall, the Scottish Government managed its budget well in 2009/10, with outturn being very close to budget. *Scotland's public finances* recognised that the current financial situation will require new approaches to deal with the unprecedented challenge facing the public sector:
- the Scottish Government's annual budget is largely developed on an incremental basis, which involves making adjustments at the margin to existing budgets. This approach is not suitable for budgeting in a financial downturn because it does not allow informed choices to be made about priorities
 - the Scottish Government has strengthened its financial management, however more could still be done to evaluate how well money is being spent to deliver outcomes
 - the current practice of over-allocating spending plans to account for slippage has been successful in reducing annual underspends, but will be more difficult to operate when resources are severely constrained, leading to a greater risk of overspending
 - the Scottish Government has fewer professionally qualified finance staff than other comparable UK departments and more needs to be done to build capacity to ensure that the right financial and analytical skills are in place to prepare for the financial challenges that lie ahead.
33. The new Permanent Secretary has created the post of Director General Finance to strengthen the profile of the finance function within the Scottish Government and the post has been filled by the Scottish Government Finance Director. Other action already taken includes creation of a new role of Finance Training Manager to build on progress and extend financial knowledge in the organisation. The Scottish Government should continue to progress the other recommendations contained in *Scotland's public finances*.

Action point 1

Management of people

34. Work is underway within the Scottish Government to ensure that Ministerial priorities can be delivered with less money, and fewer people, in the future. As part of that process, staff were invited to apply for early retirement or early severance in August of this year. We intend to review this process, and the costs, as part of the 2010/11 audit.
35. Good workforce planning will be essential to avoid risks of diminution to service delivery, and staff morale and motivation, when the workforce is shrinking. We intend to audit the Scottish Government's arrangements against best practice as reflected in our best value people management toolkit. We have agreed with HR staff that a phased self assessment of the toolkit will be of most benefit to the organisation going forward. We will liaise closely with officers during 2010/11 and report the results of this work next year.

Management and use of assets

36. The Finance Directorate has created a new Capital and Risk Division with a focus on the financing and delivery of the capital programme, strengthening the management of the Scottish Government's capital budget and sponsorship of the Scottish Futures Trust. The Division became fully staffed in December 2009 and, so far, has:
 - completed testing of a capital projects database which is in the process of being rolled out to users. Monthly financial monitoring of individual capital projects has been undertaken since June of this year
 - agreed measures designed to improve the governance and oversight of major capital investments.
37. Currently there are no formal arrangements to report publicly on progress on major capital projects. Since June 2009, however, the Permanent Secretary has provided six-monthly updates to the Parliament's Public Audit Committee on developments in the Scottish Government in managing capital projects and on major capital projects currently in progress.
38. Audit Scotland intends to carry out a national study in 2010/11 on capital investment, following up some of the messages contained in the report a *Review of major capital projects in Scotland* that was published in June 2008. The main aim of this performance audit is to provide independent assurance about how well the Scottish Government is managing its capital investment programme and associated risks. It will assess and report on:
 - the outlook for public capital investment in Scotland
 - what progress in major capital project management has been made since the 2008 review
 - how well the Scottish Government is managing its capital programme.

Procurement

39. Effective public procurement is more important than ever in the current economic climate. An Audit Scotland report in July 2009 assessed the impact of the Public Procurement Reform Programme aimed at improving purchasing practice and making annual savings of around 3%.
40. Between September and December 2009, the Scottish Government applied procurement capability assessments to around 125 public bodies across the public sector. The aim of the process was to identify best practice and gaps in procurement capability to help plan improvement across the Scottish public sector and by individual public bodies.
41. The key findings were that:
 - public bodies have seen the assessments as positive, if challenging
 - while there are many instances of best practice throughout the Scottish public sector, the results confirm a real need for improvement in many bodies
 - participating bodies are working on high-level improvement plans. The aim is to ensure all bodies can be assessed as at least “conformant” (i.e. operate essential good purchasing practice and control) by the second round of assessments due at the end of 2010.

Management and use of ICT

42. As part of the 2009/10 audit we have reviewed the Scottish Government’s information management and data handling arrangements, and followed up our previous report on e-HR.

Information Management

43. We reviewed the Scottish Government’s arrangements using our best value use of resources toolkit which covers:
 - information governance and leadership
 - information for decision making
 - service delivery
 - compliance and control
 - knowledge management.
44. We concluded that the Scottish Government’s arrangements are generally soundly based, with a number of areas of good practice. For example:
 - a strong information governance structure is in place, led by the Senior Information Risk Owner, who as Director-General for Rural Affairs, Environment and Services is a member of the Strategic Board

- information management principles, which set out staff responsibilities for the acquisition, storage and communication of information, are distributed to all staff during induction
- all staff are expected to complete mandatory information governance training to ensure that they are aware of their responsibilities
- major information system investments must have robust business cases, and are formally prioritised in terms of impact and business requirement by a group of Directors representing all Scottish Government business areas.

45. However, some areas have been identified where arrangements are at the 'basic' level in our categorisation system, and require improvement. An action plan has been agreed with senior managers setting out initial improvements going forward. These recommendations and implementations are incremental and will be phased in over time.

Data Handling

46. We reviewed arrangements for data handling, including the actions taken by the Scottish Government to address the recommendations of the *Data Handling in Government* report (published in June 2008). Key findings from this work will be reported in detail in October 2010. In summary:

- staffing issues within the IT security team mean that some of the technical security infrastructure projects are not fully completed
- delays to the delivery of a consolidated Scottish Government-wide Information Asset Register mean that this will not be in place until end-December 2010.

47. In November 2009 we undertook a survey of Scottish Government staff using the *Your Business @ Risk* audit tool to assess how well information risks are understood across the organisation. The results demonstrated staff had a good level of information security awareness. All staff were required to complete the e-learning security awareness training package 'Protecting Information 1' launched at the end of October 2009. As part of our Best Value review of Information Management during 2010, we were informed that, to date, only 76% of SG staff have completed *Protecting Information Level 1*, leaving 24% of staff who have yet to comply with this mandatory training requirement. Plans are in place to roll out additional training packages (Protecting Information 2 & 3) to appropriate staff later this year.

e-HR follow-up

48. We are pleased to report that all actions agreed as part of our 2007/08 review of the electronic Human Resources system (e-HR) have been fully implemented.

Governance and Accountability

49. High standards of governance and accountability, with effective structures and processes to support decision-making and balanced reporting of performance to the public, are fundamental features of best value. This section sets out our findings arising from a review of the Scottish Government's arrangements.

Overview of arrangements

50. This year we reviewed:
- governance arrangements
 - key systems of internal control
 - internal audit
 - arrangements for the prevention and detection of fraud and irregularity, including standards of conduct.
51. Our overall conclusion is that arrangements within the Scottish Government are sound and have operated throughout 2009/10.

Governance arrangements

52. The Scottish Government commissioned '*Shaping up*' in 2009 to review the shape and working practices of the organisation. The report was published at the end of January 2010 and confirms that the Scottish Government has made significant progress by focussing on a single overarching purpose and National Outcomes, in improving relationships with stakeholders and building effective partnerships with them, and in working better internally in the organisation. However the report also recognised the need to build upon these successes and highlighted a need for an increase in pace and greater consistency in continuous improvement across the organisation.
53. The Director General Education is taking the lead on Shaping Up, as well as wider organisational development to ensure the organisation is fit for purpose. Three key elements have been identified to:
- support restructuring and reduce the costs of the organisation
 - support more flexible resourcing and increase organisational performance and productivity
 - support leadership and expected behaviours and build organisational and individual resilience.
54. We will monitor progress on developments in these areas in 2010/11.

55. In May 2010 Sir Peter Housden was appointed as Permanent Secretary, replacing Sir John Elvidge. The new Permanent Secretary has already made some changes to the Scottish Government's governance arrangements, such as creation of a new Director General Finance post. We will also monitor the impact of these changes this year.

Systems of internal control

56. Key controls within systems should operate effectively and efficiently to accurately record financial transactions and prevent and detect fraud or error. This supports a robust internal control environment and the effective production of financial statements. In their annual report for 2009/10 the Scottish Government internal audit team provided their opinion that based on the internal audit work undertaken during the year. They were able to provide substantial assurance on overall arrangements for risk management, control and governance.
57. As part of our audit we reviewed the high level controls in all of the Scottish Government's central systems that impact on the financial statements. Our overall conclusion was that key controls were operating effectively and that the Scottish Government has adequate systems of internal control in place. Some control weaknesses, however, were identified in the payroll and travel and subsistence systems.
58. We have reported some control weaknesses in the Scottish Government's payroll system for a number of years. While significant improvements have been made, we were still required to increase our transaction testing this year as a result of these control weaknesses. This additional testing confirmed the accuracy of the processes and figures so as to enable us to place reliance on them for the final accounts.
59. Control weaknesses in travel and subsistence procedures were due to staff shortages which impacted on the segregation of duties for authorising and approving claims. These staffing issues have since been resolved.

Statement on Internal Control

60. The Statement on Internal Control is provided by the Principal Accountable Officer and records management's responsibility for maintaining a sound system of internal control. The Statement for 2009/10 reflected the Certificates of Assurance provided by Directors and Directors General, the report from the Head of Internal Audit and the main findings from external audit work. Our review concluded that the statement complies with relevant guidance and is not inconsistent with other information we are aware of from the audit.
61. The Statement on Internal Control refers to control weaknesses in the processing of applications and claims under the European Agricultural Fund for Rural Development, which are currently being addressed.

Internal Audit

62. The establishment and operation of an effective internal audit function forms a key element of effective governance and stewardship. We seek to rely on the work of internal audit wherever possible and as part of our risk assessment and planning process for the 2009/10 audit we assessed whether we could place reliance on the Scottish Government internal audit function. We concluded that the Internal Audit Division (IAD) operates in accordance with the Government Internal Audit Manual and that we could place reliance on their work during 2009/10.
63. In previous years we have reported that the Head of Internal Audit post has been filled on a temporary basis with a risk that the perception of the role and authority of the position is diluted. We are pleased to report that the position has now been filled on a permanent basis. We are concerned, however, that Internal Audit has experienced staff shortages at a time that workload has increased as a result of new EC regulations requiring additional checks on individual projects and beneficiaries of European funds. There is a risk that resources will be insufficient to meet current and future audit plans and we intend to monitor developments during 2010/11.

Action point 2

Prevention and detection of fraud and irregularities

64. The annual report on fraud in the Scottish Government was presented at the June 2010 meeting of the Scottish Government Audit Committee. The report outlined the Scottish Government's arrangements for preventing, reporting and responding to fraud. The main purpose of the report is to address instances of internal fraud arising during 2009/10. The report noted that the Fraud Response Group had not been called on to consider any instances of potential fraud in the year.

National Fraud Initiative in Scotland – extension to central government

65. In conjunction with the Audit Commission, Audit Scotland has conducted data matching exercises (the National Fraud Initiative or 'NFI') since 2000. One of the primary purposes is to help public sector bodies to prevent and detect fraud and error in their financial systems. The last exercise (NFI 2008/09) led to outcomes valued at around £21 million in Scotland. To date, the exercise has been worth £58 million to the public purse and the Parliament's Public Audit Committee has been very supportive of NFI in Scotland. Across the UK, the cumulative outcomes are more than £660 million.
66. The next exercise (NFI 2010/11) will be undertaken in Scotland using new powers for data matching contained in the Criminal Justice and Licensing (Scotland) Act 2010. These new powers are being given to Audit Scotland in order to clarify the legal framework and to allow the scope of data matching to be extended in Scotland. The main data sets that apply to central government bodies are payroll and creditors. In line with the approach in other sectors, it will be mandatory for payroll data to be submitted. Creditors are a risk-based data set which means that the body and the external auditor should discuss whether there would be merit in including the data.

67. It would not be practicable or cost effective to extend NFI to all public sector bodies for the 2010/11 exercise but we are pleased to report that the Scottish Government has agreed to include the core Scottish Government payroll and that of larger agencies and NDPBs.

68. Further information on NFI in Scotland can be found at <http://www.audit-scotland.gov.uk/work/nfi.php>. The Audit Commission's web page is at <http://www.audit-commission.gov.uk/nfi/Pages/default.aspx>. We will report the results of data matching in the Scottish Government in future reports.

Performance

69. 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. Key features of best value include:
- setting a clear vision of what the organisation wants to achieve, backed up by plans and strategies to secure improvement, with resources aligned to support their delivery
 - a performance management culture which is embedded throughout the organisation and a performance management framework which is comprehensive and supports the delivery of improved outcomes.
70. In this section we comment on:
- vision and strategic direction
 - performance and performance management
 - risk management
 - the Scottish Government's efficiency programme.

Vision and strategic direction

71. The Scottish Government's single overarching Purpose is *To focus government and public services on creating a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth*. This is supported by five strategic objectives: wealthier and fairer, smarter, healthier, safer and stronger, and greener. In turn, these are supported by 15 national outcomes which outline in more detail what the Scottish Government wants to achieve over a 10 year period. The Government Economic Strategy sets out the approach to delivering the Purpose to ensure all of the Government's resources and policies are focused on its achievement. 11 purpose targets and 45 national indicators have also been designed to track progress.

Performance overview

72. As at August 2010, the Scottish Government is reporting improved performance in three out of 11 purpose targets, while performance is being maintained in a further three. In particular, the Scottish Government is reporting improved performance in respect of reducing emissions. Reported performance is declining for five purpose targets and it is likely that the current economic climate is having an adverse impact on two of these, concerning GDP growth and labour participation.
73. As at August 2010, of the 40 national indicators (out of 45) where a performance assessment is provided, performance is improving in 21, being maintained in 11, and declining in eight. This is a similar position on this time last year (the corresponding figures were 20, seven and eight) although the availability of additional information now allows progress to be reported on five more indicators.

Performance management

74. Last year we reported our findings from an initial review of the development and operation of the Scottish Government's business planning tool (BPT). We concluded that the BPT offered significant potential to link planned activity to the achievement of national outcomes, but that it was too early to judge how well the system was being used in practice. Although the BPT has continued to be developed, it is still not applied consistently across the organisation. This is an area we intend to review again in 2010/11.
75. The BPT, however, is only one of the mechanisms by which business is managed in the Scottish Government. The Scottish Government's Performance Division has conducted an initial review of business management practices across the organisation and the public and private sectors. The findings of that review will help shape future guidance on business management.

Risk management

76. The lines of risk management and accountability that operate within the Scottish Government are currently being reviewed to ensure proper alignment with the changing shape of the organisation.
77. A professional "centre of expertise" on risk management is proposed to give the subject greater prominence and to develop an overarching risk management strategy. The Scottish Government acknowledges the need to enhance the quality of contingency planning for risks where there is a high likelihood of the risk occurring.
78. These risk areas are complex and comprise multiple issues which will require careful management to resolve. Risks are also likely to change and sharpen in the current economic climate. We will continue to monitor progress over the course of the year.

Efficiency

79. The Audit Scotland report *Improving public sector efficiency* was published in February 2010 and provided a position statement on the first year (2008/09) of the Efficient Government Programme (the Programme), which aims to deliver £1.6 billion efficiency savings over the three years to 2010/11. It also gave an update on how the Scottish Government and public bodies have addressed the recommendations made in the 2006 report about the previous efficiency programme.
80. The report found that Scottish public bodies reported more efficiency savings than the 2% target, but highlighted that the scale of the financial challenges ahead would make achieving the required savings through efficiency alone increasingly difficult.
81. The report recommended that public bodies needed to consider fresh approaches to improving efficiency and productivity. They must take a more fundamental approach to identifying priorities, improving the productivity of public services, and improving collaboration and joint working.

82. The drive to improve efficiency and productivity is not just an exercise for managers and service providers. It requires strong leadership and engagement from the very top of public bodies. Leaders and senior decision-makers within an organisation have a responsibility to check, challenge, monitor and support their organisations in delivering efficiency and productivity improvements. The report's recommendations highlighted areas that public bodies' key decision makers should look at to assess their organisation's development and to challenge existing arrangements.
83. To support these high-level recommendations, Audit Scotland, the Northern Ireland Audit Office and the Wales Audit Office have drawn on their combined experience to develop a detailed good practice checklist. The checklist is intended to promote detailed review and reflection and, if necessary, a basis for improvement. We recommend that those responsible for leading efficiency and improvement work in the Scottish Government should consider assessing themselves against each question, and recording the results.

Action point 3

Looking Forward

84. The Scottish Government faces a number of challenges in 2010/11, which include:

- **Financial management**– The UK Spending Review shows significant reductions in the Scottish Government’s budget over the coming years. Although the Scottish Government has managed its budget well in recent years, the current financial situation will require new approaches to deal with the unprecedented challenge facing the public sector. The challenge will be to prioritise spending, identify efficiencies and review future commitments to ensure delivery of key targets and objectives.
- **2010/11 Budget** - In 2010/11 the Budget Act has been amended so that all entities within the consolidated accounts boundary have a single Budget Act limit which must not be exceeded. In effect, there will no longer be Departmental/Portfolio Outturn budget limits but one overarching budget figure for the entire Scottish Government. This change will provide additional flexibility in managing the budget and it is important that it does not result in less detailed information to support the Parliamentary scrutiny process.
- **Management and use of assets** - With reduced budgets, the Scottish Government will need to reappraise capital plans in terms of their affordability. Politicians and key decision-makers will have to make tough choices about what level of investment is required, how projects can be financed and where best to spend the limited resources available.
- **Succession Planning for Non-Executive Directors** – The agreed maximum term of appointment for a Scottish Government non-executive is six years. A paper presented to the Scottish Government Audit Committee earlier in the year identified that 11 of the 17 non-executive director appointments expire during the course of 2010. Since then interviews have been held with prospective candidates and successful applicants have now been appointed. There will be a need to ensure adequate induction training and the intention is that committee meetings will be scheduled to allow the new non-executives to shadow their outgoing colleagues.
- **European Agricultural Guarantee Fund (EAGF)** – Previous weaknesses in the EAGF inspection regime have given rise to potential penalties being imposed by the European Union. The consolidated accounts, therefore, include a provision of £52 million for this and other potential EU disallowance. Provisions by their nature are uncertain and any difference between the value provided for and the future disallowance when it crystallises may have a significant impact on the future financial position. The EU has yet to inform the Scottish Government of the total disallowance it is seeking to levy.
- **Commonwealth Games** – The Scottish Government is the principal funder of the 2014 Glasgow Commonwealth Games. In addition, it has agreed to help meet any potential economic shortfall of the Organising Committee arising from the preparations for and hosting of the games. There are obvious financial risks which the Scottish Government and its partners will need to manage in the run up to 2014.

Appendix A: Forward Action Plan

Key Risk Areas and Planned Management Action

Action Point	Recommendations	Planned Action	Responsible Officer	Target Date
1	<p>The Scottish Government has managed its budget well in recent years. The current financial situation will require new approaches to deal with the unprecedented challenge facing the public sector.</p> <p>The Scottish Government should continue to progress the recommendations contained in <i>Scotland's public finances</i>.</p>	<p>The Scottish Government is alive to the financial landscape and challenges facing the public sector in Scotland. Following from CSR announcement by the UK Government on Wednesday 20th October the Scottish Government will publish a Draft Budget for 2011-12 together with Spending Plans for the period 2012-13 to 2014-15 in mid-November.</p> <p>The recommendations from the AGS report <i>Scotland's public finances</i> have been noted and the Scottish Government has been proactive in progressing these over the past year.</p>	<p>Alyson Stafford SG Director General Finance</p>	<p>November 2010</p>
2	<p>Internal Audit has experienced staff shortages at a time when workload has increased as a result of new EU regulations on European funds. There is a risk that resources will be insufficient to meet current and future audit plans.</p> <p>The Scottish Government should review the staffing levels in Internal Audit to ensure they are sufficient to provide adequate assurance on internal control and risk management.</p>	<p>Internal Audit plays a key role in the Scottish Government's assurance and governance arrangements. The structure, resources and forward planning priorities of Internal Audit are currently being considered as part of the Scottish Government's Shaping Up project. The risks are recognised as is the need to ensure the resourcing is adequate to deliver sufficient assurance to the SG on risk, governance and internal control and to meet with EC requirements.</p>	<p>Ally May Head of Internal Audit</p>	<p>March 2011</p>
3	<p>Fresh approaches to improving efficiency and productivity will be required to generate the level of savings needed in the future.</p> <p>The Scottish Government should assess itself against the good practice checklist contained in Improving public sector efficiency to ensure it is well placed to deliver savings.</p>	<p>The Scottish Government is currently undertaking work on the structure of the next efficiency programme and will consider using the good practice checklist as a self-assessment tool.</p>	<p>Gerry Hendricks Improving Public Services Directorate</p>	<p>April 2011</p>

Appendix B: Section 22(3) Report

A REPORT BY THE AUDITOR GENERAL FOR SCOTLAND UNDER SECTION 22(3) OF THE PUBLIC FINANCE AND ACCOUNTABILITY (SCOTLAND) ACT 2000

THE 2009/2010 AUDIT OF THE SCOTTISH GOVERNMENT CONSOLIDATED ACCOUNTS

1. The Scottish Government Consolidated Accounts incorporate the activities of the seven core portfolios supported by Administration, the Crown Office and Procurator Fiscal Service, all 11 executive agencies, and the NHS bodies in Scotland responsible for the planning, promotion and commissioning of health care. I submit these accounts and my report in terms of sub-section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report which I have prepared under sub-section 22(3) of the Act.
2. The accounts for the year ended 31 March 2010 are not qualified. My audit report includes my opinion that 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. It also includes my opinion that the expenditure and receipts shown in the financial statements were incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers.
3. The audit of the accounts was completed to allow them to be signed on 17 September, earlier than in previous years. This was a significant achievement, particularly in the first full year of application of the International Financial Reporting Standards (IFRS).
4. The Budget Bill for 2009/10 was approved by Parliament in February 2009. The budget was subsequently revised following due Parliamentary process in an Autumn Budget Revision (ABR) in December 2009 and a Spring Budget Revision (SBR) in March 2010. Overall, the Scottish Government and associated bodies managed their budgets well with outturn being within one per cent of budget as a whole.

Background to the report

5. In my report '*Scotland's public finances: Preparing for the future*' published in November 2009, I suggested that the Parliament should consider whether the Public Audit Committee (PAC) should be asked to scrutinise the audited accounts of the Scottish Government and make a report on any matters arising. In March 2010, I briefed the PAC on how the accounts could be used to inform Parliament's budget scrutiny and how Audit Scotland could assist this process by providing analysis of variation between outturn and budget. The PAC welcomed this proposed approach.
6. The Scottish Parliament has an important role in scrutinising Scottish Government spending plans and approving its budget. The Scottish Government's spending plans are usually published in the September preceding the financial year in question followed by a Budget Bill and supporting document which is usually presented to the Scottish Parliament in the following January. Supporting documents provide additional detail of proposed spend at what is known as Level 2 and Level 3 although there is no statutory requirement for the Scottish Government to stay within these lower level budgets¹. There is no formal requirement for the Scottish Government's consolidated accounts or any other document to report the outturn at the end of the financial year compared with budget at Level 3. However, subject committees might find it useful to have information at this level to inform their consideration of the budgets for future years. One purpose of this report is to provide some more detail on variations between outturn and budget than is contained in the accounts.
7. The UK Government's ongoing Spending Review means that the Scottish Government's proposed spending plans for the four years commencing 2011/12 are likely to be published in mid-November 2010. It is anticipated that the UK Spending Review will lead to significant reductions in the Scottish

¹ Levels 2, and 3 relate to the cascading of budgets across the Scottish Government. The lowest budgetary level which is published is Level 3 which typically reflects individual activities that contribute to the spending programmes reported at Level 2.

Government's budget over the coming years. This report is partly intended to help inform scrutiny of the 2011/12 spending plans and also the 2010/11 ABR and SBR².

The Scottish Government's budget

- 8 The Budget (Scotland) Act is an annual Act passed by the Scottish Parliament which sets a statutory budget limit for each portfolio of the Scottish Government. It also sets statutory budget limits for other bodies included within the Scottish Administration, such as the Crown Office and Procurator Fiscal Service, and four directly funded bodies³. The Act also sets overall limits on the amount of cash which the Scottish Administration and directly funded bodies can draw-down from the Scottish Consolidated Fund.

Developments in reporting on the Scottish budget

9. It is important that that the financial information provided to Parliament is timely, relevant and understandable. HM Treasury has a current project called 'Clear line of Sight' which aims to simplify the presentation of budgetary information to Westminster⁴. This is expected to contribute to better government through improved democratic involvement for, and accountability to, Parliament and the public. It is also expected to help to develop more coherent presentation of financial reporting documents that meets the needs of government and Parliament, and is consistent with best practice in the private sector.
10. In recent years the Scottish Government has made a number of improvements to the way in which financial information is presented to the Scottish Parliament:
- More detailed tables in the supporting documents to the Budget Bill and to the ABR and SBR which reconcile cash and resource budget figures and provide a reconciliation from the draft Budget to the Budget Bill and to the consolidated accounts
 - Preparation of explanatory guides to the ABR and SBR to assist parliamentary interpretation
 - Provision of more detailed financial information, for example provision of some Level 3 budgetary information as a matter of routine

Changes made to the 2009/10 budget

11. There was a technical change during the year in accounting for National Insurance contributions. The Scottish Government has no control over the level of National Insurance contributions it receives from HM Revenue and Customs. This sum had been treated as a source of income in the original approved budget but in the ABR it was accounted for as a separate source of funding⁵ from HMRC. This had the effect of increasing the overall Scottish Government budget for 2009/10 approved by Parliament by £1,724 million but had no overall effect on the amount of funding available to the Scottish Government.
12. Excluding this £1,724 million, the Scottish Government's net budget increased by £440 million (1.4 per cent) from £31,689.6 million to £32,129.4 million between the original Budget Act and the SBR. All portfolios saw some change in their overall budgets with the largest increases in budget being in the Health and Wellbeing, Education and Lifelong Learning and the Local Government Portfolios. The Finance and Sustainable Growth, Justice and the Rural Affairs and the Environment Portfolios experienced the largest reductions in budget (Exhibit 1).

² The Scottish Government can amend its budget as required during the financial year. Generally, the Autumn and Spring Budget Revisions are presented to Parliament in October and January respectively. Supporting documents detailing proposed changes from the previous figures approved by Parliament are provided for all revisions.

³ The four directly funded bodies are the Forestry Commission, the Food Standards Agency, the Scottish Parliamentary Corporate Body and Audit Scotland.

⁴ HM Treasury Clear Line of Sight – The Alignment Project http://www.hm-treasury.gov.uk/psr_clear_line_of_sight_intro.htm

⁵ The key difference between a source of funding and a source of income is that the former is not subject to Parliamentary authority and is therefore not capped.

Exhibit 1: Changes to the 2009/10 Level 1 budget

Portfolios	Original Budget	ABR	SBR	Changes between SBR and Original Budget	
	£m	£m	£m	£m	%
Office of the First Minister	265	264	263	-2	-0.7
Finance & Sustainable Growth	3,394	3,429	3,368	-26	-0.8
Health & Wellbeing	12,160	12,415	12,542	382	3.1
Education & Lifelong Learning	2,787	2,908	2,925	138	5.0
Justice	1,845	1,807	1,772	-73	-3.9
Rural Affairs & the Environment	546	517	482	-64	-11.7
Local Government	10,301	10,368	10,380	79	0.8
Crown Office & Procurator Fiscal	119	119	120	1	0.7
Total Programme	31,417	31,827	30,102	436	1.4
Administration	273	274	277	4	1.4
Total Scottish Government	31,690	32,100	32,129	440	1.2
Health and Wellbeing – NI Contributions	-1,724	0	0	1,724	
Total Published Budget	29,966	31,100	32,129	2,164	7.2

Source: Scottish Government 2009/10 budget documents

13. At the next level down – Level 2 – changes between the SBR and original budgets were relatively common. Of the 65 Level 2 budget lines, 21 show significant changes between the SBR budget and the original budget⁶.
14. In most cases, the changes to the original budget were made at the ABR although further changes at the SBR also occurred. While the supporting documents provide some explanation as to why budget changes are proposed at Level 2, it is not always clear as to which Level 3 budget line they refer. For example, the ABR and SBR supporting documents refer to technical adjustments of £292 million resulting from the implementation of IFRS but they do not stipulate which Level 3 budget lines are affected.
15. In other cases, changes to Level 2 budget lines are explained in the supporting documents as being the result of Ministerial funding announcements. For example, in January 2009 the Minister for Finance and Sustainable Growth announced additional funding for the Town Centre Regeneration Fund (£60 million), Home Insulation (£15 million) and Modern Apprenticeships (£16 million). In respect of the Town Centre Regeneration Fund and Home Insulation, this resulted in new Level 3 budget lines within the Housing and Regeneration budget of the Health and Wellbeing Portfolio in the ABR. But it is not immediately clear that the additional Modern Apprenticeships funding resulted in an increase in the budget of Skills Development Scotland Ltd within the Education and Lifelong Learning Portfolio.
16. In most cases however, budget changes are the result of the transfer of resources within and between portfolios with limited explanation as to why they were necessary. The provision of more detailed information could allow Parliament to exercise more effective scrutiny by allowing MSPs to understand better the reasons for proposed budget changes.

⁶ A significant variation is defined here as being when the SBR is greater than or less than £10 million and 5% of the original budget, or greater than or less than £20 million of the original budget.

The Scottish Government Consolidated Accounts

17. Details of the Scottish Government's expenditure during the year are contained in the Summary of Total Outturn which provides analysis of total (operating and capital) outturn against each portfolio's statutory budget limit and Level 2 budget lines (page 30 of the 2009/10 accounts). The accounts also contain individual portfolio outturn statements which provide analysis of resource outturn against budget (pages 32-40 of the 2009/10 accounts) and a single outturn statement detailing each portfolio's capital spend against budget (page 31 of the 2009/10 accounts).
18. The consolidated accounts also provide analysis of the reasons for major variances between portfolio outturn and budget (pages 41-42 of the 2009/10 accounts for resource outturn and page 68 for capital outturn). The explanations concentrate on reasons for variances at Level 2 although it can be difficult to reconcile the quoted variances back to the resource and capital outturn statements.

Variations between 2009/10 outturn and budget

19. The Scottish Government's overall net outturn for 2009/10 was within one per cent of budget. Net outturn amounted to £31,877 million against the Spring Budget Revision approved budget of £32,130 million, resulting in an underspend of £253 million. Resource underspends amounted to £314 million while there was a capital overspend of £61 million.
20. All portfolios were within their statutory budget limits. In two cases (Finance and Sustainable Growth and Health and Wellbeing) capital overspends were offset by resource underspends (Exhibit 2).

Exhibit 2: Outturn against budget 2009/10

Portfolio	Resource				Capital			
	Budget £m	Outturn £m	Variance £m	%	Budget £m	Outturn £m	Variance £m	%
Office of the First Minister	259	254	(5)	-1.9	4	1	(3)	-75.0
Finance & Sustainable Growth	2,858	2,764	(94)	-3.3	511	533	22	4.3
Health and Wellbeing	11,807	11,661	(146)	-1.2	735	795	60	8.2
Education & Lifelong Learning	2,805	2,759	(46)	-1.6	120	103	(17)	-14.2
Justice	1,634	1,620	(14)	-0.9	138	134	(4)	-2.9
Rural Affairs & the Environment	478	479	1	0.2	4	1	(3)	-75.0
Local Government	10,380	10,378	(2)	0	0	0	0	0
Crown Office and Procurator Fiscal	113	113	0	0	7	6	(1)	-14.3
Total Programme	30,334	30,028	(306)	-1.0	1,519	1,573	54	3.6
Administration	269	261	(8)	-3.0	8	15	7	87.5
Total Scottish Government	30,603	30,289	(314)	-1.0	1,527	1,588	61	4.0

Source: Scottish Government Consolidated Accounts 2009/10

21. There are many reasons why outturn will not exactly match budget. For example, some budget lines are demand-led and hence the level of demand will affect outturn. In other cases, the development and implementation of policies and projects may be faster or slower than anticipated with the result that expenditure is greater or less than estimated. Furthermore an approved level of overallocation is built into the total budget in order to help minimise the level of underspending. It is neither possible in a report of this size nor is it appropriate, to provide analysis of every variation between outturn and budget. I have, therefore, decided to report only significant variances at the Level 2 budget line, where 'significant' is defined as a variance between outturn and budget of at least £10 million and 5 per cent of budget.
22. There were 11 instances in 2009/10 where net resource outturn varied from budget by more than £10 million and five per cent of budget at Level 2. Capital outturn also varied from budget by more than £10 million in three portfolios. Analysis of these variances indicates they can be grouped into four main categories:
- Variances as a result of technical accounting adjustments
 - Variances as a result of budget classifications
 - Variances as a result of amendments to provisions
 - Other differences reflecting real variances in spend or activity against budget.

The following paragraphs look at these variances in more detail.

Variances as a result of technical accounting adjustments

23. Variances between outturn and budget can sometimes arise as a result of the difficulty in estimating the value of expenditure lines which are dependent on a number of assumptions. This tends to affect non-cash items such as depreciation and capital charges which are dependent on the value of fixed assets on which they are calculated. This resulted in two instances of significant variances between outturn and budget at Level 2 in the Finance and Sustainable Growth Portfolio:
- Motorways and Trunk Roads - resource outturn of £302 million exceeded the resource budget of £279 million largely as a result of increased roads depreciation. The charge is affected by a model used by Transport Scotland to value the trunk road network. The model relies on the collection of data on technical measurements taken during the year on, for example, road condition and is also subject to a considerable number of assumptions.
 - Motorways and Trunk Roads (capital charges) - resource outturn of £538 million against budget of £589 million. The cost of capital charge is dependent on Transport Scotland's roads asset valuation model together with forecast depreciation, revaluations and net additions to the trunk road network. The budget is estimated as a 3.5 per cent charge based on projected valuation. Outturn is difficult to predict and is treated as Annually Managed Expenditure to recognise the difficulties in budgeting.
24. Variances can also result from the introduction of revised accounting standards. The introduction of IAS 32 Financial Instruments during 2009/10 contributed to an underspend of resource outturn of £251 million against a budget of £266 million within the Other Lifelong Learning Level 2 budget line of the Education and Lifelong Learning Portfolio. This was largely due to negative capital charges associated with the impairment adjustment on student loans. At the time the budget was set, it was not clear whether this capital charge would need to be made.

Variances as a result of budget classifications

25. In two cases variances at Level 2 were, at least in part, due to expenditure being recorded as capital when the budget had been established as a operating budget:
- The Health and Wellbeing Portfolio Housing and Regeneration Level 2 budget line reported a resource outturn of £629 million against a budget of £725 million, while a

capital overspend was reported with outturn of £795 million against a budget of £735 million. This was due to the shared housing equity scheme within the Affordable Housing Investment Programme which provides loans for those on low income who cannot raise enough funds to purchase a house even on their maximum mortgage. A review of accounting for this scheme in 2009/10 concluded it should be capitalised as a financial instrument.

- The Education and Lifelong Learning Portfolio Children, Young People and Social Care Level 2 budget line reported a resource outturn of £93 million against budget of £118 million, partly due to £13 million recorded as capital expenditure although it was budgeted for as resource expenditure. This relates to Disclosure Scotland's establishment of a new IT system to support its responsibilities under the Protection of Vulnerable Groups (Scotland) Act 2007.

Variations as a result of amendments to provisions

26. Provisions are created in the accounts of a body in recognition that it has a liability which it is likely to have to meet at some point in the future. They are essentially best estimates and are regularly revised as more information becomes available at the year end. A provision increases outturn for the year but it does not involve a cash outflow. Instead, it assumes that the cash required to meet the liability has been put to one side until such a time it is required. Failure to provide adequately for future liabilities could result in the body having insufficient funds when they are required.
27. There were two instances in the Scottish Government's 2009/10 accounts of provisions being revised which resulted in significant variations between outturn and budget:
- The Finance and Sustainable Growth Portfolio reported capital outturn of £533 million against a budget of £511 million. The overspend was largely the result of an increased provision in respect of land acquisition to allow completion of the M74 and the M80 Stepps to Haggs project and increased associated capital expenditure on the M74 completion project which was ahead of schedule.
 - The Rural Affairs and Environment Portfolio EU Support and Related Services Level 2 budget line reported resource outturn of £172 million against a budget of £136 million. This was largely as a result of the creation of a £39 million provision for potential EU disallowance of expenditure relating to the European Agricultural Guarantee Fund and European Agricultural Fund for Rural Development.

Other general underspends against budget

28. There were also a number of other variances across portfolios:

Finance and Sustainable Growth Portfolio

- Rail Services in Scotland – resource outturn of £639 million against a budget of £661 million. This was due to reduced payments by Transport Scotland to ScotRail Ltd as a result of a recent rail industry wide recalculation of track access charges and reduced performance payments of £1.8 million as a result of the bad winter of 2009/10 which affected punctuality performance.
- Other Transport Directorate Programmes – resource outturn of £14 million against a budget of £46 million as a result of the release of a provision which was no longer required (£20 million) and lower than expected take-up of Freight Facilities Grant (£12 million).

Education and Lifelong Learning Portfolio

- Children, Young People and Social Care - resource outturn of £93 million against a budget of £118 million. In addition to a change in the budget classification highlighted in paragraph 24, the two other factors that contributed most to the underspend were:

- i. The High Risks and Transition programme which compensates local authorities for unused capacity within secure accommodation had an underspend of £1.5 million because more children were placed in secure accommodation than expected.
- ii. The Scottish Social Services Council generated extra income from registration fees due to more registrants than anticipated and less expenditure from reduced numbers of social work students and associated bursary costs. The effect was an underspend against budget of £1.1 million.

Rural Affairs and the Environment Portfolio

- Research Analysis and Other Services - resource outturn of £72 million against a budget of £84 million as a result of the non-cash budgets for research institutes not being required and lower than expected transition costs for a new institute which will take over the functions of other bodies and which carry out programmes of research into crops and land use. It will be established in April 2011. There was also a £1.4 million underspend on the Contract Research Fund due to fewer projects than expected coming to fruition.
- Marine and Fisheries - resource outturn of £52 million against a budget of £62 million was largely the result of higher income levels and lower than expected spend by Marine Scotland across a number of budget lines.

Administration Portfolio

- Directly Employed Staff costs – resource outturn of £164 million against a budget of £179 million as a result of vacancies not being filled in anticipation of future budget reductions. This was offset by an overspend of £9 million on other staff costs, which included the cost of early severance agreements, and £7 million capital on other spend to save measures, such as new lighting for Scottish Government buildings designed to lead to cost savings in the medium/long term.

Conclusions

29. Overall, the Scottish Government and associated bodies managed their budgets well in 2009/10 with outturn being within one per cent of the budget as a whole. Below this level i.e. at individual Level 2 and 3 budget lines, some variance between budget and outturn is always likely to occur.
30. In 2010/11 the Budget Act has been amended to maintain budgetary limits for all portfolios but to recognise that the Act will only be breached if the total for all portfolios is breached. It is important that this change does not result in less detailed information to support the Parliamentary scrutiny process.
31. Given the likely financial constraints that the Scottish Government will face in the coming years, it is more important than ever that high-quality and detailed financial information is made available so that Parliament can exercise adequate scrutiny of the proposed budget. With this in mind, there is scope for:
 - Improved clarity of reporting to Parliament of the reasons for proposed budget changes at the ABR and SBR
 - Provision of more detailed financial information to Parliament on outturn against budget. Subject committees in particular may find it useful to receive more detailed reports on portfolio outturn, and results achieved from spend, as part of their scrutiny of subsequent years' budgets.



ROBERT W BLACK
Auditor General for Scotland
28 September 2010

Scottish Government

Report on the 2009/10 audit

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