

# Scottish Government

## Annual report on the 2012/13 audit



Prepared for the Auditor General for Scotland and the Scottish Government  
December 2013

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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.

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# Contents

<b>Key messages</b> .....	<b>3</b>
<b>Introduction</b> .....	<b>5</b>
<b>Financial statements</b> .....	<b>6</b>
Audit opinions .....	6
Accounting issues .....	6
Scottish Consolidated Fund and Non Domestic Rating Account .....	8
Whole of Government Accounts .....	9
<b>Financial position</b> .....	<b>10</b>
Financial results .....	10
<b>Governance and Accountability</b> .....	<b>16</b>
Corporate governance .....	16
Prevention and detection of fraud and irregularities .....	22
Standards of conduct and arrangements for the prevention/ detection of bribery and corruption .....	23
<b>Best Value, use of resources and performance</b> .....	<b>24</b>
Management arrangements .....	24
Performance audit .....	27
<b>Outlook</b> .....	<b>31</b>
<b>Appendix A: action plan</b> .....	<b>34</b>
<b>Appendix B: audit reports</b> .....	<b>38</b>

# Key messages

2012/13

The Scottish public sector is experiencing significant financial challenges in providing expected levels of service within available resources. In 2012/13 we assessed 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

Unqualified audit opinions were provided on the Scottish Government Consolidated Accounts and the Non Domestic Rating accounts. We have, however, issued a qualified auditors report on the 2012/13 Scottish Consolidated Fund accounts, highlighting that one transaction failed to comply with the required approval process.

The signed consolidated accounts were published on 26 September 2013. Unaudited accounts were submitted in line with agreed timetables and working papers and responses provided by officials were of a good standard, allowing us to conclude our audit on time.

## Financial position

Budget rules require spending to be controlled to a single budget total for the Scottish Administration. Notwithstanding the flexibility this allows, spending in all portfolios included in the consolidated accounts was within the budget set for each. Overall outturn for the Scottish Administration was within the limit set.

The reported underspend of £179 million in fiscal DEL for the aggregate Scottish budget is all available to be carried forward to 2013/14. Budget management during the year was effective. The Scottish Government directs significant effort toward managing its financial position to minimise the risk of underspends that are not able to be carried forward. Further developments are being implemented to help ensure resources are best targeted to priorities.

A significant amount of work is required to ensure that arrangements are in place to support new tax and borrowing powers. Some key arrangements are now either in place or are close to conclusion. However, there remains much to do if all the necessary arrangements are to be in place on time. The Scottish Government needs to ensure that Register of Scotland implements required improvements to its IT arrangements to support new tax systems.

## Governance and accountability

Overall, governance arrangements operated effectively during 2012/13. There were adequate systems of internal control in place and key financial controls operated effectively.

The Head of Internal Audit provided reasonable assurance on risk management control and governance. This was a reduction from the substantial assurance provided in previous years

due to specific control issues and actions are being taken forward to address these. Given the ongoing pressures being experienced by the organisation as costs and staffing numbers are reduced, internal control standards will require to be closely monitored.

Improvements continue to be made in control over European funding, although this remains a high risk area, with any deficiencies having a direct financial impact as a result of the European Commission's approach to compliance. The introduction of new programmes will present significant challenges for the Scottish Government. Programme management arrangements are in place, but some delays have been experienced in early work to implement required IT systems for agricultural programmes. More generally, it is important that changes to IT systems are managed effectively.

The Scottish Government has been working to bring greater consistency in the approaches of its audit and risk committees, and is making some encouraging progress. Efforts continue to ensure an appropriate balance between the support and challenge offered to senior officials.

### **Best Value, use of resources and performance**

As the Scottish Government develops its approach to performance management, a key challenge will be aligning financial and performance information in a meaningful way, so that the impact of spending decisions on performance and outcomes can be better understood.

The Scottish Government has made good progress in establishing more effective risk management throughout the organisation over the last few years, and continues to enhance its approach. Workforce management and procurement arrangements are generally well developed with plans for further improvement. As costs and staff numbers continue to reduce, the Scottish Government will need to maintain a strong focus on ensuring it has sufficient capacity, skills and experience.

Our recent performance audit reports have highlighted the continuing pressures on public sector budgets, and the importance of effective change management, partnership working, long-term financial planning and transparency in financial reporting.

### **Outlook**

The financial outlook remains very challenging, with continuing reductions in real terms funding through the block grant anticipated. The draft 2014/15 budget sets out the Government's current spending priorities. As it progresses its priorities in areas such as the economy or welfare, and as new tax and borrowing powers come in, the Scottish Government will need to manage the risks to its overall financial position.

The Scottish Governments financial reporting framework has evolved through time to reflect developments in recognised good practice. Further review of current approaches is needed leading up to the introduction of new tax raising and borrowing powers. Key issues will include considering how existing accounts and budget materials should be developed, and whether consolidated public accounts covering the wider public sector are needed.

# Introduction

1. This report is the summary of our findings arising from the 2012/13 audit of the Scottish Government. The purpose of the annual audit report is to set out concisely the scope, nature and extent of the audit, and to summarise the auditor's opinions (i.e. on the financial statements) and conclusions and any significant issues arising. The report is divided into sections which reflect the extent of our public sector audit model.
2. A number of reports have been issued in the course of the year in which we make recommendations for improvements (Appendix B). We do not repeat all of the findings in this report, but instead we focus on the financial statements and any significant findings from our wider review of the Scottish Government.
3. Appendix A is an action plan setting out the high level risks we have identified from the audit. Officials have considered the issues and agreed to take the specific steps in the column headed "planned management action". We do not expect all risks to be eliminated or even minimised. What we expect is that the Scottish Government understands its risks and has arrangements in place to manage these risks. In some cases management had already identified the issues highlighted and action is underway. The Strategic Board and Accountable Officer should ensure that they are satisfied with the proposed management action and have a mechanism in place to assess progress.
4. This report is addressed to Scottish Government and the Auditor General and should form a key part of discussions with audit and risk committees, as soon as possible after the formal completion of the audit of the financial statements. Reports should be made available to stakeholders and the public, where appropriate. Audit is an essential element of accountability and the process of public reporting.
5. This report will be published on our website after consideration by the Scottish Government Audit and Risk Committee.
6. The management of the audited body is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems. Weaknesses or risks identified by auditors are only those which have come to our attention during their normal audit work, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

# Financial statements

7. Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources.
8. We are required to audit financial statements in accordance with the timescales set by Audit Scotland, which may be shorter than statutory requirements, and give an opinion on:
  - whether they give a true and fair view of the financial position of audited bodies and their expenditure and income
  - whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements
  - the regularity of the expenditure and income (except for local government bodies).
9. We review and report on, as appropriate, other information published with the financial statements, including the management commentary, governance statement and the remuneration report. Where required, auditors also review and report on the Whole of Government Accounts return. This section summarises the results of our audit of the financial statements.

## Audit opinions

10. The Auditor General for Scotland provided her unqualified opinions on the Scottish Government Consolidated Accounts on 25 September.
11. The Scottish Government is required by Ministerial Direction to follow the 2012/13 Government Financial Reporting Manual (the FReM). We confirmed that financial statements have been properly prepared in accordance with the FReM.
12. We also reviewed the Governance Statement and concluded that it complied with Scottish Government guidance.

## Regularity

13. We confirmed that the expenditure and income in the financial statements was in accordance with applicable legislation and Ministerial guidance, the Budget Act for 2012/13 and legislation governing sums paid out of the Scottish Consolidated Fund.

## Accounting issues

### Accounts submission

14. The unaudited schedules for the core accounts and the consolidated accounts were submitted in line with agreed plans. The unaudited sub-consolidation pack for health was also received by the agreed deadline. Working papers and responses provided by staff in Finance were of a high standard and allowed the Auditor General to conclude the audit within the agreed

timetable and provide her opinion on 25 September. Matters arising from the audit were reported to the Scottish Government Audit and Risk Committee on 23 September 2013. The signed consolidated accounts were laid in the Scottish Parliament and published on 26 September 2013.

## Estimates and valuations

15. In accordance with accounting standards, the valuation of a number of assets and liabilities included in the accounts are based on estimates or other judgements. These need to be clearly disclosed in the accounts to support financial transparency, helping to ensure that the issues and risks associated with valuations are well understood and appropriately monitored. Particular valuation issues impacting the 2012/13 accounts are described at paragraphs 17 to 22 below.
16. We reviewed the valuation approaches taken in these and other areas, and were content that these were appropriate. We also noted some improvements in the level of disclosure including explanation of budget variances and more financial information on specific categories of financial assets. In other areas such as the description of provisions classed as 'other' and some contingent liabilities, while we were content that minimum disclosure requirements had been met there remains scope to further develop the level of disclosure to improve financial transparency.

## Student loan debt

17. Outstanding student loan balances were valued at £2.690 billion at 31 March 2013, taking account of an estimate of the element of debt that will not be recoverable. Older 'mortgage style' loans make up around 5% of the value of the total. The Scottish Government impaired these loans by a further £11.2 million in 2012/13, following a reduction in valuation of £61.5 million in 2011/12. The revised valuation of £23.1 million reflected the age and profile of the outstanding loans, the relatively high repayment threshold and the prevailing economic position. Provision for non-payment is an accounting adjustment and does not affect the Scottish Government's efforts to collect all debts due.

## Road network assets

18. The trunk road network was valued at £17.433 billion as 31 March 2013, using recognised valuation methods. An adjustment of £132 million was made as a result of re-measurement of the physical dimensions of the network. A further adjustment of £8 million was made in 2012/13 to charge depreciation of Special Structures which had previously been overlooked.

## NHS bodies - equal pay claims

19. National Health Service (NHS) in England have settled equal pay claims for employees in traditionally female roles and similar claims have been received by Boards in Scotland. At the end of March 2013, there remained approximately 11,000 grievances registered against NHS in Scotland.



20. The valuation of any liability associated with these was discussed with the Scottish Government and the NHS Scotland Central Legal. It was agreed that due to lack of movement in any cases, there is no additional information which would enable NHS Scotland to estimate the probability and the value of the liability associated with these claims. Consequently these claims continue to be disclosed as an unquantifiable contingent liability.
21. Accounting standards highlight that only in “extremely rare” cases, will an entity be unable to determine a range of possible outcomes in order to make an estimate of the obligation that is sufficiently reliable. As more information becomes available, including further details of the progress of cases in Scotland and England, we would expect it would become possible for the Scottish Government to prepare a sufficiently reliable estimate of probable liabilities.

**Refer Action Plan No. 1**

### **European funds**

22. The accounts include provisions for liabilities and charges in relation to European Community funding programmes which are based on a best estimate of amounts due. These include:
- £64 million in relation to potential disallowance of funding from the European Agricultural Guarantee Fund (EAGF) and the European Agricultural Fund for Rural Development (EAFRD). These arise from a failure to comply with European Regulations identified in audits undertaken between 2005 and 2011. There remains uncertainty over the timing and amount of the disallowance that will ultimately be imposed.
  - £15 million in relation to potential financial corrections in relation to the European Structural Funds (ESF). These provisions are held in respect of expected unrecoverable amounts following from the closure of the programmes which operated prior to 2007. The closure process is expected to be concluded during 2013/14, but the amount unrecoverable remains uncertain.

### **Scottish Consolidated Fund and Non Domestic Rating Account**

23. The Scottish Government prepares separate financial statements for the Scottish Consolidated Fund (SCF) and Non-Domestic Rating (NDR) account on a receipts and payments basis. These are subject to separate audits. Key outcomes were:
- we issued a qualified regularity opinion on the SCF accounts on the grounds that a payment of £150,000 was made from the fund without a credit granted on the fund by the Auditor General for Scotland
  - our other opinions on the SCF accounts were unqualified
  - we issued unqualified opinions on the financial statements on the NDR for the year ended 31 March 2013. This is a memorandum account covering non-domestic rate transactions through the SCF.
24. Further details of our audits of the SCF and NDR accounts are included in the respective annual audit reports for these audits.

## Whole of Government Accounts

25. Whole of Government Accounts (WGA) are consolidated financial statements for all parts of Government in the UK. These are prepared by HM Treasury with the aim of providing improved data for fiscal planning, increasing transparency and improving accountability. The main legislative authority for WGA does not apply in Scotland. However, Scottish Ministers have agreed that Scottish bodies will provide information to HM Treasury for the purposes of WGA.
26. The 2011/12 WGA were published on 17 July 2013. This was the third year of publication. The Comptroller and Auditor General has qualified the accounts in each year since publication began. The 2011/12 WGA were qualified on six counts, one of which was a limitation in audit scope due to lack of evidence supporting the completeness of the elimination of intra-government transactions and balances.
27. HM Treasury replaced their accounting system during 2012/13. This contributed to delays in the release of the new WGA packs to preparers. Improvements in the Scottish Government arrangements meant that despite this, the 2012/13 pack was available for audit a month earlier than in 2011/12. The initial pack was also of a higher quality than it had been in 2011/12, enabling us to conclude our audit by the target date of 31 October.
28. We gave an unqualified opinion in respect of the WGA pack's consistency with the audited Scottish Government consolidated accounts. However, we concluded that the reported counter party information was incomplete and inaccurate in respect of the intra-government transactions and balances that should be eliminated. We were unable to verify some of the values disclosed and there was incomplete information in respect of grants to the public sector, and purchases of goods and services. Similar issues have affected other UK public bodies, contributing to qualification of the WGA in previous years.

[Refer Action Plan No. 2](#)

## Proposed amendments to 2013/14 FReM

29. A number of technical amendments have been made to accounting requirements contained in the Government Financial Reporting Manual. These are not anticipated to have a significant impact on the Scottish Government Consolidated Accounts.

# Financial position

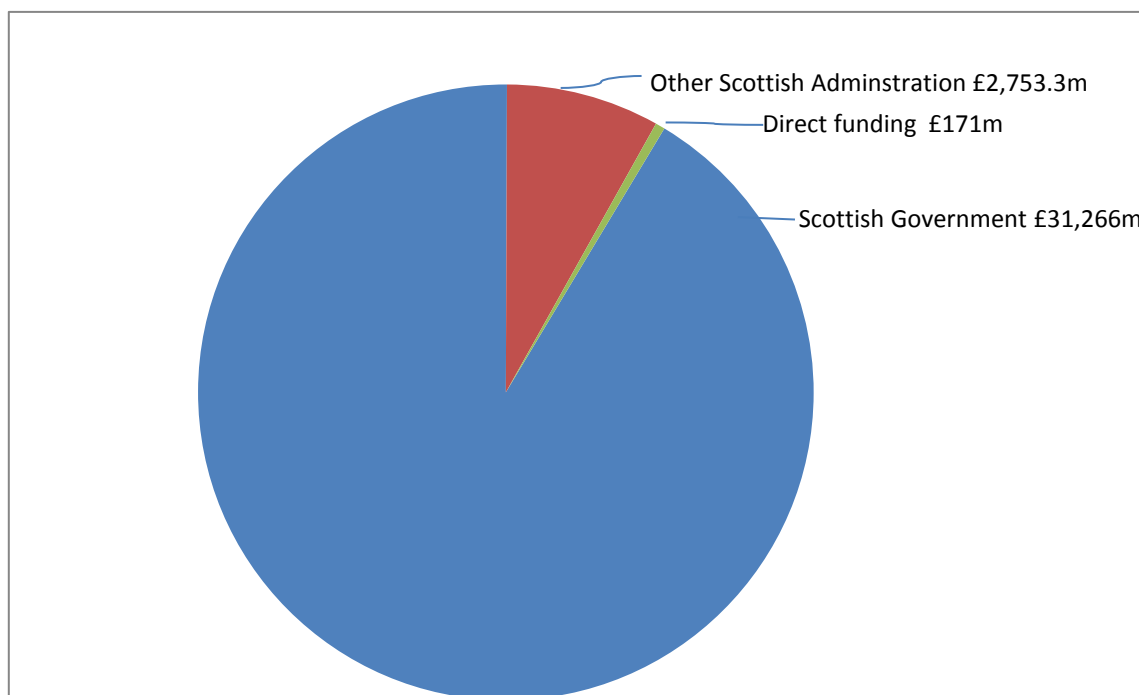
30. Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based. We consider whether audited bodies have established adequate arrangements and examine:
- financial performance in the period under audit
  - compliance with any statutory financial requirements and financial targets
  - ability to meet known or contingent, statutory and other financial obligations
  - responses to developments which may have an impact on the financial position
  - financial plans for future periods.
31. These are key areas in the current economic circumstances. This section summarises the financial position and outlook for the organisation.

## Financial results

### Scottish Budget for 2012/13

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**Exhibit 1: The Scottish Budget 2012/13 (£ million)**



*Source: Audit Scotland from the Spring Budget Revision 2012*

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32. The Budget (Scotland) Act 2012 made provision for financial year 2012/13 for the use of resources by the Scottish Administration and certain bodies whose expenditure is payable directly out of the Scottish Consolidated Fund. The final budget approved by the Scottish Parliament permitted total expenditure of £34,190.3 million. The majority of this relates to

spending programmes and administration costs covered by the Scottish Government Consolidated Accounts, but amounts are also allocated to other parts of the Scottish Administration and directly funded bodies as shown in exhibit 1.

## Outturn reported in the Consolidated Accounts

33. The final budget for the expenditure included in the Scottish Government's Consolidated Accounts for 2012/13 was £31,266 million. Total net expenditure during the year was £31,066 million, resulting in an overall underspend of £200 million (2011/12 £201 million) - resource by £106 million and capital by £94 million. Spending in all portfolios was within the individual budgets for each as set out in table 1.

**Table 1: Scottish Government outturn against budget 2012/13**

Portfolio	Outturn £m	Budget £m	Over / (under) spend £m
Finance and Sustainable Growth	438	443	(5)
Health and Wellbeing	11,830	11,857	(27)
Education and Lifelong Learning	2,820	2,935	(115)
Justice	1,850	1,850	-
Rural Affairs and the Environment	446	447	(1)
Culture and External Affairs	202	204	(2)
Infrastructure and Capital Investment	2,628	2,663	(35)
Local Government	10,519	10,519	-
Administration	225	240	(15)
Crown office and procurator fiscal service	108	108	-
<b>Total</b>	<b>31,066</b>	<b>31,266</b>	<b>(200)</b>

Source: Scottish Government Consolidated Accounts 2012/13

34. Outturn was within 0.6% of budget and overall budget management during the year was effective. An analysis and explanations for major variances over £3 million are disclosed in the consolidated accounts. The Scottish Government directs significant effort toward managing its financial position to minimise the risk of underspends that are not able to be carried forward. Further developments of its approach are being implemented in 2013/14, to improve its in-year budget monitoring to help ensure all resources are targeted to priorities.
35. Scottish Government consolidated accounts outturn must be taken together with other expenditure set out in Schedule 1 of the budget act in order to determine whether the Scottish Administration has remained within the statutory budget limit. The outturn against budget for all relevant purposes is summarised in table 2.

**Table 2: Scottish Administration entities outturn against budget 2012/13**

Entity	Outturn £m	Budget £m	Over/ (Under) spend £m
Scottish Government Consolidated	31,066	31,266	(200)
National Records of Scotland	22	22	-
Teachers' and National Health Service Pension Schemes	2,550	2,634	(84)
Office of the Scottish Charity Regulator	3	3	-
Scottish Courts Service	79	90	(11)
Scottish Housing Regulator	4	4	-
<b>Total</b>	<b>33,724</b>	<b>34,019</b>	<b>(295)</b>

Source: Audited Accounts 2012/13

36. The net position for all of the Scottish Administration is an underspend of £295 million, meaning that spending has been contained within the limit set.
37. In December each year the Scottish Ministers lay before Parliament a statement of total audited outturn for the preceding financial year against the final Budget for the Scottish Administration. This forms an important part of the Scottish Government's accountability to the Scottish Parliament. We expect such a report will be prepared shortly for 2012/13.

### Implications for Total Managed Expenditure

38. Total Managed Expenditure (TME) is the total budget agreed with HM Treasury, and is used by the UK Government to manage its spending on the Scottish Block. This varies slightly from the budget approved by the Scottish Parliament, largely for technical reasons reflecting differences between accounting rules and UK budget rules. A reconciliation of the two amounts is included at Note 24 to the Scottish Government's Consolidated Accounts for the year ended 31 March 2013 (summarised in table 3).
39. TME is categorised as either Annually Managed Expenditure (AME) or Departmental Expenditure Limit (DEL). AME is not subject to firm multi-year limits and does not impact on the Scottish Government's spending power. DEL is subject to greater control, with a particular focus on fiscal DEL as a measure of real spending power. This excludes depreciation, some impairment and other technical accounting non-cash items.

**Table 3: Calculation of fiscal DEL budget for 2012/13 (£ million)**

Scottish Budget approved	34,190
Add: planned carry forward to 2013/14	158
Add: planned Forth Replacement Crossing re-profiling	50
Less: Net technical adjustments	(7)
<b>HM Treasury Budget</b>	<b>34,391</b>
HM Treasury AME Budget	(5,411)
<b>HM Treasury DEL Budget</b>	<b>28,980</b>

<u>Scottish DEL Budget agreed with HM Treasury</u>	
Fiscal Resource DEL Budget	25,118
Capital DEL Budget	2,969
<b>Total Fiscal DEL Budget</b>	<b>28,087</b>
Non-Cash Resource DEL	893
<b>Total DEL Budget</b>	<b>28,980</b>

Source: Audit Scotland

40. The Scottish Government carried forward £179 million of fiscal DEL under the Budget Exchange scheme from 2011/12 to 2012/13. In June 2013, the Cabinet Secretary for Finance, Employment and Sustainable Growth announced the provisional outturn, indicating that the fiscal DEL budget was underspent by £179 million (£150 million resource £29 million capital) against a fiscal DEL carry forward cap of £195 million. After taking account the planned carry forward of £158 million, the unplanned underspend was £21 million. The Scottish Government is able to carry forward the full amount of this underspend into 2013/14.

### Preparing for increased fiscal autonomy

41. The Scotland Act 2012 gives new tax and borrowing powers to Scotland. The power to borrow to support capital expenditure will take effect from April 2015, with borrowing up to 10% of the Scottish Government's capital DEL budget possible in any one year. The Scottish

Government has proposed to make full use of available borrowing in 2015/16, amounting to £296 million in 2015/16, factoring this into its indicative spending plans.

42. Newly devolved taxes - the Land and Buildings Transaction Tax and a Scottish Landfill Tax - are also expected to come into force from the start of 2015/16. Together these taxes have an estimated annual value of around £400 million. Work is continuing to factor the impact of these taxes and other new financial powers, including the introduction of the Scottish Rate of Income Tax (SRIT) from 2016/17 and powers to operate a cash reserve, into future financial plans.
43. A significant amount of work is required to ensure that effective arrangements for the introduction of new financial powers are in place. In April 2013, both the UK and Scottish Governments made their first annual reports. Progress has continued since then, and is summarised in exhibit 2. Some key arrangements are now either in place or are close to conclusion. However, there remains much to do if all the necessary arrangements are to be in place on time. Critical issues for the Scottish Government in the period ahead will include ensuring capacity to support tax administration, the effective forecasting of tax revenues as a basis for future financial planning and development of budgeting, accounting and financial management arrangements.
44. The Scottish Government also needs to work effectively with its partner organisations Revenue Scotland, Registers of Scotland (RoS) and the Scottish Environmental Protection Agency ensuring that they have sufficient capacity to help deliver the required arrangements. Development of appropriate Information and Communication Technology (ICT) systems will be an appropriate component of this. Our 2012 report on *Managing ICT projects* highlighted significant weaknesses in the management of RoS' ICT arrangements. We are pleased to note that progress is being made in addressing these, establishing a basis for further improvement. However, significant further work is required to bring systems up to the required standard and to develop and implement the changes needed to support tax collection.

**Refer Action Plan No. 3**

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## Exhibit 2: Summary of progress in implementing new financial powers

The **Land & Buildings Transaction Tax** act received Royal Assent on 31 July 2013. The **Scottish Landfill Tax** Bill was introduced in April 2013 and is expected to be approved by the Scottish Parliament by early 2014.

Scottish and UK Government officials have been discussing options for the **block grant adjustment for devolved taxes**. This will be discussed at the next joint Ministerial meeting.

Consultation has concluded on proposals for **tax management**, addressing the administrative arrangements for all devolved taxes. A Revenue Scotland and Tax Powers Bill is expected in December 2013.

**Revenue Scotland** has been established as a Scottish tax authority to administer devolved taxes. It is currently an administrative entity of the Scottish Government, and has nine staff, expected to increase to 25 – 30 by the time it is established as a non-ministerial department.

HM Treasury and the Scottish Government have agreed a process to enable **borrowing** for all three purposes set out in the Scotland Act (capital investment, revenue borrowing, cash flow management) from the National Loans Fund. The UK Government has consulted on expanding the range of ways the Scottish Government can borrow.

Edward Troup (Tax Assurance Commissioner and Second Permanent Secretary, HMRC), was appointed **Additional Accounting Officer** with responsibility for the SRIT in November 2012.

A **Memorandum of Understanding** was agreed between the HMRC and the Scottish Government in late 2012 setting out arrangements for overseeing the necessary work on developing and operating SRIT.

Work is continuing on detailed planning for **implementation of the SRIT**. This is being led by HMRC with Scottish Government involvement. In the first phase of the project HMRC is examining UK tax systems in order to consider the impact of SRIT. Detailed work to implement the IT system changes required for the SRIT is expected to begin in 2014 with completion in time to enable implementation for PAYE taxpayers in April 2016. Detail of the approach to block grant adjustment continues to be discussed.

In May 2013, the Cabinet Secretary for Finance, Employment and Sustainable Growth announced plans to establish an **independent forecasting body** to support the Scottish Government and Parliament prior to April 2015. The Finance Committee of the Scottish Parliament is currently conducting an inquiry into these proposals.

Work on arrangements for tax collection and administration is continuing as part of a **Tax Administration Programme**. The programme board includes representatives of the Scottish Government, Revenue Scotland, Registers of Scotland, the Scottish Environmental Protection Agency, HMRC and a local authority Director of Finance.

*Source: Audit Scotland*

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# Governance and Accountability

45. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all audited bodies, whether their members are elected or appointed, or whether they comprise groups of people or an individual accountable officer.
46. Through its chief executive or accountable officer, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.
47. Consistent with the wider scope of public audit, we have a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to:
  - corporate governance and systems of internal control
  - the prevention and detection of fraud and irregularity
  - standards of conduct and arrangements for the prevention and detection of corruption.
48. In this part of the report we comment on key areas of governance.

## Corporate governance

### Overall effectiveness

49. We found that overall, corporate governance arrangements operated effectively during 2012/13, although there is scope to make improvements in some areas as outlined below.

### Boards and committees

#### Strategic board

50. The Strategic Board has responsibility for ensuring that the Scottish Government is organised and managed to support Ministers in the delivery of their Programme for Government. A review of the board's operation was completed in December 2012. It was led by Non-Executive Directors, supported by the Director General Finance, and considered the Board's purpose and its functions; its relationship with other boards and groups; frequency and format of meetings; membership; communications and visibility; and general governance arrangements. The evaluation concluded the Board was working well, with scope to further enhance its operation.
51. Recent changes to the strategic board include the appointment of a new Director General Health and Wellbeing and an Acting Director General Governance and Communities.

## Non-executive directors

52. The Scottish Government has 13 independent non-executive directors. They support the Permanent Secretary, Directors General and other senior managers in their leadership of the Scottish Government. Their role is to provide an effective assurance and challenge function to the Executive Team, with primary responsibility to Parliament and Ministers remaining with Accountable Officers.
53. Non-executive directors serve on the Strategic Board, Audit and Risk Committees (ARCs), and many other of the main organisational boards and groups. It is evident that they play an important part in the organisation, bringing valuable experience and an independent perspective to their roles. Their involvement over a number of different Boards and ARCs helps to promote and maintain understanding, and knowledge sharing.
54. The recruitment of six new non-executive directors is nearing completion. The new appointees will fill vacancies that have arisen due to the expiry of previous appointments, and increase the overall complement to respond to business demands. The decision has been taken to increase the complement of non-executive directors on the Strategic Board from three to four.
55. In our 2012/13 report we highlighted the extent of variation of approaches between different ARCs. The Scottish Government has made some encouraging progress in this area, working through the non-executive network to bring a greater consistency in areas such as coverage of arms length organisations and consideration of the effectiveness of risk management. These efforts continue. There remain opportunities to work toward greater consistency between committees in the balance between support and challenge offered to senior officials.

**Refer Action Plan No. 4**

## Internal Control

56. While we concentrate on significant systems and key controls in support of the opinion on the financial statements, our wider responsibilities require us to consider the financial systems and controls of audited bodies as a whole. The extent of this work is informed by our assessment of risk and the activities of internal audit.
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 adequate systems of internal control were in place.
58. In his annual report on 2012/13, the Head of Internal Audit provided reasonable assurance on overall arrangements for risk management, control and governance. This was lower than the substantial assurance provided in both 2010/11 and 2011/12. This change was a result of a number of specific control issues identified during internal audit's work during the year, including:
- IT security issues for aspects of the main accounting system (SEAS)
  - poor governance arrangements for the EASEbuy procurement system

- lack of overall central control of overtime/ travel time
- eligibility control issues for LEADER projects under the Common Agricultural Policy
- European funding financial reconciliations and irregularities
- issues resulting in interruptions and or/pre-suspension of European Structural Fund programmes.

59. Actions are being taken forward to address the specific control issues in each of these areas. It is important that the position is subject to close monitoring, and that further action is taken as necessary to ensure that there is no reduction in the effectiveness of underlying arrangements.

**Refer Action Plan No. 5**

### Governance Statement

60. Arrangements for the preparation of the Governance Statement functioned well during the year. The statement is based on a well established pyramid of assurance that includes reviews by each Accountable Officer supported by the work of ARCs. Improvements were made to both arrangements, supporting consideration of the statement at an earlier stage, and the extent of disclosure of risk related items.

### Internal Audit

61. 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. 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 2012/13.

62. Internal audit resources have continued to come under pressure, partly as a result of increasing demands to undertake European Community (EC) related work. There is a risk that these pressures may impact on the completion of future planned work programmes and a possible impact on the robustness of the overall control environment. This did not lead to any significant concerns about the quality and extent of internal audit work undertaken in 2012/13, but the position will need to be kept under review by the Scottish Government.

63. The reshaping within the Scottish Government continues to have an impact on the roles and responsibilities of key staff. The IAD changed its structure in 2012/13 to facilitate greater flexibility of staff resources across work areas to respond more quickly to audit needs and priorities as they arise throughout the audit year. A new Assistant Head of Internal Audit role has been created and filled, with the aim of building leadership and strategic capacity.

## European funding

### European Agricultural Guarantee Fund

64. The Scottish Government has made significant progress in addressing the control issues previously identified by European Commission (EC) auditors, particularly in relation to the inspection regime which now incorporates a more integrated approach across all relevant schemes and has been supported by additional staff training and improved guidance. Management control and oversight have also been strengthened.

### European Agricultural Fund for Rural Development

65. Last year's audit highlighted significant weaknesses in the administration of the LEADER scheme and in the monitoring arrangements applied by the Scottish Government. During 2012/13, action has been taken to address monitoring and other weaknesses. However, there are several key areas where further improvement is required, including the need to:

- improve the LEADER regulatory framework and associated guidance, and in particular to ensure greater consistency between the primary legislation and the more detailed operating guidance
- improve the quality of checks applied by Local Action Groups (LAGs) in respect of project applications and claims for grant, and associated documentation standards
- strengthen the effectiveness of the LAG monitoring functions undertaken by the Scheme Manager Team within SGRPID.

66. An action plan to address these issues has been agreed.

### European Structural Funds

67. The Scottish Government has worked to limit the financial consequences of previous EC control concerns. Additional work has been undertaken by IAD to provide further evidence of compliance. Procedures have also been improved to ensure better compliance with required prepayment checks and future audit activity scheduled in line with required timescales.

68. A detailed Management Control system was developed and agreed with the EC in 2007/08. The Scottish Government continue to carry out a process of rolling reviews of this system to ensure that it is fit for purpose and is further developed to reflect changing circumstances.

### Future funding programmes

69. Current European Agricultural Fund and Structural Funds programmes are due to conclude in December 2013. The EC is currently negotiating with the Council of Ministers and the European Parliament on the regulations for future spending programmes. These will set out how these funds are managed and implemented. The EC is proposing significant changes to existing arrangements to improve and simplify financial management and accountability, increase consistency of practice between funds and align outcomes with strategic objectives.

70. These changes will present significant challenges for the Scottish Government in ensuring that funding is appropriately directed and managed. The difficulties are exacerbated by uncertainty about the details of how new programmes will be required to operate, and the tight timescales required. An EU Funds Integration Project Board has been established by the Scottish Government. This has agreed core areas of focus for future funding. A shadow version of the likely future delivery and governance arrangements has been established, involving both partners and stakeholder and have been implemented during the summer. A public consultation has also taken place. The outputs of these activities will feed into the Partnership Agreement for the 2014-20 Funds and individual operational programmes.
71. The Scottish Government's 'Futures Programme' is aimed at implementing new IT systems and associated business change to support the introduction of new Common Agricultural Policy funding programmes from the commencing of the new EU budget period in 2014.
72. The build phase for the IT Programme is behind the original schedule with a range of difficulties relating to capacity and performance with the IT partner identified. A recovery plan was put in place in mid-August 2013 aiming to address the issues and get the delivery back on track. This included the appointment of a new IT Project Delivery Director and a wide range of remedial actions being undertaken by the IT partner. In September 2013, an integrated business and IT delivery plan was presented to the Programme Board. This established a baseline delivery plan covering initial IT releases for monitoring the future programme.
73. The overall Futures Programme has also experienced long-standing issues in securing essential business change staff with the necessary skills and experience. While many of the vacancies have now been filled, this was only very recently. The Scottish Government is currently considering other measures that will reduce the overall risk to delivery of the programme.

**Refer Action Plan No. 6**

### **Adam Smith College**

74. A joint audit team from the Internal Audit Division and the European Structural Funds Division (ESFD) of the Scottish Government investigated allegations of financial mismanagement of European funds at Adam Smith College. The team identified serious issues relating to the mismanagement of project expenditure, particularly in relation to staff costs. The investigation resulted in the withdrawal of funding for six projects where the College was the lead sponsor. The College has now repaid the £5.5 million grant and the money will be reallocated to support other eligible activity.
75. The Fraud Response Plan was initiated and police investigations are ongoing. The ESFD has undertaken a review of similar projects within the further education sector to confirm that this was an isolated incident. In September 2013, the Auditor General reported publicly on this issue under section 22 of the Public Finance and Accountability (Scotland) Act 2000.

## Information systems

### Secure communications

76. The SCOTS network is used by Scottish Government and a number of associated organisations. It is a secure network that is officially accredited by the Cabinet Office, on an annual basis, to handle data up to 'restricted' level, which allows it to be connected to the Government Secure Intranet (GSI), a secure network sponsored by the UK government that facilitates secure data exchange between public sector organisations.
77. The UK government is in the process of 'retiring' GSI and replacing it with the Public Services Network (PSN). In order to maintain their facility to securely exchange data with other organisations, the Scottish Government were required to seek PSN accreditation for the SCOTS network. This was a challenging since the accreditation criteria for PSN were more exacting than those previously in place for GSI. In early 2013, a number of required technical infrastructure improvements were identified to allow the Scottish Government to gain PSN accreditation. Following implementation, the required accreditation was achieved in September 2013.

### Payroll project

78. In May 2011 the Scottish Government approved the implementation of a new payroll system, so that all aspects of SG payroll processing would be under direct control with no reliance on external agencies. The original plan stated that this would be achieved by October 2012, however as the project developed it became evident that this date would not be met. An internal review was undertaken, to determine the delivery status of the project and identify the actions required by management to assure successful completion.
79. Key areas of concern identified by the internal review were that:
- the project was more complex than anticipated. The need for more complex solutions led to higher implementation costs than planned and there was also a time overrun
  - the requirements definition was not sufficiently robust, leading to an excessive number of change requests. This was partly due to the high number of changes which were required as a result of new pay and pensions legislation which came into force during project
  - peripheral costs such as licensing and support, were not properly understood, evidenced by being missed or misplaced in financial forecasts
  - cost increases were not escalated in a timely or appropriate fashion to senior management.
80. In response to these concerns the SG's Chief Technology Officer was appointed as the Senior Responsible Officer in November 2012 with the task of strengthening the technical governance of the project and agreeing a new delivery plan. We are able to report that this was achieved and the payroll system commenced full operation in July 2013, and that management actions to tackle an emerging risk were ultimately effective. However, it is important that the Scottish Government identifies lessons learned from the original phases of the project, and acts on these in future IT projects.

## IT systems Infrastructure

81. In December 2012 the Scottish Government experienced hardware failure on the main server that supports the main financial system (SEAS). For a period of time, while the fault was resolved a limited SEAS service had to be provided. This highlighted that the infrastructure arrangements in place were no longer able to fully support the current SEAS activity levels. This impacted payment performance and management reporting capability for a number of weeks.
82. The internal incident report prepared following this failure identified a range of actions including improvements to the system infrastructure and a review of the business continuity plans to ensure that both reflected the current activity levels. A programme to implement a more resilient system architecture is now underway, starting with the relocation of the servers to Saughton House in May 2013 and further improvements due in 2014. We will continue to monitor developments in this area, including the review and update of the business continuity plans.

## Freedom of information

83. Scottish Freedom of Information (FOI) legislation gives everyone the right to ask for any recorded information held by a Scottish public authority. Information can only be withheld where specific exemptions apply. Where, after having asked for an internal review, an individual is still dissatisfied with the response to their request, they have a right of appeal to the Scottish Information Commissioner. During 2012, the Commissioner considered 106 appeals (2011; 86 appeals) in relation to the Scottish Government, and found wholly or partially in favour of the SG on 61 occasions (58%) (2011; 62 occasions (72%)).
84. This highlights an increasing volume of appeals (and an increasing numbers of requests) with a corresponding reduction in the success of the Scottish Government in defending these. One area that has been of particular concern to the Commissioner has been the incidence of technical appeals she has to consider for example, where there has been a failure to respond at request and/or review stage.

**Refer Action Plan No. 7**

## Prevention and detection of fraud and irregularities

85. The Scottish Government is responsible for establishing arrangements to prevent and detect fraud and other irregularity. We review and report on these arrangements. Robust procedures following the requirements of the Scottish Public Finance Manual are in place within the Scottish Government to help prevent and detect fraud and irregularities.
86. Arrangements have recently been further enhanced by the introduction of a new on-line tool '*Delivering Essentials*' that summarises the essential information staff need to know about a range of topics ranging from Financial Management and Risk Management, through to Fraud Awareness and Programme and Project Management. This online solution is a more rationalised, cohesive and user friendly way to access guidance and information on corporate



governance, financial and delivery responsibilities. The pilot phase successfully went live in April 2013 with full go live during August.

### **National Fraud Initiative in Scotland**

87. The Scottish Government participates in the National Fraud Initiative (NFI). This is a bi-annual counter-fraud exercise that uses computerised techniques to compare information about individuals held by different public bodies to identify circumstances that might suggest the existence of fraud or error (matches). Where matches are identified public bodies are expected to investigate these and if fraud and error has taken place, to stop payments and attempt to recover the amounts involved. The exercise also provides assurance on the effectiveness of arrangements and helps deter fraud and helps the Scottish Government work towards achieving the strategic objectives outlined in the Counter Fraud Strategy.
88. The current exercise considers Scottish Government's payroll and creditor payments data. Investigation of matches is undertaken on a risk basis. To date payroll matches have been concluded and no frauds, irregularities or monetary errors have been identified. We have been advised that more time and resource is required to follow up the creditor matches, with an expected completed date of March 2014, rather than the NFI target of 31 December.
89. National results are due to be published by Audit Scotland in June 2014. Fraud, overpayments and recoveries totalling £19.8 million were identified across Scotland in the 2012 exercise and outcomes of £78 million have been achieved since NFI was introduced.

### **Standards of conduct and arrangements for the prevention/detection of bribery and corruption**

90. Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and have proper arrangements in place for implementing and monitoring compliance with standards and codes of conduct, standing orders and financial instructions. We consider whether bodies have adequate arrangements in place. We are satisfied that the Scottish Government has appropriate procedures in place to help ensure appropriate standards of conduct and to help prevent and detect bribery and corruption.



# Best Value, use of resources and performance

91. Audited bodies have responsibility to ensure that arrangements have been made to secure best value. The Auditor General may require that we consider whether accountable officers have put in place appropriate arrangements to satisfy their corresponding duty of best value. Where such requirements are not specified we may, in conjunction with audited bodies, agree to undertake local work in this area.
92. As part of their statutory responsibilities, the Auditor General may procure, through Audit Scotland, examinations of the use of resources by audited bodies and publish reports or guidance. We may be requested from time to time to participate in:
- a performance audit which may result in the publication of a national report
  - an examination of the implications of a particular topic or performance audit for an audited body at local level
  - a review of a body's response to national recommendations.
93. During the course of our audit appointment we also consider and report on progress made by audited bodies in implementing the recommendations arising from reviews in earlier years. We may also consider the use of resources in services or functions, where the need for this is identified through local audit risk assessments.
94. This section includes a commentary on the best value and performance management arrangements within the Scottish Government. We also summarise headline performance measures used by the Scottish Government, highlight any relevant national reports and comment on the body's response to these.

## Management arrangements

### Performance management

95. The Scottish Government's National Performance Framework sets out its purpose, objectives and national outcomes that describe in more detail what the government wants to achieve. The Scottish Government reports whether recent performance against each indicator is improving, being maintained or worsening. As at the end of October 2013 the Scottish Government was reporting improving performance against 4 purpose targets, and maintained performance against 6 targets. There was worsening performance against only 1 of the targets. Overall, this is an improved position from that highlighted in our 2011/12 annual audit report (4 improving, 4 maintaining and 3 declining).
96. Detailed analysis of available performance data is available from the Scotland Performs website. The detail reported is 'live' with information and assessments being updated as and when new data comes on-stream.

97. A key challenge in managing performance is aligning financial and performance information in a meaningful way, so that the impact of spending decisions on performance and outcomes can be better understood. The Scottish Government has been discussing with the Finance Committee of the Scottish Parliament how best this might be achieved, and provided additional performance analysis as an input to the 2014/15 budget process. However, it is recognised that continued development of approaches is required.

## Risk management

98. In 2010 the Scottish Government completed a detailed review of its risk management structures and arrangements. Since then there has been considerable improvement in its approach to risk management. The Governance and Risk Team have been successful in facilitating and supporting more effective risk management practices across the Scottish Government and its Agencies. Further refinements were introduced during 2013 and work is continuing to ensure effective risk management approaches are embedded throughout the organisation.

99. There is scrutiny of risk management at portfolio audit and risk committee level and SGARC provides oversight and support for the risk management framework. An approach of reviewing one risk in detail at each portfolio ARC has been successful. Further developments planned include the further enhancing of risk interrogation across audit and risk committees, establishing improved links with other public bodies in identifying, assessing and addressing risk, and the development of a programme for scrutinising cross-cutting risks.

## Workforce management

100. The Scottish Government has continued to reshape the organisation to ensure alignment with business priorities and improve the efficient delivery of its organisational responsibilities. As part of this process, and to deliver required cost savings, the government has continued the use of voluntary exit schemes. These were available to all staff in the Scottish Government core and the majority of its agencies. The terms of exit arrangements offered to staff were in accordance with the Civil Service Compensation Scheme rules.

101. Over the course of 2012/13 two exit schemes were operated. As in previous years, applications were considered against defined criteria, including financial case and organisational implications. During 2012/13 a total of 461 departures were agreed across the organisations included in the consolidated accounts, at a cost of £18 million; with 146 of these departures within core Scottish Government departments. This was significantly less than the 2011/12 figures of 964 staff at a cost of £38 million.

102. Progress in reducing staff numbers and costs continues to be monitored by the Scottish Government's Resources Board. This allows progress to be made against the 5 year (2010/11 to 2014/15) target of reducing the Scottish Government's administration budget by at least 20% by 2015. Overall progress has been broadly in line with plans, but inevitably continuing staff reductions will become more challenging to achieve through time.

103. The ongoing Workforce 2015 project aims to change the organisational structure to best match resources and skills to Government priorities, and prepare for constitutional reform, as well as making the organisation more efficient and more effective in delivering better outcomes with fewer resources. During 2013 further developments included enhancing improvement capacity through skills development, ongoing improvement of corporate systems and processes and continued implementation of flexible resourcing.
104. We facilitated a self-evaluation of aspects of the Scottish Government's workforce management arrangements using Audit Scotland's People Management toolkit. Overall many elements of good practice were identified in the arrangements in place, with some further improvements planned. Nonetheless the reductions in staffing levels and continuing financial pressures are inevitably stretching the organisation's capacity.
105. The Scottish Government will need to maintain a strong focus on maintaining sufficient capacity, skills and experience within the organisation while it continues its staff reduction programme. We will keep this area under review in future audits.

## Procurement

106. The Scottish Government continues to lead public procurement reform, working with bodies across the public sector to provide strategic direction, monitor progress, coordinate activity and provide advice and guidance. An effective approach, including improved procurement and better commercial management of contracts, will ensure greater value for money in public spending across Scotland. Efficiency savings of £70 million from procurement are anticipated in 2013/14. Recently developed quarterly performance reports show progress towards achievement of the planned savings.
107. The Procurement Reform (Scotland) Bill was introduced to the Scottish Parliament in October 2013. The bill is intended to maximise the impact of the £9 billion annual procurement spend and ensure that public procurement in Scotland delivers environmentally sustainable, socially responsible and innovative goods, services and works. The Bill proposes a set of general duties on contracting authorities, some specific measures to encourage good practice, and allows Ministers to make regulations and issue guidance in a number of key areas.
108. The Scottish Government is improving the way public procurement operates. However, continued improvement is required to enable the best outcomes across the Scottish Public sector.

## Asset management

109. Our 2011/12 report highlighted that work to rationalise office space across central government remained at an early stage. It also highlighted the absence of an overarching scheme which looks at opportunities for joint property working across public bodies. The Scottish Futures Trust (SFT) had been asked to lead in this area, and established a Programme Board in September 2012 to oversee the public sector property asset management programme.

110. Ministers wrote to all public bodies in May 2012, advising them of SFT's new remit. Key targets were that by the end of 2016 the expectation was public bodies in the local civil estate achieve cost efficiencies of at least £500 million in total (including revenue savings and capital receipts) through a more strategic and collaborative approach to property asset management. In addition the central civil estate reduce their office footprint by at least 25%, building up after five years to an annual saving of about £28 million annually. On the central civil estate work is underway, jointly with SFT, to deliver a coherent, efficient and cost effective approach to meet future property needs for the Scottish Government in collaboration with the wider public sector. The outcome of this work will inform the delivery of future annual savings.

**Refer Action Plan No. 8**

## Performance audit

111. The Scottish Parliament's Public Audit Committee considers performance audit reports published on behalf of the Auditor General. The Committee may agree to note a report; ask audited bodies to provide further information; or hold its own inquiry. In many instances, the Committee will ask the Scottish Government to respond to the recommendations in the report.
112. Audit committees of individual public bodies and local auditors also play a role in scrutinising how individual audited bodies' management has responded to the recommendations in Audit Scotland's performance audit reports.
113. Since the start of 2012/13, Audit Scotland has published 16 performance audit reports on behalf of the Auditor General or jointly, for the Auditor General and the Accounts Commission (exhibit 3) which contain findings or recommendations of relevance to the Scottish Government and its associated public bodies.
114. The key themes that are highlighted by the reports in our performance audit programme are summarised below, together with the findings of a performance audit on a subject of high public interest - the Management of patients on NHS waiting lists.

## Pressures on public sector budgets

115. Our earlier report on *Scotland's public sector finances: addressing the challenges* (published in August 2011) documented the combination of falling public sector budgets for the immediate future and rising levels of demand for public services. Our recently published reports illustrate the continuing nature of these pressures.
116. Scottish Government support for the college sector will fall 24 per cent in real terms between 2011/12 and 2014/15. This decrease will take place during a period of major structural change in the college sector with a reduction in the number of colleges from 37 to less than 23. *Scotland's Colleges: current finances, future challenges* highlighted these challenges, together with other cost pressures such as rising demand for college places and increasing maintenance and building costs. We reported again on the finances of the college sector during 2013/14 and the Public Audit Committee is currently conducting an inquiry in the light of this more recent report.

**Exhibit 3: Performance audit reports published since start of 2012/13**

<b>Learning the lessons of public body mergers</b>	<b>14 June 2012</b>
<b>Managing ICT contracts: an audit of three public sector programmes</b>	<b>30 August 2012</b>
<b>Scotland's Colleges: current finances, future challenges</b>	<b>18 October 2012</b>
<b>NHS financial performance 2011/12</b>	<b>25 October 2012</b>
<b>Reducing reoffending in Scotland</b>	<b>7 November 2012</b>
<b>Health inequalities in Scotland</b>	<b>13 December 2012</b>
<b>Prescribing in general practice in Scotland</b>	<b>24 January 2013</b>
<b>Management of patients on NHS waiting lists</b>	<b>21 February 2013</b>
<b>Improving community planning in Scotland</b>	<b>20 March 2013</b>
<b>Managing early departures from the Scottish public sector</b>	<b>23 May 2013</b>
<b>Scotland's key transport infrastructure projects</b>	<b>21 June 2013</b>
<b>Developing financial reporting in Scotland</b>	<b>4 July 2013</b>
<b>Housing in Scotland</b>	<b>11 July 2013</b>
<b>Scotland's colleges</b>	<b>29 August 2013</b>
<b>Renewable energy</b>	<b>12 September 2013</b>
<b>NHS financial performance 2012/13</b>	<b>10 October 2013</b>
<b>Police reform: progress update 2013</b>	<b>14 November 2013</b>

*Source: Audit Scotland*

117. *NHS financial performance 2011/12* noted that, overall; the NHS had managed its finances within its budget for that year, albeit with movement of funding between individual NHS boards. However, it noted that, in addition to the well-documented pressures on the NHS resulting from an aging population (for example, as noted in *Prescribing in general practice in*

Scotland), capital budgets were falling at a time when the NHS maintenance backlog was estimated at £1 billion.

## Change management

118. *Learning the lessons from public sector mergers* highlighted the importance of effective long-term planning and of ensuring that leaders were in post well in advance of the actual date of merger. Given the extent of structural change under way across the Scottish public sector, the report also provided a good practice guide for planning for a merger. We reported on *Police Reform* in November 2013. This report drew on the findings and recommendations contained within *Learning the lessons from public sector mergers*.

119. The efficiency and effectiveness of public services may be improved through the introduction of better ICT systems. However *Managing ICT contracts: an audit of three public sector programmes* reported that a lack of specialist skills and expertise, weak project management and poor systems of control had resulted in delays, cost overruns or cancellations in three major ICT projects that had been undertaken by the Crown Office and Procurator Fiscal Service, Disclosure Scotland and the Registers of Scotland. The report presented a series of questions for non-executive board members and senior managers to ask at various stages of ICT projects.

## Partnership working

120. A key element of the Scottish Government's public sector reform agenda is the need for better coordination among public bodies. This may be through formal partnership or through more informal joint working and collaboration.

121. *Health inequalities in Scotland* concluded that better partnership working was required to address health inequalities. It recommended that there also needed to be greater clarity about the roles and responsibilities of the many partner organisations involved in trying to reduce health inequalities.

122. *Reducing reoffending in Scotland* noted that although there is a good understanding of which approaches help to reduce reoffending, this is not always what is delivered. We recommended that the Scottish Government, the Scottish Prison Service, community justice authorities and councils should work together to improve how services to reduce reoffending are planned, designed and delivered.

123. *Improving community planning in Scotland* drew on the findings of our first three audits of community planning partnerships. It concluded that, to date, community planning partnerships had not met their objectives to improve outcomes for people in Scotland. The Scottish Government is seeking to make community planning partnerships central to public sector reform at a local scale. Our report stressed the importance of leadership, changes in culture and a shift towards joint planning and budgeting among community planning partners. During 2013/14, we will conduct audits of a further five community planning partnerships.

## Transparency of financial reporting

124. Our report on *Developing financial reporting in Scotland* set out, for the first time, an assessment of Scotland's assets and liabilities. It stressed the importance of comprehensive and transparent reporting of public finances in enabling clear accountability and good decision-making.
125. Our report on *Scotland's key transport infrastructure projects* continued the theme of transparency in public reporting. It noted that the total financial commitments across the lifetime of the five projects had not been publicly reported. In addition, some of the forecast building costs had been incompletely or inconsistently reported. This makes it difficult for the Scottish Parliament and the public to assess the long-term affordability of these projects.

## Long-term financial planning

126. Our reports on *Housing in Scotland*, *Renewable energy* and *NHS financial performance 2012/13* made recommendations relating to the need for more strategic, longer term financial planning. Renewable energy recommended that the Scottish Government estimates how much public sector investment might be needed beyond the current spending review period to support its ambitions for renewable energy.
127. *NHS financial performance 2012/13* commented on financial management by NHS boards and recommended that the Scottish Government consider moving away from setting annual financial resource limits for each NHS board as this would help NHS boards plan more effectively for the longer term.

## Reports of public interest

128. In the light of evidence of manipulation of the statistics behind waiting times targets in NHS Lothian, we audited NHS boards' use of waiting list codes in patient records for the period April to December 2011. *Management of patients on NHS waiting lists* concluded that the systems used to manage waiting lists had inadequate controls and audit trails. In some cases, this meant that it was impossible to determine whether there had been human error, inconsistent of application of guidance or deliberate manipulation. We made a series of recommendations to the Scottish Government and NHS boards. We are assessing progress against these recommendations and will publicly report our findings in December 2013.



# Outlook

129. The Scottish public sector is experiencing considerable financial constraints in providing current levels of service within available resources. The financial outlook remains challenging, with continuing reductions anticipated in real terms funding through the block grant. The draft 2014/15 budget sets out the Government's spending priorities.
130. A significant amount of work is required to ensure measures are in place to support new tax and borrowing powers. Some key arrangements are now in place or are close to conclusion. However, there remains much to do if all the necessary arrangements are to be in place on time.
131. Our recent performance audit reports have also highlighted the continuing pressures on public sector budgets, and the importance of effective change management, partnership working, long-term financial planning and transparency in financial reporting.
132. This section outlines some of the financial challenges facing the Scottish Government which we would expect to be of continuing audit interest. We also summarise the key messages from our recent report on Developing Financial Reporting.

## Financial planning to support priority setting and cost reductions

133. The size of the Scottish Budget is largely determined by the block grant from Westminster based on the Barnett formula. The amount allocated forms part of the UK public expenditure control regime. This requires the Scottish Government to plan, monitor and report its spending against the control aggregates set by the UK Parliament and HM Treasury alongside those set by the Scottish Parliament.
134. The UK Government announced the outcomes of its Spending Round 2013 in June 2013, confirming budget totals for the last round of the current spending review period (2010/11 to 2014/15) and setting out budget totals for 2015/16.
135. The Draft Scottish Budget for 2014/15 was published and presented to the Scottish Parliament on 11 September 2013. This included the Scottish Government's proposed budget for 2014/15 and indicative spending plans for 2015/16. It also summarised the current budget total for 2013/14. This highlights annual real terms reductions of 2.5%/ 1.3%/ 1.9% in spending power (Fiscal DEL) in the three years from 2013/14 to 2015/16. In total the document highlights that spending power will have fallen by 10.9% in real terms between 2010/11 and 2015/16 given current assumptions about inflation using available GDP deflators published by HM Treasury. It also highlights that it is likely that budget reductions are likely to continue until at least 2017/18.
136. Annual budget documents summarise the Scottish Government's spending plans, which are subject to scrutiny by the Scottish Parliament following an agreed process. Further review of the budget takes place during the year through the Autumn and Spring Budget Revision processes. The draft 2014/15 budget sets out the Government's current spending priorities:



- accelerating recovery by: supporting investment; boosting employment, creating economic opportunity and enhancing business confidence; and, rebalancing the economy
- the social wage and tackling welfare cuts including targeted actions to mitigate the impact of welfare reforms and financial measures aimed at supporting household budgets
- improving public services by efficiency savings and public service reform. This is based on: a decisive shift toward preventative spending; partnership between public services; greater investment in people delivering services; and a sharp focus on performance.

137. The Scottish Government has an important role providing leadership and support to public sector bodies as they try to reduce costs, improve efficiency and deliver on national priorities.

### Economic intervention

138. Scottish Ministers have recently advised Parliament of two areas where they have made arrangements to support operations it considers strategically important to the Scottish economy:

- the acquisition of Prestwick airport. The Ministerial announcement highlighted the Government's view that the airport is of significant strategic importance to the economy but was in danger of being closed. It also drew attention to the need to undertake due diligence and develop a 'strong and credible' business plan.
- involvement in discussions surrounding the future of the Grangemouth petrochemical plant. The Ministerial announcement highlighted the Government's view that the site is of strategic significance to the Scottish economy, and the priority it has given to securing its future. It also highlighted financial assistance as part of a wider package that included loan guarantees by the UK Government.

139. The Scottish Government will need to ensure that it manages the overall impact of these and any similar initiatives on its own financial position. This means being clear about the extent of the financial risks involved, establishing sound business cases for any investment and developing effective monitoring arrangements. We will keep this area under review in future audits.

### Responding to welfare reform

140. In its Draft Budget for 2014/15 the Scottish Government has outlined the significant impact it expects welfare reform to have in Scotland - reducing benefit expenditure in Scotland, impacting on organisations providing other welfare assistance and related services such as health and housing. Many of these organisations and services are in the devolved public sector or are funded by it. They rely to a great extent on Scottish Government funding, and any funding or service pressures they experience will, in turn, place pressure on the Scottish Government's finances which will need to be managed.

141. The Scottish Government has proposed a range of specific measures and funding commitments, noting the challenge to be 'creative and innovative'. In working with its partners, the Scottish Government will need to be clear about its overall financial commitment.

## Developing financial reporting

142. Our performance audit report on *Developing Financial Reporting in Scotland* (July 2013) highlighted that the Scottish Government's financial reporting framework has continued to evolve since devolution, reflecting developments in recognised good practice. However, the changing financial environment suggests that this would be a good time for the Scottish Government to review, in discussion with the Scottish Parliament, the current arrangements. There is scope for the Scottish Government to further develop its financial reporting to make it more transparent and comprehensive.
143. The report highlighted that there is scope to further develop existing financial reporting in the accounts, supplementing this with additional analysis as necessary. It recognised that the public reporting of financial information can take a number of forms, including audited accounts, budget documents and supporting materials, published plans and statements to Parliament. Good financial reporting involves getting the right balance between these different methods, and ensuring that overall financial reporting meets users' needs.
144. The Public Audit Committee considered the report and took evidence from the Permanent Secretary and the Director General Finance of the Scottish Government. It agreed to note the evidence, given it will receive a progress report from Audit Scotland towards the end of 2014.

## Reclassification of public bodies

145. Following a decision by the Office of National Statistics, Further Education colleges, will be classified as Central Government Bodies from 1 April 2014. This means that expenditure by these bodies will be subject to HM Treasury spending controls for the first time in financial year 2014/15. Work is underway to develop the Scottish Government financial monitoring arrangements to incorporate the Further Education sector and the budgetary impact was reflected in the Draft Budget for 2014/15.

## European Funding Programmes

146. New requirements for an audit of 'Legality and Regularity' in relation to European Agricultural Funds are being introduced by the European Commission. These are in addition to existing arrangements and are expected to have significant implications of the extent of external audit required. Discussions are continuing with other UK audit bodies in the audit consortium about application of the new requirements. Initial requirements are expected to need to be implemented from early summer 2014, with the full implications anticipated in 2015.

# Appendix A: action plan

## Key Risk Areas and Planned Management Action

Action point	Recommendation	Planned management action	Responsible officer	Target date
1.	<p><b>NHS Bodies- Equal pay claims</b></p> <p>As more information becomes available, we would expect it would become possible for the Scottish Government to prepare a sufficiently reliable estimate of probable liabilities arising from equal pay claims in the NHS.</p>	<p>There is a well-established approach that involves the Central Legal Office, the NHS Equal Pay Unit, Audit Scotland and Scottish Government Health Finance who meet each year to review current developments relating to NHS equal pay and to agree an appropriate disclosure in NHS Board annual accounts. This group will meet around February 2014 to discuss disclosure and again we would expect to reach an agreement in advance that both Scottish Government and Audit Scotland are content with.</p>	Deputy Director: Finance Health and Wellbeing	February 2014
2.	<p><b>Whole of Government Accounts (WGA)</b></p> <p>The Scottish Government should undertake to improve the completeness and accuracy of the reported counter party information in respect of intra-government transactions and balances to support WGA reporting.</p>	<p>The delays and difficulties with the HM Treasury system impacted on the capacity to make improvements to counter party analysis. Planning for the 2013-14 process will allow for additional effort in this area.</p>	Deputy Director: Finance Corporate Reporting	September 2014
3.	<p><b>Preparing for increased fiscal autonomy</b></p> <p>Significant further work is required to bring Registers of Scotland's ICT systems up to the required standard and to</p>	<p>Effective, well-integrated IT systems for tax administration across Revenue Scotland (RS), Registers of Scotland (RoS) and the Scottish</p>	Head of Revenue Scotland	Various target dates

Action point	Recommendation	Planned management action	Responsible officer	Target date
	<p>develop and implement the changes needed to support their role in tax collection.</p> <p>The Scottish Government should ensure that Register of Scotland implements required improvements to its IT arrangements to support new tax systems.</p>	<p>Environment Protection Agency (SEPA) are critical for the effective collection of the devolved taxes from April 2015, including compliance work. This is being actively managed through the Tax Administration Programme and by the relevant Project Boards at RoS and SEPA. Both the Tax Administration Programme and the change project at RoS have been and will continue to be subject to Gateway Review, with checks in place that recommendations are followed up through the project and programme management arrangements. The IT systems development is also subject to the new, enhanced assurance arrangements put in place by Scottish Government following the Audit Scotland report mentioned here. RS has been working closely with RoS and SEPA on issues relating to IT system design but now that the work moves into a more intense implementation phase, RS is in the process of appointing a specialist IT manager to take the lead on ensuring system integration and appropriate IT system development at RS itself.</p>		

Action point	Recommendation	Planned management action	Responsible officer	Target date
4.	<p><b>Audit and Risk Committees</b></p> <p>There remain opportunities to work toward greater consistency between committees in the balance between support and challenge offered to senior officials.</p>	<p>Bi-annual meetings are now being held to bring together the chairs of SGARC and the individual to review emerging audit and risk issues and how these are addressed consistently by the ARCS. This will provide the opportunity to ensure that there is clarity around the role and scope of the ARCs.</p> <p>The induction process being arranged for the new non-executive directors will provide them with a clear briefing on the role of ARCs.</p> <p>The regular meetings of the non-executive director network provide a further opportunity to ensure a common understanding of the role and scope of ARCs.</p>	Head of Cabinet, Parliament and Governance Division Corporate, Parliament and Governance Division.	Ongoing
5.	<p><b>Monitoring internal control</b></p> <p>The Scottish Government should continue to monitor the overall internal control arrangements, taking action as necessary to ensure that there is no reduction in effectiveness.</p>	Audit and Risk committees will continue to play a key role in consider the emerging outputs from the assurance processes.	DG Finance	Ongoing
6.	<p><b>European rural funding programmes</b></p> <p>The build phase for the IT component of the Futures programme is behind schedule and capacity problems have led to slow progress in other parts of the</p>	The status and progress of the Futures IT Delivery Programme is being monitored closely by senior management and by the appropriate governance procedures, being subject to Gateway Review and close scrutiny by the FIRA	Senior Responsible Office, Futures-Agriculture, Food & Rural Communities	Regular oversight throughout 2013/14

Action point	Recommendation	Planned management action	Responsible officer	Target date
	programme. The Scottish Government should ensure that actions to address identified issues with the futures programme are addressed effectively.	Audit and Risk Committee. Recommendations from the recent Gateway Review are being implemented and good progress is currently being made recently towards delivering improvement to the Futures Programme.		
7.	<b>Freedom of information</b> There has been a rise in FOI appeals and the extent to which they have been upheld. The Scottish Government should review the effectiveness of its FOI arrangements.	The FOI Unit continues to revise and update staff guidance and training material. Internal FOI recording and monitoring processes are also regularly reviewed.	Team Leader, Freedom of Information Unit	Ongoing
8.	<b>Asset management</b> The Scottish Government should continue to progress plans to improve its asset management to deliver on key aims for the central estate.	Scottish Futures Trust to continue to support and challenge public bodies to improve their property asset management. Reports on options for the central estate will be completed to inform management decisions during 2014.	Senior Responsible Officer, Asset Management Programme and Deputy Director, Infrastructure Investment	June 2014

# Appendix B: audit reports

## Exhibit 1: 2012/13 Outputs

Outputs		
<b>Audit Opinions</b>		
Independent auditor's opinion on the Scottish Government Consolidated Account		September 2013
<b>Governance</b>		
Key Controls Assurance - Central Financial Systems		April 2013
Review of the Adequacy of Internal Audit		May 2013
Progress report on European Funding Issues		May 2013
Report to Audit Committee in terms of ISA 260 (Communication of audit matters to those charged with governance)		September 2013
<b>Performance</b>		
People management best value toolkit		March 2013
<b>Annual Audit Reports</b>		
Scottish Government		December 2013
<b>NHS sub-consolidation</b>		
Independent auditor's assurance on the NHS sub-consolidation		July 2013
<b>Whole of Government Accounts</b>		
Report and certification letter to NAO and Scottish Government		November 2013