



# **SCOTTISH GOVERNMENT**

Annual audit report 2014/15

October 2015

Prepared for Scottish Government and the  
Auditor General for Scotland

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This report has been prepared for the use of the Scottish Government and no responsibility to any member or officer in their individual capacity or any third party is accepted. This report will be published on our website after it has been considered by the audit committee. The information in this report may be used by Audit Scotland in any reporting to the Scottish Parliament.

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# Key messages

<p>Audit of financial statements</p>	<ul style="list-style-type: none"> <li>The Auditor General's opinion on the 2014/15 financial statements is unqualified.</li> </ul>
<p>Financial management and sustainability</p>	<ul style="list-style-type: none"> <li>Effective overall management of the 2014/15 budget.</li> <li>Spending in 2014/15 within the limits authorised by the Scottish Parliament.</li> <li>Effective financial management, with further developments underway as the new financial powers take effect.</li> </ul>
<p>Governance and transparency</p>	<ul style="list-style-type: none"> <li>Sound overall governance in place, including well-developed and effective risk-management processes.</li> <li>Systems of internal control operated effectively in 2014/15, with scope for improvement in some systems.</li> <li>Internal audit needs to be strengthened to ensure that the service continues to be effective.</li> <li>Further developments in financial reporting required and underway, particularly in the context of the new financial powers.</li> </ul>
<p>Performance and value for money</p>	<ul style="list-style-type: none"> <li>Long-term financial strategies are increasingly important, to confirm sources of savings and affordability.</li> <li>Workforce skills and capacity need to be maintained and be sufficient to meet current and future demands.</li> </ul>
<p>Outlook</p>	<ul style="list-style-type: none"> <li>The financial outlook remains challenging, with further reductions in budgets likely.</li> <li>ONS classification work programme has the potential to affect future capital plans.</li> <li>Further devolution of financial powers has significant implications for how public finances are managed and controlled.</li> <li>An expanded annual report including a more rounded account of performance would help strengthen accountability and scrutiny.</li> </ul>

# Introduction

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1. This report is a summary of our findings arising from the 2014/15 audit of the Scottish Government (SG).
2. The management of the SG is responsible for:
  - preparing financial statements which give a true and fair view, in accordance with the relevant financial reporting framework
  - ensuring the regularity of transactions, by putting in place systems of internal control
  - maintaining proper accounting records
  - preparing and publishing with the financial statements an annual governance statement and a remuneration report.
3. Our responsibility, as the external auditor of the SG, is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.
4. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. This does not relieve management of its responsibility for the preparation of financial statements.
5. We have issued a number of audit reports, both local and national, during the course of the year. These reports are summarised at [appendix II](#) and [appendix III](#).
6. [Appendix IV](#) is an action plan setting out our recommendations to address the high level risks we have identified from the audit. We recognise that not all risks can be eliminated or even minimised. What is important is that the SG understands its risks and has arrangements in place to manage these risks. The SG should ensure it is satisfied with proposed action and has a mechanism in place to assess progress and monitor outcomes.
7. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures; consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.
8. The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged.

# Audit of the 2014/15 financial statements

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## Audit opinions

### Financial Statements

- The Scottish Government's consolidated accounts for 2014/15 give a true and fair view of the state of its financial affairs and of its net expenditure for the year.
- The financial statements have been properly prepared in accordance with the 2014/15 Financial Reporting Manual and other applicable guidance.

### Regularity

- In all material respects, the expenditure and income in the financial statements were incurred or applied in accordance with applicable enactments and guidance, including the Budget (Scotland) Act covering 2014/15.
- The sums paid out of the Scottish Consolidated Fund to meet the expenditure included in the consolidated accounts were applied in accordance with the Scotland Act 1998.

### Other prescribed matters

- The remuneration report has been properly prepared in accordance with applicable enactments and guidance.
- The information in the strategic report is consistent with the financial statements.

## Audit of the 2014/15 financial statements

### Submission of financial statements for audit

9. We received the unaudited SG core financial statements on 10 June 2015 and the first version of the unaudited consolidated accounts on 3 August 2015, in accordance with the agreed timetable. The working papers were generally of a satisfactory standard. Our audit identified the need for more presentational changes to the accounts compared with previous years. SG staff provided good support to the audit team and we substantially completed our audit on 18 September 2015.

### Overview of the scope of the audit of the financial statements

10. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan presented to the SG Audit and Risk Committee on 11 March 2015.
11. As part of the requirement to provide full and fair disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2014/15 agreed notional audit fee was set out in the Annual Audit Plan and, as we did not carry out any work additional to our planned audit activity, the notional fee remains unchanged.
12. The concept of audit risk is of central importance to our audit approach. During the planning stage of our audit we identified a number of key audit risks which had the greatest effect on

the audit strategy, resources and effort. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance.

13. [Appendix I](#) sets out the significant audit risks identified at the planning stage and how we addressed each risk during the audit in arriving at our opinion on the financial statements.
14. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

### Materiality

15. Materiality can be defined as the maximum amount by which auditors believe the financial statements could be misstated and still not be expected to affect the decisions of users of financial statements. A misstatement or omission, which would not normally be regarded as material by amount, may be important for other qualitative reasons (for example an item contrary to law).
16. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

## Audit of the 2014/15 financial statements

17. We summarised our approach to materiality in our Annual Audit Plan. Based on the financial statements, we reviewed our materiality levels and revised our planning materiality for 2014/15 to £327m (1% of total outturn). Performance materiality of £65 million is determined to ensure that total uncorrected and undetected audit differences do not exceed our planning materiality level. In practice, we work to lower materiality levels, meaning individual errors between £10 million and £20 million may be material depending on their nature and impact. We report all misstatements greater than £100,000. No matters arose during the audit that required us to revise our materiality levels.

## Evaluation of misstatements

18. A number of presentational and monetary adjustments were identified during the audit. These were discussed with senior finance officials who agreed to amend the material misstatements. Gross monetary misstatements totalled £1,427 million were therefore corrected; the overall effect of these amendments was to decrease total comprehensive net expenditure by £1.4 million and increase net assets by the same amount.
19. We are required to report to those charged with governance all unadjusted misstatements which we have identified during the course of our audit, other than those of a trivial nature. The total unadjusted misstatements identified during the audit were £86 million, of which £43 million relate to the SG core

accounts, £10 million to the NHS and £33 million to agency accounts. If these adjustments were made, the effect would be to reduce total comprehensive net expenditure in the SG consolidated accounts by £51 million and increase net assets by £51 million.

20. The value of unadjusted misstatements exceeds our performance materiality threshold and we have considered the implications of this for our audit. We are content that uncorrected misstatements are of a one-off nature and not representative of wider misstatements. As a result we consider that the overall level of misstatements in the accounts is not material.
21. We requested that SG correct all financial misstatements but the final decision rests with those charged with governance. The SG decided not to adjust the remaining financial misstatements as they are not material to the accounts as a whole, and we concur with this assessment.

## Significant findings from the audit

22. International Standard on Auditing 260 requires us to communicate to you significant findings from the audit:
- The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and disclosures.
  - Significant difficulties encountered during the audit.

## Audit of the 2014/15 financial statements

- Significant matters arising from the audit that were discussed, or subject to correspondence with management.
  - Written representations requested by the auditor.
  - Other matters which in the auditor's professional judgment, are significant to the oversight of the financial reporting process.
23. The following table details those issues or audit judgements that, in our view, require to be communicated to those charged with governance in accordance with ISA 260.

### Significant findings from the audit in accordance with ISA 260

#### 24. European Structural Funds (ESF)

The financial statements include £127 million (representing a conversion of €144 million) of ESF funding receivable from the European Commission (EC), for expenditure the SG has declared in 2014 for programme funding. The EC has suspended three of the four ESF programmes and interrupted the fourth. This means that ESF funding payments to the Government will not be resumed until the EC is content that its underlying concerns about controls over the eligibility of declared expenditure are resolved. More details are provided at paragraphs 73 to 78 below. It is expected that some correction to expenditure declared as eligible will be made before all funding payments resume, but the timing and amounts involved are uncertain. We are content that this does not have a significant impact on the overall transactions and balances associated with ESF in the 2014/15 accounts.

**Resolution** – No change required to 2014/15 accounts. The accounting implications for the closure of these programmes will need to be kept under review.

#### 25. Accounting for the Clinical Negligence and Other Risks Indemnity Scheme (CNORIS)

Health bodies in Scotland are required to participate in the Clinical Negligence and Other Risks Indemnity Scheme (CNORIS), a risk sharing agreement used to manage financial risk. During last year's audit we identified the need to review the accounting treatment associated with CNORIS, to reflect the true position of the scheme. Adjustments were made to the 2013/14 consolidated accounts as a result. SG undertook a full accounting review of the CNORIS scheme in 2014/15. This resulted in changes in accounting treatment for the scheme. NHS Boards recognise a provision for individual claims against the board and a provision and related debtor for their participation in the national scheme. On consolidation, the SG's CNORIS provision represents the overall national scheme liability, with the provision for the individual claims against the Boards and related debtor eliminated. The SG's CNORIS provision represents the national anticipated costs for all clinical and non-clinical cases.

**Resolution** - we are content with the 2014/15 accounting treatment. SG will perform a post implementation review during 2015/16 to consider how the



## Significant findings from the audit in accordance with ISA 260

process has worked and whether further improvements are needed.

### 26. **Transport Scotland – Indexation of the valuation of the trunk road network**

To ensure that the depreciated replacement cost of the trunk road network reflects inflation, Transport Scotland uplifts the unit rates of each element of the network using a rate known as the Baxter index which is published by the Department for Business, Innovation and Skills. Due to the timing of this information, the figure for quarter three is routinely used to produce the year-end road network valuation for the annual financial statements. A further calculation is required each year when the quarter four figure is received, to assess whether applying this figure would have materially affected the figures stated in the financial statements.

**Resolution** - In 2014/15 the Baxter index movement between these two quarters represented a 2.06% decrease of £329 million. As this is above the overall materiality level an adjustment has been made in the final version of the accounts to reflect the 2014/15 quarter 4 Baxter index figure. This process for adjustment is consistent with previous practice.

### 27. **NHS Equal Pay Costs**

The 2013/14 consolidated accounts included an unquantified contingent liability in regard to equal pay claims made under the Equal Pay Act 1970. This was due to the uncertainties surrounding the number of claims and any financial impact arising from successful claims. In our 2013/14 annual report we recommended that, as more information became available, the SG should prepare a reliable estimate of probable liabilities.

**Resolution** - there have been significant developments in relation to Equal Pay in 2014/15. Following a review of the position by the Director for Health Finance, eHealth and Analytics, based on advice from the NHS Central Legal Office and agreed with Audit Scotland, Health Boards have now included provisions in their accounts for potential liabilities.

### 28. **Provision for additional pension payments to retired police and fire officers**

The 2014/15 consolidated accounts include a provision for £115 million for estimated additional pension payments to retired police and fire officers following a decision by the Pensions Ombudsman relating to the calculation of pensions. In our view, the SG should only provide for the pension and interest element of these payments (total £72 million) as HM Treasury has provided for the tax element in its accounts. There is uncertainty around which department will pay the tax and the SG has judged it prudent to provide for the full amount in its accounts.

## Significant findings from the audit in accordance with ISA 260

**Resolution** – For audit purposes, we have treated the difference between the provision included in the accounts and our assessment of the position (i.e. £43 million, being £115 million less £72 million) as an unadjusted amount. This forms the majority of the unadjusted amounts set out in paragraph 19. This is matter of judgement about the estimated impact.

### 29. Scottish Prison Service - Strategy for the management of female offenders

In January 2015 the Cabinet Secretary for Justice announced that plans for a female prison in Inverclyde would not go ahead. The decision resulted in the write off of design costs of £1.3 million and an impairment of land value of £3.0 million. A further announcement was made on 22 June 2015 which confirmed that there would be a new national facility on the site of HMP Cornton Vale and a number of new community custody units across Scotland.

**Resolution** – we are content with the accounting treatment. The financial statements were updated to include disclosure of the post balance sheet event.

### 30. Disclosure Scotland

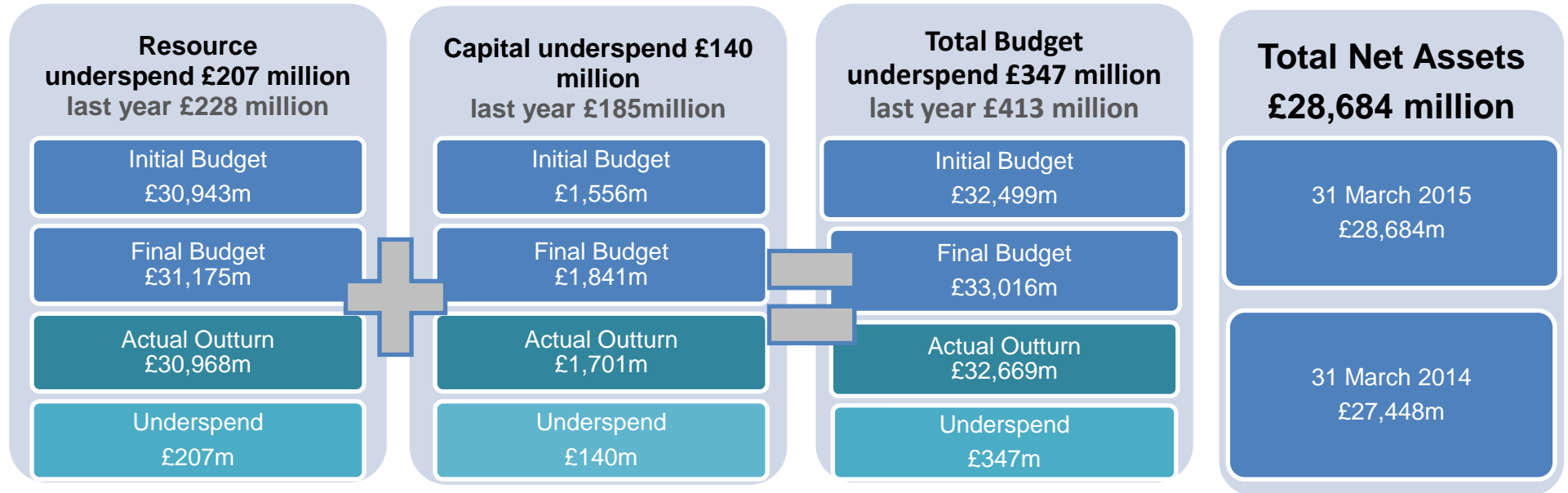
The auditor of Disclosure Scotland disagreed with the accounting treatment of some significant income and expenditure items relating to different aspects of an IT contract. Income of £1.455 million was incorrectly classified as relating to 2015/16 when it should have been accrued in 2014/15, and a payment of £1 million made in March 2015 should have been classified as a prepayment. In addition, the financial statements record an unquantifiable contingent asset / liability relating to ongoing discussions on the non-completion of a separate IT contract which Disclosure Scotland awarded in May 2014. The losses and special payments note also records that Disclosure Scotland made an initial milestone payment, under the contract, to this supplier of £1.1 million. The supplier subsequently did not complete.

**Resolution** - Disclosure Scotland agreed to make the required adjustments to income and expenditure, which are appropriately reflected in the 2014/15 consolidated accounts. The external auditor of Disclosure Scotland will continue to monitor the other issues.

31. Revenue Scotland was established as a Non-Ministerial Department from January 2015 to administer and collect new devolved taxes (the Land and Buildings Transaction Tax and the Scottish Landfill Tax) which came into effect from 1 April 2015. Expenditure incurred by Revenue Scotland in the 3 months to 31 March 2015 is included within the SG's 2014/15

consolidated accounts and reported as a note. This shows staff costs of £0.943 million and non-staff costs of £0.896 million. We are content with this interim accounting measure, given the amounts involved. Revenue Scotland will publish full annual accounts from financial reporting year 2015/16 onwards, under Accounts Direction from Scottish Ministers.

# Financial management and sustainability



## Financial performance

### Budget management

32. The SG’s overall budget consists of the Scottish Block Grant determined within the framework of public expenditure control in the United Kingdom and other sources of income, mainly Non-Domestic Rates and funding connected with European programmes of financial assistance. The Block Grant is calculated using the Barnett formula which adjusts grant on the

basis of a population share of changes in comparable programmes of expenditure in the rest of the UK. The UK Parliament votes the necessary provision to the Secretary of State for Scotland who makes grants to the SG into the Scottish Consolidated Fund.

33. The Scottish Parliament approves the resources to be used by all the bodies whose expenditure is payable out of the Scottish Consolidated Fund. The majority of the budget relates to

## Financial management and sustainability

spending programmes and administration costs covered by the SG consolidated accounts, but amounts are also allocated to other parts of the Scottish Administration and directly funded bodies.

34. The SG requires to manage overall spending within both the Scottish Budget and UK Treasury limits. The consolidated accounts reflect the areas that it is directly responsible and accountable for. They include spending against the relevant components of the Scottish Budget. Separate accounts are prepared by other bodies to reflect their own accountability to Parliament.
35. Budget management during 2014/15 was effective in managing overall spending. The SG operated within its budget, resulting in an overall underspend of £347 million (1.1% of final budget) - resource by £207 million and capital by £140 million. Table 1, over page, shows a summary of the amounts spent in each portfolio.
36. Information on variances in each portfolio is shown in the accounts. This, for example, shows that Justice overspent by £12 million, largely due to police and fire pension payments being more than anticipated. Rural Affairs, Food and Environment overspent by £16 million, mainly due to capital overspend of £31 million on the Futures Programme to support Common Agricultural Policy (CAP) reforms in Scotland. The largest portfolio underspend was in Infrastructure, Investment and Cities mainly due to the impact of changes to the rail franchise, savings in the Forth Road Crossing and

underspending against budget on other major capital projects, such as motorway improvements.

**Table 1: Scottish Government outturn against budget 2014/15**

Portfolio	Outturn £m	Budget £m	Over / (under) spend £m
Finance, Constitution and Economy	524	537	(13)
Health, Wellbeing and Sport	12,341	12,355	(14)
Education and Lifelong Learning	2,732	2,804	(72)
Fair Work, Skills and Training	252	252	-
Justice	2,585	2,573	12
Social Justice, Communities and Pensioners' Rights	11,223	11,274	(51)
Rural Affairs, Food and the Environment	479	463	16
Culture, Europe and External Affairs	191	194	(3)
Infrastructure, Investment and Cities	2,031	2,252	(221)
Administration	198	199	(1)
Crown Office and Procurator Fiscal Service	113	113	-
<b>Total</b>	<b>32,669</b>	<b>33,016</b>	<b>(347)</b>

Source: Scottish Government Consolidated Accounts 2014/15

## Scottish Administration

37. SG consolidated accounts outturn must be taken together with other spending provided for 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, over page.
38. The net position for all of the Scottish Administration is an underspend of £369 million (2013/14 £445 million), meaning that spending has been managed within the limit set. The underspend represents approximately 1% of budget.
39. 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 SG's accountability to the Scottish Parliament.

## HM Treasury Budget

40. 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 is included at Note 24 to the SG's consolidated accounts for 31 March 2015.

**Table 2: Scottish Administration entities outturn against budget 2014/15**

Entity	Outturn £m	Budget £m	Over/ (Under) spend £m
Scottish Government Consolidated	32,669	33,016	(347)
National Records of Scotland	19	20	(1)
Teachers' and National Health Service Pension Schemes	3,596	3,617	(21)
Office of the Scottish Charity Regulator	3	3	-
Scottish Court Service	75	75	-
Scottish Housing Regulator	5	5	-
<b>Total</b>	<b>36,367</b>	<b>36,736</b>	<b>(369)</b>

Source: Audited Accounts 2014/15.

41. 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

SG'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.

42. In June 2015, the Deputy First Minister and Cabinet Secretary for Finance, Constitution and Economy announced the provisional outturn for 2014/15, reporting that the fiscal DEL budget was underspent by £192 million (£151 million resource and £41 million capital) against a fiscal DEL carry forward cap of £200 million. The SG is able to carry forward the full amount of this underspend into 2015/16 under the Budget Exchange Mechanism.

### Financial position

43. The Consolidated Statement of Financial Position summarises what is owned and owed by the Government. This amount is known as taxpayers' equity – an accounting measurement of the amount invested by taxpayers that has continuing public benefit. It shows how much of this has arisen from the application of funding (including the Scottish Block Grant) and that which has resulted through changes over time in the value of physical assets.

44. The statement of financial position includes:

- items which are owned, have already been funded from revenues and will provide continuing economic benefit in future periods. These increase taxpayers' equity.

## Financial management and sustainability

- items which are owed and expected to require to be funded from future revenues. These decrease taxpayers' equity.
  - an analysis between amounts that will release or require funding within a year and those which will be carried into future years.
45. In public finances, the position at a point in time is helpful but the most valuable insight comes from an analysis of trends in assets and liabilities over time. This provides important information about the impact of past decisions on future budgets and in turn highlights potential risks to financial sustainability. The key items in the balance sheet over the last three financial years are summarised in table 3.
46. There are no significant concerns about the overall financial position. The value of the assets directly owned by the SG has been increasing over the last three years, largely as a result of capital investment. At the same time the value of liabilities directly owed by the SG has stayed broadly consistent.
47. Off-balance sheet means an asset, debt or financing activity is not shown on the statement of financial position under accounting rules. This may be because of the high level of uncertainty involved. This includes potential liabilities, such as unfunded pension schemes, contingent liabilities and Government guarantees. The SG has reported on these in the consolidated accounts, including various contingent assets and liabilities of which only some are able to be quantified, totalling £365 million. Some of these amounts may fall to require to be funded in the future, but this is by no means certain.

**Table 3: Summary of consolidated balance sheets over last 3 financial years**

	At 31/3/15	At 31/3/14	At 31/3/13
	£m	£m	£m
Physical assets	26,698	26,153	25,887
Financial assets	6,879	6,228	5,775
Receivables	1,098	973	921
<b>Total assets</b>	<b>34,675</b>	<b>33,354</b>	<b>32,583</b>
Payables	(4,520)	(4,572)	(4,527)
Financial liabilities	(693)	(698)	(705)
Provisions	(778)	(636)	(720)
<b>Total Liabilities</b>	<b>(5,991)</b>	<b>(5,906)</b>	<b>(5,952)</b>
Net Assets	28,684	27,448	26,631
General Fund	18,822	17,397	16,468
Revaluation Reserve	9,862	10,051	10,163
Taxpayers Equity	28,684	27,448	26,631

Source: Audit Scotland from Audited Accounts 2014/15, 2013/14, 2012/13

## Financial management and sustainability

48. The information provided in the accounts complies with accounting requirements. It is important that the SG can also show how it is managing its overall financial position, and the main components of this. While it provides other outputs in support of its budget, it should provide clearer information about the opportunities and risks that arise from balance sheet and off-balance sheet items, and how these are affecting annual budgets over time.

### Action plan point 1

## Financial management

49. As auditors we consider whether bodies have established adequate financial management arrangements.

50. In examining financial management in the SG we have considered a number of factors, including:

- the 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
- the relationships and liaison with agencies and sponsored bodies
- the effectiveness and transparency of budget setting, monitoring and reporting

- the level of challenge provided by board and audit and risk committee members on significant budget variances
- financial planning for future periods.

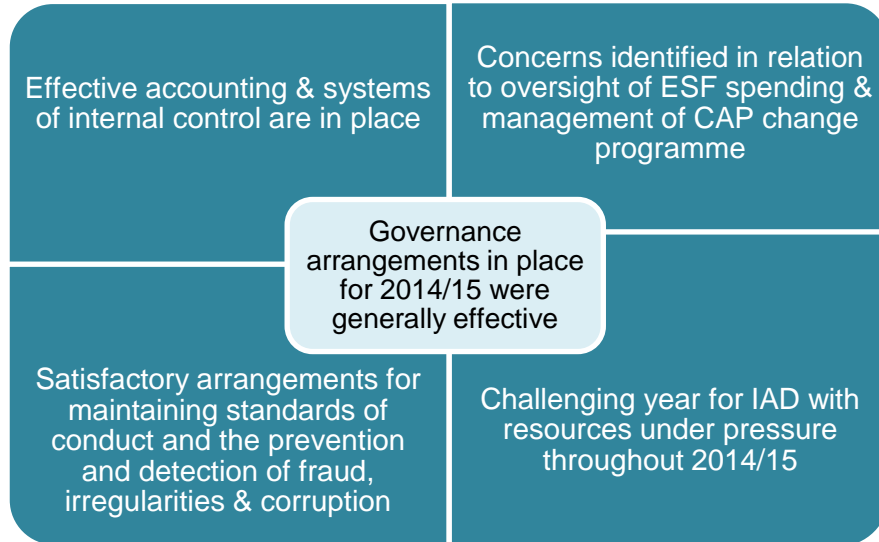
51. Based on our audit work, our review of board and committee papers and through our attendance at audit and risk committees we conclude that the SG has appropriate financial management arrangements in place.

52. Increasing financial devolution means that the SG has increasing responsibilities for financial management. These significant changes require sufficient resources, to establish new arrangements and to operate these alongside existing responsibilities. There are some concerns about available capacity and resourcing for this, which could lead to significant risks to future day-to-day delivery and the ability to implement the effects of the Smith Commission if these are not addressed.

### Action plan point 2



# Governance and transparency



55. The core SG is managed by a Strategic Board, chaired by the Permanent Secretary as Principal Accountable Officer. The Board meets quarterly and is supported in its role by six corporate boards as illustrated below. All boards include non-executive directors as members appointed by the Permanent Secretary.



## Corporate governance

- 53. The SG, through its Principal Accountable Officer is responsible for establishing arrangements for ensuring the proper conduct of its affairs and for monitoring the adequacy of these arrangements.
- 54. The SG has effective overarching and supporting governance arrangements which provide an appropriate framework for organisational decision making. Risk management processes are well-developed and effective.

## Governance and transparency

56. An overarching SG Audit and Risk Committee (SGARC) is supported by four portfolio-aligned audit and risk committees as illustrated below:



57. The audit and risk committees meet at least quarterly to consider relevant matters. There are currently 17 non-executive directors sitting on the SG's audit and risk committees and corporate boards. Their involvement provides challenge and support to senior management and brings an independent perspective.

## Transparency

58. The SG updated and reissued its *On Board* guidance (<http://www.gov.scot/Publications/2015/04/9736/0>), for board members of public bodies in April 2015. This was intended specifically for Non Departmental Public Bodies but it contains important principles. The guidance recognises that the nature and functions of boards vary and states that boards should demonstrate high standards of corporate governance at all times including openness and transparency in decision making. It recommends boards should consider:

- Holding an annual open meeting
- Holding board meetings in public unless there is a good reason not to
- Publishing summary reports and/or minutes of meetings
- Inviting evidence from members of the public in relation to matters of public concern
- Consulting stakeholders and users on a wide range of issues
- Making corporate plans and the annual report widely available.

59. With the further devolution of responsibilities to the SG and Parliament, the SG should review its own arrangements in this area to ensure they remain appropriate.

### Action plan point 3

60. We review the minutes of the Government's boards and committees as part of our routine audit work. This is a key

## Governance and transparency

element in terms of our responsibility to understand SG's business, helping to inform our audit planning. Under auditing standards we require to obtain the Principal Accountable Officer's written assurance that the minutes of all management and other meetings have been made available.

61. There have been delays in receiving minutes of meetings of the SG's management boards. Some progress was made in resolving this during the year. This enabled us to form an opinion on the accounts. SG has yet to establish a system which ensures we have regular and timely access to all minutes of all relevant boards.

### Action plan point 4

## Internal control

62. As part of our audit we reviewed the high level controls in a number of systems fundamental to the preparation of the financial statements. Our objective was to obtain sufficient audit evidence to support our opinion on the financial statements.
63. No material weaknesses in the accounting and internal control systems were identified during the audit which could adversely affect the SG's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements. Our overall conclusion was that key controls were operating effectively.

64. We made a number of recommendations for strengthening controls in some systems, including:
- **SEAS** – an annual review of user access to the ledger system and closer monitoring of authorisation for new user request forms
  - **Grant payments** – ensuring payments are made within agreed authorisation limits.
65. In his annual report on 2014/15, the Head of Internal Audit provided substantial assurance on overall arrangements for risk management, control and governance. This is based on a well established internal audit approach and is the top of four available levels of assessment (Substantial, Reasonable, Limited, Insufficient). This is an improvement in the overall assessment compared to the previous two years.

## Internal audit

66. We carry out an annual assessment of internal audit to determine the extent to which we can place reliance on its work. Our review this year concluded that the SG's Internal Audit Division (IAD) operates in accordance with the Public Sector Internal Audit Standards (PSIAS) and has sound documentation standards and reporting procedures in place.
67. It has been a challenging year for IAD with a shortfall in resources and competing priorities, including increasing requirements relating to EU funding programmes. Resources were under pressure throughout 2014/15 and were a

## Governance and transparency

contributing factor in the postponement or cancellation of over 10% of planned internal audit outputs. Of those public bodies that receive internal audit services from IAD, some raised concerns about the ability of IAD to deliver its agreed plan of work and to provide the assurance they require.

68. The Head of Internal Audit (HIA) left under voluntary exit arrangements at the end of April 2015. A temporary HIA for SG was appointed at the end of July 2015 for an initial period of six months.
69. The temporary HIA is completing a strategic review of the future leadership direction and the requirements of IAD necessary to respond to the changing environment and risks facing SG. This will help define the requirements for the leadership of the internal audit function and the actions necessary to ensure that the service remains effective going forward. A permanent HIA is expected to be appointed in early 2016.
70. With the extension of devolved powers and increased fiscal responsibility, it is critical that the SG's internal audit function is strengthened.

### Action plan point 5

## ICT audit

71. We carried out a high level review of the SG's oversight of its own ICT arrangements. This considered investment in infrastructure and systems, the response to the national

resilience review and strategies and plans for the implementation of digital services. Overall, arrangements for the oversight of existing systems are satisfactory. We have highlighted a number of specific issues relating to ICT improvement programmes elsewhere in this report.

72. SG's Information Services and Information Systems (ISIS) has a Business Continuity Plan (BCP) in place that is well maintained. An exercise to review and refresh the BCP was planned for 2014. This project was deferred to allow resource to be deployed to other priorities. A full BCP exercise is now scheduled for September 2015, the results of which will inform the refresh of the BCP. We will review progress during our planning of the 2015/16 audit.

## European Structural Funds

73. The European Commission (EC) has suspended three European Structural Fund (ESF) programmes for 2007-13<sup>1</sup> and interrupted the remaining programme<sup>2</sup>. This procedure is set out in European Regulations. It aims to avoid EU funds being paid over to member states where there is a risk that European rules on how the Funds are spent may not have

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<sup>1</sup> Lowlands and Uplands Scotland (LUPS) European Social Fund, LUPS European Regional Development Fund (ERDF), Highland and Islands (H&I) European Social Fund.

<sup>2</sup> H&I ERDF.

## Governance and transparency

been followed. Payments by the EC are stopped until it considers such risks have been removed:

- interruptions are relatively common across Europe and are applied where the EC considers that there *may* be a serious deficiency in the functioning of the management and control system. They are usually resolved by member states correcting the expenditure declared as programme expenditure.
  - suspensions represent an escalation where the EC considers that there *is* a serious deficiency in the management and control system or there *is* a serious irregularity in expenditure declared. This requires the SG to provide the EC with further assurances about the extent and effectiveness of controls, and correct declared expenditure.
74. This follows concerns and projected error rates reported by SG Internal Audit Division in their role as Audit Authority for ESF. The auditor highlighted a number of concerns, including the robustness of information being retained by some grant recipients about how ESF funds were being spent.
75. The SG has been working to provide the EC with the assurances it requires about how it and the bodies in receipt of funds are addressing the control weaknesses identified. It has also estimated the correction it thinks is required (which we understand are of the order of £1 million to £2 million).
76. European Regulations provide for member states to make self-corrections to the expenditure they declare for funding. If

the EC is content, available grant may be applied to other eligible projects not previously funded ('re-cycled within the programme').

77. Where the EC does not initially agree that corrections proposed by member states are sufficient, there are provisions for dispute resolution aimed at reaching an agreed position. These are likely to take a number of months to conclude. If ultimately agreement cannot be reached the EC can impose the correction it determines is appropriate. In such circumstances the funding affected cannot be 're-cycled'.
78. The matter remains unresolved, and ESF funding will not resume until the EC is satisfied. In the meantime, the SG continues to make grant payments to approved projects. We will continue to monitor progress and report as appropriate. It is critical that the SG ensures that its arrangements for ESF and those of the other bodies in receipt of funds are fully robust.

### Action plan point 6

## Common Agricultural Policy Futures programme

79. The SG provides financial support to farmers and other rural businesses as part of the Common Agricultural Policy (CAP). The 2014/15 accounts include expenditure of £62 million on the Futures Programme - an IT enabled change programme to implement CAP reforms in Scotland. The programme is costing

## Governance and transparency

significantly more and taking longer to implement than planned. Capital expenditure in 2014/15 was £50 million, £32 million more than budgeted. The total forecast cost of the programme is now £178 million, 74 per cent above the amount included in the original business case. The largest element of spend relates to the IT delivery partner, £45 million in 2014/15, more than twice the amount forecast.

80. The programme has proved significantly more complex and challenging than anticipated, with limited availability of in-house expertise and experience. The programme team has had to prioritise the delivery of IT systems to ensure CAP compliance. As a consequence, other intended benefits of the programme have not yet been delivered. The SG is improving internal processes, including those for making payments to the delivery partner, following recommendations by internal and external audit. Work is ongoing to deliver the programme and further IT software releases are scheduled throughout 2015 and 2016.
81. There remain significant risks to successful delivery. The timescale for implementing the remaining elements of the IT system for direct support payments is now very tight. Any inadequacies in the control system implemented are likely to have significant financial consequences arising from the potential disallowance of European funding.
82. The Futures Programme involves substantial change; the complexity of the CAP scheme, the regulatory requirements and the timescales for implementation add further challenges.

The programme has carried a significant level of risk from the outset, and risks will remain until full implementation and beyond. Successful implementation is key to ensuring timely and accurate payments to farmers and other rural businesses.

### Action plan point 7

83. The Auditor General reported on the Futures Programme in October 2014 to draw Parliament's attention to the ongoing risks to delivery and overall value for money. She provided an update to Parliament in April 2015 and stated that we would keep CAP Futures under review as part of the annual audit process. We will continue to assess progress and will report further to management as appropriate and to the Scottish Parliament's Public Audit Committee in Spring 2016.

## Arrangements for the prevention and detection of fraud

84. We assessed the arrangements for the prevention and detection of fraud. This included reviewing SG's whistleblowing policy and counter fraud policy.
85. The SG Counter Fraud Forum was set up in 2013/14 with the aim of improving counter fraud awareness and practices across Scotland. Membership of the group includes COSLA, the Department of Work and Pensions, Trading Standards, Scottish Local Authorities Investigators Group & Chief Internal Auditors, Audit Scotland, the Crown Office and Procurator Fiscal Service, Police Scotland (Counter Corruption Unit),

## Governance and transparency

National Services Scotland (NHS), Student Awards Agency Scotland and the Scottish Public Pensions Agency. This initiative has continued to develop through 2014/15 with an annual counter-fraud conference now established, regular forum meetings and the publication of an agreed strategy in June 2015, [Protecting Public Resources in Scotland](#).

86. The SG has taken steps to protect against cyber threats to its computer systems and services. A Cyber Strategy has been established to increase awareness and share knowledge, and continuing vigilance in this area is critical.
87. We conclude that there are effective arrangements in place to help prevent and detect fraud.

### National Fraud Initiative in Scotland

88. The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise led by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify circumstances (matches) that might suggest the existence of error or fraud.
89. We assess the arrangements that bodies have put in place to prevent and detect fraud, including how they approach the NFI exercise itself. Audit findings will feed into the national report on NFI which Audit Scotland will publish in June 2016.

90. As part of this year's NFI exercise, the SG submitted payroll and creditor data on time. We have no concerns over the SG's engagement with the NFI exercise at this early stage. We will follow up progress on match investigation and the reporting of results by the SG in 2015/16.

### Arrangements for maintaining standards of conduct and the prevention and detection of corruption

91. We have reviewed the arrangements in place to maintain standards of conduct including the Staff Handbook and Civil Service and Members' Codes of Conduct. There are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.
92. Based on our review of the evidence we concluded that there are appropriate arrangements in place to help prevent and detect corruption and we are not aware of any specific issues that we need to record in this report.

# Performance and value for money

93. This section summarises key themes drawn from our reviews of performance and value for money. Since November 2014, we have published eight performance audit reports, which contained findings or recommendations of relevance to the SG. These are listed in Table 4 and summarised in [appendix III](#).
94. The Scottish Parliament's Public Audit Committee (PAC) considers performance audit reports which are published on behalf of the Auditor General for Scotland (AGS). The PAC can take a range of actions such as noting the report, referring it to another committee for consideration, asking the audited bodies concerned to provide further information, or conducting an inquiry. In many instances the PAC will ask the SG to detail how it intends to implement any recommendations made.
95. We also undertake local review of the SG's arrangements to manage performance in key areas. As part of our 2014/15 audit, we reviewed how the SG manages budgetary controls and financial risks in respect of its relationships with agencies and sponsored bodies. We also carried out a review of alternative sources of capital financing offered by the SG to other bodies. We are currently completing the audit work and reports on these topics will be issued to management in due course.

**Table 4: Performance audit reports published in last year**

Title	Publication date
Community Planning: Turning ambition into action	November 2014
Preparation for the implementation of the Scotland Act 2012	December 2014
The Scottish Government's purchase of Glasgow Prestwick Airport	February 2015
Superfast broadband for Scotland: a progress report	February 2015
Commonwealth Games 2014: third report	March 2015
Update on developing financial reporting	March 2015
The Scottish Fire and Rescue Service	May 2015
Managing ICT contracts in central government: an update	June 2015

Source: Audit Scotland



### Financial sustainability and reporting

96. All of our recent and current performance audit activity is set against the challenging financial environment in which public bodies are operating. All bodies face increasingly difficult choices in reducing spending while maintaining service standards and meeting rising demand and public expectation of services.
97. In this challenging financial environment, the SG needs to ensure that budgetary control is fully effective and maximises the value from the funding which is available. We reviewed the operation of budgetary controls and the management of financial risk, in respect of relationships with sponsored bodies and the impact this has on the overall SG budget and the effective use of resources. We concluded that overall budgetary control arrangements are reasonable. We are currently preparing a detailed report for management which will include areas where there is scope for improvement.
98. With reducing capital budgets, public sector bodies are looking at new ways to fund capital expenditure, such as Tax Increment Financing (TIF) and the Growth Accelerator Model (GAM). These funding models are complex and involve a range of public and private stakeholders. We reviewed the management and long-term planning associated with these initiatives as well as the potential impact on disclosures in the SG's consolidated financial statements. Overall, we concluded that the SG has adequate systems in place to monitor and assess commitments and longer-term affordability of these initiatives and that disclosures in the accounts are appropriate. We are currently preparing a detailed report which we will issue to management in due course.
99. A recurring theme from performance audits is the importance of longer-term financial strategies. These help clarify the financial sustainability of an organisation over an extended period and can help identify problems with affordability at an early stage.
100. In our report on the [Scottish Fire and Rescue Service](#), for example, we highlighted that due to future cost pressures and likely reductions in funding, the Service faced a potential funding gap of £42.7 million in 2019/20. We recommended that the Service agreed a long-term financial strategy by the end of March 2016, developed from evidence-based options for achieving savings. We also recommended that the Service:
- agrees long-term strategies in the main areas that will contribute to savings and form the basis of the long-term financial strategy, including workforce, asset management and procurement
  - reviews how it can deliver a sustainable national service that meets current and future demands in the context of decreasing budgets.
101. We concluded that completing these reviews and developing a long-term (five to ten year) financial strategy were matters of urgency for the Scottish Fire and Rescue Service.

## Performance and value for money

102. With the provisions of the Scotland Act 2012 now taking effect and the likelihood of further financial powers for the Scottish Parliament the case for comprehensive, transparent and reliable financial reporting has never been stronger. Our [Update on developing financial reporting](#) highlighted the significant changes in the environment for public finances in Scotland and that transparent financial reporting is more important than ever. We concluded that consolidated Scottish public sector accounts would provide a better understanding of the financial position and noted that the SG is further developing its approach to financial reporting.

## Workforce skills and capacity

103. One consequences of reducing budgets is the reduction in the number of people working in the public sector. A recurring theme in our reports is the need to ensure that sufficient skills and capacity are maintained to support day to day business, accommodate new responsibilities and deliver initiatives designed to secure efficiencies and improvement.

104. Our report [Managing ICT Contracts in central government: An update](#) reviewed what progress the SG and central government bodies had made against the recommendations in our 2012 report on managing ICT contracts (August 2012). In relation to workforce and capacity we found that public sector bodies still experience difficulty identifying, recruiting and retaining the range of skills required to manage ICT programmes. We noted that the SG had introduced a central

government Digital Transformation Service (DTS) to help address the skills issue, and to support bodies going forward.

105. In [Superfast broadband for Scotland: A progress report](#) we recommended that the SG and Highlands and Islands Enterprise keep staffing levels and workloads under review and alter the skills mix and number of staff when needed, to ensure that project teams are able to fulfil their contract management and monitoring roles well.

## Performance management

106. A recurring theme in our performance audit work is the need for effective arrangements to monitor improvements in services and processes. We identified further evidence in our performance audit work this year.

107. Our report [Community planning: turning ambition into action](#) assessed progress locally and nationally and identified opportunities for further improvement. The report recommended that the SG should hold central government bodies and the NHS to account more consistently for their performance within CPPs. It also recommended that the SG and the Convention of Scottish Local Authorities (COSLA) develop a national framework for assessing and reporting progress in improving community planning, and work with other bodies to establish and coordinate a programme of targeted support for CPP's.

## Performance and value for money

108. In [Superfast broadband for Scotland: A progress report](#) we recommended that the SG and Highlands and Islands Enterprise further develop their performance measurement frameworks, by including measures that address speeds delivered, the unit cost of providing access to superfast broadband to each premise and levels of take-up, as well as measures that allow benchmarking with other countries' implementation of superfast broadband. We also recommended that both bodies should report publicly on these measures each year.
109. Our report [The Scottish Government's purchase of Glasgow Prestwick Airport](#) recommended that public bodies make sure that they have appropriate skills for the preparation of business cases. This should include the ability to challenge the findings provided by external advisers.

## Leadership and governance

110. A recurring theme in our reports is the need for public bodies to improve leadership and governance; and we found scope for improvements in this year's performance audit work.
111. For example, our report *Community planning: turning ambition into action* found renewed energy nationally and locally to improving community planning, although leadership, scrutiny and challenge are still inconsistent. There was ambiguity about the extent to which the focus of community planning should be

on local needs or about delivering national priorities, and SG guidance was not clear enough about the specific role that CPPs should play in the implementation of public service reform programmes.

## Disseminating lessons learned

112. Our reports this year have highlighted opportunities for sharing experience of managing and delivering complex initiatives and projects.
113. For example, our report [Commonwealth Games 2014 - final report](#) recommended that the SG and Glasgow City Council disseminate the lessons learned from Games delivery and evaluation of legacy in order to inform future public sector projects, including lessons learned from: partnership working, transport planning, safety and security planning; and governance arrangements
114. Similarly, our report [Managing ICT Contracts in central government: An update](#) recommended that, to help improve the management of ICT programmes, the SG should develop a more detailed approach to reviewing lessons learned, and use interactive and innovative ways to disseminate them, so that bodies can learn from other projects. We suggested this could include using workshops, case studies, and further developing online resources.

# Outlook

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115. The Scottish public sector continues to experience significant financial constraints in providing current levels of service within the resources available. The draft 2015/16 budget set out the Government's spending priorities alongside anticipated revenues from devolved taxes and planned borrowing using powers set out in the Scotland Act 2012 which came into force from 1 April 2015.

116. This section outlines some of the financial challenges facing the Government which are of continuing audit interest.

## New financial powers

117. The consolidated accounts are a critical component of SG's accountability for the use of public money. These accounts and others that sit alongside them, such as the Scottish Consolidated Fund accounts, and will become increasingly important as the new financial powers in the Scotland Act 2012 come into effect.

118. The SG recognises the need to improve and enhance financial reporting as a result, and is preparing proposals for this. Any changes to the consolidated accounts and related accounts will start to take effect from 2015/16.

119. Following the referendum on Scottish independence in September 2014, the UK Government established the Smith

Commission to consider what further powers should be devolved to the Scottish Parliament. The Commission published its report in November 2014 and in May 2015, the UK Government introduced the Scotland Bill 2015 to the UK Parliament, which is based on the recommendations made by the Smith Commission. The Bill proposes substantial new financial powers for the Scottish Parliament, including:

- the power to set income tax rates and bands on earned income and to retain the tax collected from Scottish taxpayers
- responsibility for some social security and employability powers
- assigning a share of the Value Added Tax (VAT) collected in Scotland to the SG's budget
- devolving two further taxes to the Scottish Parliament, to replace the UK-wide air passenger duty and aggregates levy.

120. A new fiscal framework for Scotland will be agreed between the Scottish and UK Governments to accompany the further powers included in the Scotland Bill 2015. We are continuing to monitor progress in this important area and will report publicly, as the SG develops its plans and as the new financial powers are introduced. Financial management and reporting arrangements will be a key part of this.

## Outlook

### National accounts classification

121. The Office for National Statistics (ONS) assesses bodies and transactions against international rules<sup>3</sup> to decide how they should be classified in the National Accounts statistics. The National Accounts statistics are used by HM Treasury to inform guidance on UK fiscal budgets. Publicly classified capital projects currently require HM Treasury budget cover (capital DEL). For privately classified capital projects, HM Treasury revenue DEL budget is required to cover the spending over the lifetime of the contract.
122. ONS is considering a number of Scottish Non Profit Distributing (NPD) projects. In relation to the Aberdeen Western Peripheral Route (AWPR) project, ONS concluded in July 2015 that it should be classified as a public sector project. The Scottish Futures Trust is in discussions with ONS and other parties to clarify the basis for this classification with a view to re-classification as private sector.
123. Two other NPD projects will be reviewed – Dumfries and Galloway Royal Infirmary and the Edinburgh Royal Hospital for Sick Children. There is a risk that these may also be classified as public sector, with further potential implications for capital budgets. In addition, there is a risk of potential delays to other projects in the capital programme in the short term.

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<sup>3</sup> *European System of Accounts 2010*, European Commission 2010

124. The SG recognises the risk and is taking action to mitigate this. It is currently in discussion with HM Treasury on contingency arrangements and how these will be applied in practice. The SG will need to balance the financial and governance implications of its mitigating actions.
125. Looking beyond this, if the AWPR and other NPD projects are classified as public sector these capital projects will need to be managed within HM Treasury annual capital budgets. If this is the case, the SG will have less capital DEL budget to spend elsewhere and will face a choice of progressing fewer capital projects, or finding alternative ways of funding them.
126. The accounting treatment of NPD projects does not change upon classification. Such projects are treated within the accounts as ‘on-balance sheet’ capital investment and will continue to do so regardless of ONS classification. We are content that the SG has applied the correct accounting treatment in preparing the consolidated accounts.

### Revisions to the Financial Reporting Manual (FReM)

127. The financial statements are prepared in accordance with the Government financial reporting manual (FReM). Two significant revisions will apply from 2015/16:
- Adoption of IFRS13 *Fair value measurement* for the first time – this also includes IAS 16 and IAS 38 adaptations.
  - Simplification and Streamlining Project – changes to the form and content of the annual report and accounts.

## Outlook

### 128. **International Financial Reporting Standards (IFRS)13 Fair value measurement:**

sets out the requirements for assets to be valued at fair value and is applied in full by the FReM only to assets that are not held for their service potential (i.e. investment properties and assets held for sale). It also applies to operational assets which are surplus to requirements where there are no restrictions on disposal which would prevent access to the market.

129. IFRS 13 does not apply to operational assets which are in use delivering front line services or back office functions, and surplus assets with restrictions on their disposal. These will be valued in accordance with the adaptations to *IAS (International Accounting Standard) 16 property, plant and equipment*.

130. **Restructuring of the annual report:** the 2015/16 FReM has been re-written to require the annual report and accounts to include:

- a performance report which will give a fair, balanced and understandable analysis of performance and will include an overview section and a performance analysis section.
- An accountability report incorporating the following three main sections:

- corporate governance report consisting of a directors' report, a statement of the Accountable Officer's responsibilities and a governance statement
- remuneration and staff report which will cover a number of prescribed disclosures including remuneration policy, payments to directors, staff numbers and sickness absence rates
- parliamentary and accountability report which will include information on the regularity of expenditure and the independent auditor's report

131. The SG will consider the amendments to the FReM when preparing the SG Annual Report as part of the 2015/16 consolidated accounts. This will require a more extensive analysis in the annual report of the SG's overall performance and development during the year, drawing on relevant performance data including key financial information from the financial statements. A more rounded account of the Government's overall performance as part of an expanded Annual Report would enhance reporting to the Scottish Parliament and the public, and help strengthen accountability and scrutiny.

# Appendix I – Significant audit risks

The table below sets out the financial statement audit risks, how we addressed each risk and our judgement in arriving at our opinion on the financial statements.

Audit Risk	Assurance procedure	Results and conclusions
<b>Financial audit issues</b>		
<p><b>Referendum expenditure</b>  <i>(Statement of Comprehensive Net Expenditure)</i></p> <p>We are required to confirm that government expenditure is in line with relevant legislation and regulations. The referendum on Scottish independence was a unique and significant event and the Scottish Government must demonstrate that expenditure associated with it is a permitted use of public funds.</p>	<ul style="list-style-type: none"> <li>• Review as part of the annual audit</li> <li>• Discussions with key officers and review relevant documentation.</li> </ul>	<p>A sample of referendum expenditure items was tested as part of our work on the Finance, Constitution and Economy (FCE) portfolio. No issues were identified.</p>
<p><b>Student loans</b>  <i>(Statement of Comprehensive Net Expenditure, Statement of Financial Position, Statement of Cash Flows, Notes 8, 14 and 21)</i></p> <p>Student loans figures within the financial statements are arrived at through use of estimates. The future cash-flows expected in this area are inherently uncertain and subject to significant fluctuations.</p> <p>The narrative within the accounts must accurately reflect this.</p>	<ul style="list-style-type: none"> <li>• Review student loans disclosures during financial statements audit</li> <li>• Discussions during the year with relevant finance staff</li> </ul>	<p>We reviewed disclosures relating to student loans as part of our year end testing.</p> <p>The accounting policies contain narrative at section 1.7 outlining the significant uncertainties around actual likely costs and the estimations used when calculating figures within the financial statements.</p> <p>We have reviewed and are content with this disclosure and accounting treatment.</p>

## Appendix I – Significant audit risks

Audit Risk	Assurance procedure	Results and conclusions
<p><b>Information provided by MyCSP</b> <i>(Remuneration Report)</i></p> <p>There have been problems with the information supplied by MyCSP to support pensions disclosures across the central government sector in Scotland.</p> <p>The information received from MyCSP for inclusion in the Scottish Government remuneration report must be accurate.</p>	<ul style="list-style-type: none"> <li>• Take account of any work by the National Audit Office at a UK level</li> <li>• Review remuneration report as part of financial statements audit</li> <li>• Perform reasonableness checks on data provided by MyCSP</li> </ul>	<p>No issues were identified on checks performed on MyCSP information as part of our review of the Remuneration Report.</p> <p>We did not experience the same scale of issues encountered in previous years with information provided by MyCSP.</p>
<p><b>Equal Pay Claims</b> <i>(Statement of Financial Position)</i></p> <p>As changes in the position on equal pay are expected on the basis of discussions underway, it should be possible for the Scottish Government to prepare a sufficiently reliable estimate of probable liabilities arising from equal pay claims in the NHS.</p>	<ul style="list-style-type: none"> <li>• Review position as part of financial statements</li> </ul>	<p>Equal pay claims have now been included as a provision in the accounts of NHS boards as a reasonable assessment of the potential liability is now possible.</p> <p>We are content that the amounts recognised are reasonable.</p>
<p><b>Open cast mines</b> <i>(Statement of Financial Position, Note 19)</i></p> <p>Dis-used open-cast mines across Scotland now require significant restoration work and discussions about potential funding sources are ongoing. Any liability that falls on the Scottish Government may require disclosure in its accounts.</p>	<ul style="list-style-type: none"> <li>• Attendance at the Enterprise and Environment Audit and Risk Committee</li> <li>• Inquiry of relevant Scottish Government staff and review of documentation</li> </ul>	<p>No significant developments have been made which would lead to a liability for the Scottish Government in 2014/15; however, we will continue to keep under review in 2015/16.</p>



## Appendix I – Significant audit risks

Audit Risk	Assurance procedure	Results and conclusions
<p><b>CNORIS</b> <i>(Statement of Financial Position, Notes 14)</i></p> <p>Health bodies in Scotland are required to participate in the Clinical Negligence and other Risk Indemnity Scheme (CNORIS). In 2013/14 we highlighted an accounting issue relating to CNORIS which resulted in changes to the accounts. It is important that these changes are carried through into 2014/15 accounts and the actions of a full review of the scheme undertaken in 2014/15 are implemented.</p>	<ul style="list-style-type: none"> <li>• Current disclosure contained within the accounting policies and relevant note within the financial statements</li> <li>• Scottish Government review and resulting actions.</li> </ul>	<p>We reviewed guidance issued to NHS Boards and reviewed the methodology for reasonableness.</p> <p>We tested the consolidation adjustments and reviewed the relevant disclosures on receipt of the Scottish Government consolidated accounts requesting changes where necessary.</p> <p>We are content with the accounting treatment.</p>
<p><b>Revenue and expenditure recognition</b></p> <p>ISA 240 presumes a risk of fraud in relation to revenue recognition in the financial statements which is extended to include expenditure recognition.</p>	<ul style="list-style-type: none"> <li>• Obtain an understanding of key controls around the recognition and accounting for income and expenditure</li> <li>• Testing transactions around the year-end</li> <li>• Monitor budget control, monitoring and reporting</li> <li>• Consider internal audit reports</li> </ul>	<p>We tested controls in this area and tested transactions around the year-end. We examined budget control, monitoring and reporting processes and considered internal control findings.</p> <p>The results of this audit work were satisfactory.</p>

## Appendix I – Significant audit risks

Audit Risk	Assurance procedure	Results and conclusions
<p><b>Management override of controls</b></p> <p>ISA 240 presumes a risk of fraud to the financial statements from potential management override of internal controls.</p>	<ul style="list-style-type: none"> <li>• Test the appropriateness of journal entries and other adjustments to the financial statements; review the reasonableness of any accounting estimates; examine any significant transactions outside the normal course of business</li> <li>• Monitor internal audit reports</li> <li>• Consider the results of controls testing</li> </ul>	<p>We carried out testing of internal controls and journal entries and reviewed accounting estimates and unusual transactions.</p> <p>We monitored internal control reports.</p> <p>The results of this audit work were satisfactory.</p>
<p><b>Wider audit issues</b></p>		
<p><b>Budgetary control</b></p> <p>It is important that financial governance and control arrangements in respect of agencies and sponsored bodies operate effectively. There is scope to increase the clarity and transparency in respect of in-year budget transfers to ensure that these arrangements reflect the most efficient and effective use of resources.</p>	<ul style="list-style-type: none"> <li>• Review the operation of budgetary controls and the management of financial risk, in respect of relationships with agencies and sponsored bodies and the impact this has on the overall Scottish Government budget.</li> </ul>	<p>We have carried out a review of budgetary control and will issue a report in October 2015 containing our observations and recommendations.</p> <p>Overall, we concluded that budgetary control arrangements are reasonable.</p>

## Appendix I – Significant audit risks

Audit Risk	Assurance procedure	Results and conclusions
<p><b>Financing capital and investment</b></p> <p>Alternative funding models involving a number of public and private stakeholders are being used to fund capital expenditure.</p> <p>Liabilities that sit with the SG must be accounted for and disclosed correctly and any longer-term commitments included in budgets.</p>	<ul style="list-style-type: none"> <li>• Review of financial statements and further audit testing as required</li> <li>• Review of long term plans.</li> </ul>	<p>We carried out a local review considering oversight of the alternative sources of capital financing being offered by the Scottish Government to other bodies.</p> <p>We found that the Scottish Government has adequate arrangements in place for management of these commitments. Systems exist to assess long-term affordability and build assumptions into budgets as part of the Spending Review process.</p>
<p><b>Increased fiscal autonomy</b></p> <p>The new devolved taxes come into effect from April 2015. Other significant fiscal developments are contained in the Bill that will lead to the implementation of the Smith Commission Agreement.</p> <p>Revenue Scotland needs to be ready to administer effectively the devolved taxes from April 2015.</p> <p>Disclosure of Revenue Scotland expenditure is material by nature.</p>	<ul style="list-style-type: none"> <li>• Review of Revenue Scotland governance arrangements</li> <li>• Review of Revenue Scotland control systems</li> <li>• Review of Revenue Scotland accounting systems</li> <li>• Review as part of the audit of Scottish Government’s financial statements</li> </ul>	<p>Revenue Scotland has been collecting the new devolved taxes since April 2015.</p> <p>We have reviewed the governance arrangements and reviewed minutes of meetings.</p> <p>We tested monetary disclosures in the Scottish Government consolidated accounts, and reviewed narrative disclosures seeking additional disclosures as necessary.</p> <p>We are content the approach adopted was reasonable in 2014/15.</p>

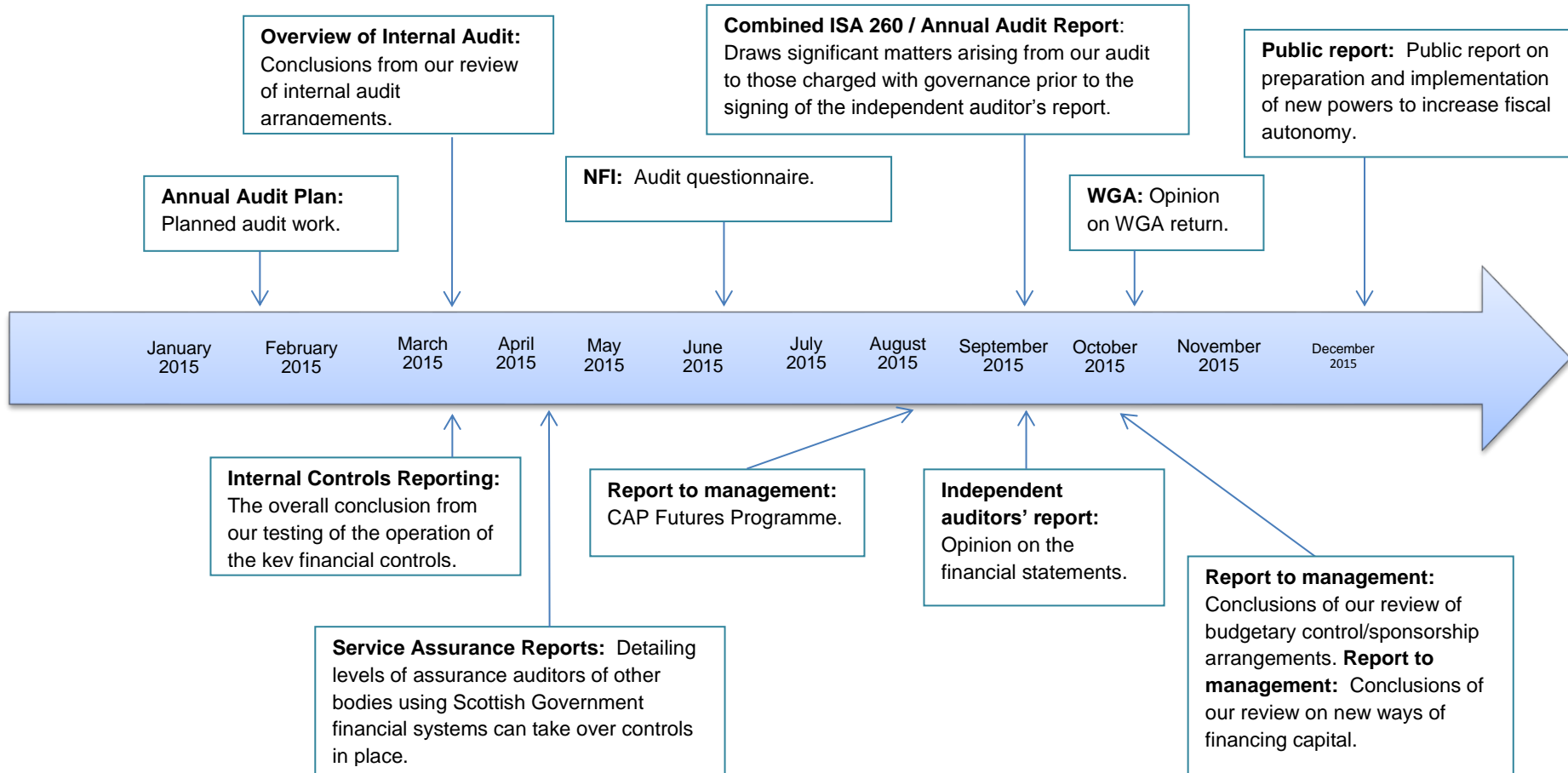
## Appendix I – Significant audit risks

Audit Risk	Assurance procedure	Results and conclusions
<p><b>CAP Futures programme</b></p> <p>This programme aims to implement new IT systems and business change to support the introduction of new Common Agricultural Policy funding programmes. It is important that regulatory requirements are met to avoid financial consequences and to ensure that value for money is secured from the new system.</p>	<ul style="list-style-type: none"> <li>• Review of progress</li> <li>• Review of minutes and papers</li> <li>• Review as part of annual audit, with reference to other outputs included report to management and update to PAC.</li> </ul>	<p>Following on from our earlier audit work we assessed progress to April 2015. The programme has carried a significant level of risk from the outset and risks will remain until full implementation and beyond. We will continue to assess progress and report further to management as appropriate, and to the Scottish Parliament’s Public Audit Committee in Spring 2015.</p>
<p><b>Organisational capacity</b></p> <p>The Scottish Government needs to have sufficient staff with the appropriate skills to deliver planned outputs and services.</p>	<ul style="list-style-type: none"> <li>• Review of People and Resources Board minutes to ensure that capacity and other workforce planning issues are recognised and appropriate management arrangements have been established.</li> <li>• Consideration and review of workforce planning processes.</li> </ul>	<p>We have reviewed minutes of the People and Resources Board. We reviewed financial capacity and we found no evidence of significant skills or knowledge gaps in key finance posts. SG acknowledge the need to maintain sufficient skills and capacity to support day to day business, accommodate new responsibilities and deliver initiatives designed to secure efficiencies and improvements.</p>

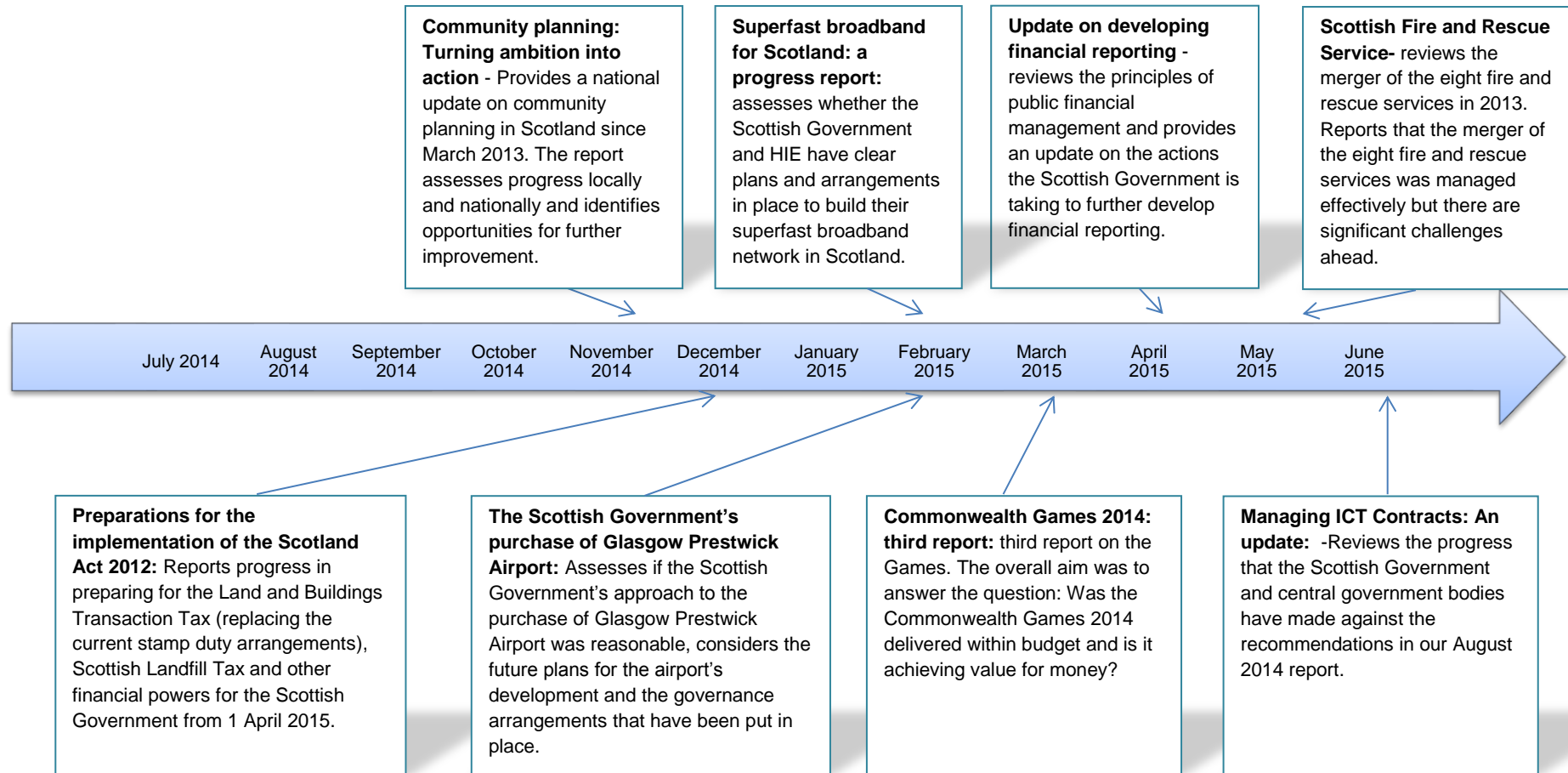
## Appendix I – Significant audit risks

Audit Risk	Assurance procedure	Results and conclusions
<p><b>Internal audit</b></p> <p>Resourcing pressures may lead to planned internal audit work being delayed or postponed. This will impact on the level of assurance provided by internal audit to the Audit &amp; Risk Committees and the Principal Accountable Officer.</p>	<ul style="list-style-type: none"> <li>• Attendance at Audit &amp; Risk Committee, consultation with external auditors at other government bodies</li> <li>• Review of internal audit progress reports, plans and reports</li> <li>• Review of internal audit working papers where placing formal reliance on their work</li> <li>• Regular engagement with internal audit</li> </ul>	<p>Our audit work has confirmed that it has been a very challenging year for Internal Audit. Resourcing pressure was a contributing factor in over 10% of planned outputs being cancelled or postponed. The Head of IAD departed in April 2015. Recruitment for a permanent Head has commenced. We remain concerned about the resources available to Internal Audit and the impact on their programme of work and this is reflected in our action plan.</p>

# Appendix II – Summary of local audit reports 2014/15



# Appendix III – Summary of national reports 2014/15



# Appendix IV – Action plan

No/Para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
1/48	<p><b>Financial position transparency</b></p> <p>The information supporting the statement of financial position complies with accounting requirements. There is limited commentary on how the SG is managing its overall financial position.</p> <p><b>Risk</b></p> <p>The implications of balance sheet items and the overall financial position are not understood by Parliament and other users of the accounts.</p> <p><b>Recommendation</b></p> <p>SG should review the commentary it provides about the financial position in future years' annual reports and other reporting arrangements. This could include a discussion of the opportunities and risks arising from balance sheet and off-balance sheet items, and the implications for budgets over time.</p>	<p>The SG will review the commentary in the accounts for the current year and information provided in other financial documents.</p>	<p>Head of Corporate Reporting</p>	<p>By March 2016</p>



Appendix IV – Action plan

No/Para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
2/52	<p><b>Financial devolution – capacity and resources</b></p> <p>Increasing financial devolution is leading to increased responsibility for financial management, at a time of growing resource pressures.</p> <p><b>Risk</b></p> <p>SG may not have sufficient capacity or resources to effectively manage its increased financial responsibilities and implement the provisions of the Smith Commission, alongside business as usual.</p> <p><b>Recommendation</b></p> <p>SG should satisfy itself that it has sufficient capacity and resources to deliver the changes required for greater fiscal responsibilities and related financial management alongside existing responsibilities.</p>	<p>The Fiscal Capability programme oversees the introduction of the new financial powers in the Scotland Act. The impact on resourcing is a significant consideration in the planning for the changes associated with the new powers. The changes take place on a stepped basis so capacity is kept under review, and any growth is proportionate to need.</p> <p>The Scottish Government’s SG2020 programme has a key workstream to ensure that as it manages within an ever-tightening budget to match resources to priorities.</p>	Director of Financial Management	First assessed by March 2016

## Appendix IV – Action plan

No/Para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
3/59	<p><b>Openness and transparency of decision making</b></p> <p>The SG has updated its guidance for board members of public bodies which contains important principles which are relevant to SG. As further responsibilities are devolved to SG and to the Scottish Parliament, SG must ensure that it can demonstrate appropriate openness and transparency in the operation of its boards and committees.</p> <p><b>Risk</b></p> <p>SG may not be able to demonstrate it is sufficiently open and transparent.</p> <p><b>Recommendation</b></p> <p>SG should review its current arrangements for openness and transparency of organisational decision making against relevant best practice.</p>	<p>The On Board guidance is designed to support board members of Non Departmental Public Bodies and is therefore not directly transferable to the Scottish Government. The Scottish Government does however recognise the value of the underlying principles and is publicly committed to open government and where possible proactively publishes information and considers consultation as an essential and important aspect of Scottish Government working methods. This is demonstrated in our proactive release of the Agenda and Minutes of the Strategic Board and the launch of the Scottish Government’s new online consultation hub – Citizen Space – that will provide access to material, and help facilitate engagement with stakeholders and wider civic society across the range of policy areas that the government is responsible for.</p>	Head of Cabinet, Parliament and Governance Division	SG aims to publish Strategic Board Papers quarterly in arrears

## Appendix IV – Action plan

No/Para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
4/61	<p><b>Minutes of management boards</b></p> <p>There have been delays in providing minutes of the management boards for consideration in the course of the audit. Although some progress has been made in resolving this issue, SG does not have a systematic approach to providing minutes as they are approved.</p> <p><b>Risk</b></p> <p>Restrictions are placed on the conduct of the audit.</p> <p><b>Recommendation</b></p> <p>SG should review its processes to ensure that approved minutes of all relevant boards are provided to its external auditor in a timely manner.</p>	<p>Governance &amp; Risk and Cabinet &amp; Corporate Secretariat will review the protocol between the Scottish Government and Audit Scotland, to examine how requests are made, processed and answered. This review will look at what corporate information is provided on a standard basis and culminate in a systematic, clear approach outlined for the conduct of audits and the supply of related information.</p>	<p>Heads of Governance &amp; Risk and Cabinet &amp; Corporate Secretariat</p>	<p>By Jan 2016</p>
5/70	<p><b>Resourcing of Internal Audit</b></p> <p>The Internal Audit Division (IAD) has had another challenging year with resources under pressure throughout 2014/15. The Head of IAD left under voluntary exit arrangements in April 2015 and a temporary Head has been appointed who will identify the requirements of a permanent Head. This work is continuing.</p>	<p>DG Finance has commissioned a Strategic Review of Internal audit which is already well advanced and lead by a high level experienced individual sourced from an outside firm. The review is focussing on the future leadership requirements, business delivery model for IAD and the other actions necessary to ensure that the internal audit function remains effective and</p>	<p>Head of Internal Audit</p>	<p>March 2016</p>

Appendix IV – Action plan

No/Para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
	<p><b>Risk</b></p> <p>Resourcing and leadership uncertainty mean that there is an ongoing risk that:</p> <ul style="list-style-type: none"> <li>• Audit work will be delayed or cancelled</li> <li>• Control weaknesses with the organisation are not identified</li> <li>• Any postponed work will impact on the level of assurance provided</li> <li>• Expectations of Executive Agencies will not be met.</li> </ul> <p><b>Recommendation</b></p> <p>Following conclusion of the current review, SG should ensure that the capacity and capability of IA is sufficient.</p>	<p>well placed to meet future challenges.</p> <p>The process for a new permanent Head of Internal Audit has already commenced with an appointment expected to be in place by early 2016. The new HIA will drive implementation of the Strategic Review.</p> <p>The risk of operational capacity and required expertise is constantly monitored by the audit senior management team and resource requirements are an integral part of the strategic review noted above. In the meantime we have filled vacant posts and employed qualified contractors to maintain delivery of the audit programme.</p> <p>In accordance with our risk based planning approach decisions on which reviews to defer are taken on a on a risk and priority basis. All reviews under this category are agreed with respective Audit Committees and the impact on annual assurance is assessed prior to decisions being taken.</p>		

## Appendix IV – Action plan

No/Para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
6/78	<p><b>European Structural Funds</b></p> <p>All of the 2007-13 ESF programmes are currently in suspension or interruption.</p> <p><b>Risk</b></p> <p>If the EC element of ESF funding is withheld for a prolonged period this may mean that some funding is unable to be recycled and is lost. Any continuing control deficiencies may lead to further intervention.</p> <p><b>Recommendation</b></p> <p>The SG should continue to work with other public bodies to ensure that underlying concerns about the control system and retention of documentation are promptly addressed.</p>	<p>The Scottish Government is working closely with organisations and with the European Commission. Action is in hand to:</p> <ul style="list-style-type: none"> <li>• Implement the Action Plan agreed with the Commission to address the underlying issues in the 2007-13 programmes.</li> <li>• Develop and implement additional risk based management and control measures for the 2014-20 programmes, incorporating these into the overall control system.</li> <li>• Target funding through organisations with the capacity and capability to manage the audit and procurement requirements successfully.</li> <li>• Ensure ESF Management and Internal Audit's responsibilities dovetail efficiently.</li> </ul>	Deputy Director, European Structural Funds and Director for Economic Development.	June 2016

Appendix IV – Action plan

No/Para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
7/82	<p><b>CAP Futures programme</b></p> <p>SG is working to implement the Futures Programme – an IT based programme to implement the European Union’s Common Agricultural Policy reforms in Scotland. The programme is costing significantly more and taking longer to implement than planned.</p> <p><b>Risk</b></p> <p>There are ongoing risks to achieving successful delivery of this complex and challenging programme and to overall value for money. Successful implementation is key to ensuring accurate and timely payments to farmers and other rural businesses.</p> <p><b>Recommendation</b></p> <p>SG should ensure that issues identified in respect of its CAP Futures programme are addressed effectively.</p>	<p>The Futures Programme has already delivered key elements of the new CAP including the ability for customers to apply for a range of schemes and some of the capability to support application processing.</p> <p>While delivery remains challenging, the Programme continues to actively prioritise delivery to support CAP compliance and business mitigations are being developed and implemented as appropriate.</p> <p>The Gateway Review process continues to be a key mechanism for assurance of both the Programme Strategy and the readiness to deliver new capabilities into service.</p> <p>Review of Programme outcomes and governance is currently underway to support the next tranche of the Programme to March 2017.</p>	Senior Responsible Owner, Futures Programme, Agriculture, Food & Rural Communities	<p>June 2016 (Completion of CAP 2015)</p> <p>March 2017 (Completion of Futures Programme)</p>