

# HM Inspectorate of Education

## Annual Report on the 2010/11 audit



Prepared for HM Inspectorate of Education and the Auditor General for Scotland  
August 2011

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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# Key messages

## 2010/11

We have given an unqualified opinion on the financial statements of HMIE for 2010/11. We have also concluded that in all material respects, the expenditure and receipts shown in the financial statements were incurred or applied in accordance with applicable enactments and relevant guidance, issued by Scottish Ministers.

In 2010/11 HMIE achieved a net over spend of £0.410 million. This is the difference between the net operating costs for the year of £15.87 million and the funding received from the Scottish Government of £15.46 million. The overspend was as a result of additional expenditure on early departure costs and agreement to incur these costs was given by Scottish Government. The early severance scheme resulted in 37 staff leaving the organisation in anticipation of the need to make significant savings in future years. The cost to HMIE was £1.795 million.

HMIE met its efficiency saving targets during the year, mainly through more efficient school and child protection inspection models and the use of Scottish Government collaborative contracts.

Overall the corporate governance and control arrangements for HMIE operated satisfactorily during the year, as reflected in the Statement on Internal Control. These include an effective Audit Committee which challenges senior management on key issues as appropriate.

HMIE took a decision mid year to radically alter its planned programme of school inspections, to provide additional support for the Curriculum for Excellence. In addition, HMIE established the Schools Inspection Framework Review, to identify where the next set of improvements in schools inspection might be focussed. HMIE successfully met its main performance targets against the four strategic objectives set out in the corporate plan.

This period of significant change for HMIE presented risks to staff morale and retention, which were managed to ensure business continuity. HMIE had robust systems for the identification and management of risks in place and it was able to deliver its planned inspections.

## Outlook

Scotland's economy is in recession and the public sector is under the greatest financial pressure since devolution ten years ago. The position going forward is becoming even more challenging than in previous years with limited increases in funding, increasing cost pressures and challenging savings targets. It will be very challenging to maintain current levels of public services and meet new demands when resources are tight.

The Scottish budget will reduce in real terms but the full extent of this is not yet known. Two per cent efficiency savings will not be sufficient beyond 2011 to bridge the gap between public spending and the smaller budget available. In the current economic climate difficult decisions will have to be made across the public sector about priority spending programmes.

HMIE was dissolved on the 30 June 2011 and joined with Learning and Teaching Scotland to form a new executive agency, Education Scotland. The new national body is responsible for supporting quality and improvement in Scottish education, from early years to adult and community learning. Education Scotland will be responsible for maintaining control over the resources applied to functions previously carried out by both of the predecessor organisations and for reviewing future spending plans to ensure the best value.

# Introduction

1. This report is the summary of our findings arising from the 2010/11 audit of HM Inspectorate of Education (HMIE). 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. Reports have been issued in the course of the year (Appendix A) and we do not repeat all of the findings in this report, but instead we focus on the financial statements. Our audit did not identify any high level risks which required action by HMIE. However, given the imminent formation of Education Scotland, we have included a number of issues throughout the report which the senior management of Education Scotland may wish to consider going forward.
3. This report is addressed to HMIE and the Auditor General and should form a key part of discussions with audit committees, either prior to or 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.
4. This report will be published on our website after consideration by the Audit Committee.
5. 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 our 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

6. 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.
7. Auditors 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).
8. Auditors review and report on, as appropriate, other information published with the financial statements, including the management commentary, statement on internal control 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 on the financial statements.

## Audit opinion

9. We have given an unqualified opinion that the financial statements of HMIE for 2010/11 and give a true and fair view of the state of the body's affairs and of its excess of comprehensive expenditure over income for the year.
10. HMIE is required to follow the 2010/11 Government Financial Reporting Manual (the FReM) and we confirm that the financial statements have been properly prepared in accordance with the FReM.

## Going concern

11. As at 31 March 2011 HMIE has a net liability on the statement of financial position of £0.515 million (£0.235 million surplus as at 31 March 2010). This significant movement was due to a £0.185 million net reduction in non-current assets; a £0.392 million increase in net current liabilities and a £0.173 million increase in non-current liabilities. A significant component of these movements was the recognition of costs for HMIE staff choosing to depart early under one of the Scottish Government's approved severance schemes. The financial statements have been prepared on a going concern basis as the Board has no reason to believe that the support of the sponsor department, the Education and Lifelong Learning Directorate, will not be forthcoming.

## Regularity

12. In accordance with the requirements of the Public Finance and Accountability (Scotland) Act 2000, we have also provided an opinion, that in all material respects, the expenditure and

receipts in the financial statements were incurred or applied in accordance with applicable enactments and guidance.

## Remuneration report and statement on internal control

13. In our opinion, the audited part of the remuneration report has been properly prepared and the remaining elements of the remuneration report and management commentary are consistent with the financial statements.
14. We also confirm that we have no issues to report to you on the statement of internal control and its compliance with guidance.

## Accounting issues

### Accounts submission

15. The financial statements were submitted for audit on 21 April, in accordance with a pre-agreed timetable. The audit fieldwork was completed on 13 May and matters arising were discussed on a regular basis with the HMIE accountant. The final clearance meeting was on 17 May.

### Presentational and monetary adjustments to the unaudited accounts

16. A small number of presentational changes were required to the annual report and accounts as a result of our review of the disclosures required by the FReM and the audited financial statements have been adjusted to reflect this.

### Prior year adjustments

17. All central government bodies have been affected by the removal of the cost of capital in the 2010/11 FReM. This change is identified in the accounting policies and appropriate amendments have been made to the prior year statements.

### Whole of government accounts/consolidation packs

18. The whole of government accounts (WGA) is the consolidated financial statements for all branches of government in the UK. Most central government bodies are required to provide information to their auditors by 29 July however Scottish Government agencies are expected to provide consolidation information for the Scottish Government consolidated accounts by mid-July. HMIE submitted its pack to Audit Scotland for audit on 6 June and we have no significant issues to report. We submitted our Consolidation Certificate to the Scottish Government on 12 July. In addition agencies are also required to submit a WGA consolidation pack. HMIE submitted its pack to Audit Scotland on the 18 July. Auditors need only audit WGA returns from bodies that have gross assets, gross liabilities, or gross income (including grant in aid) or gross expenditure of more than £50 million. As the HMIE's assets, liabilities, income and expenditure fall below the threshold no audit is required.

## Outlook

19. The main change in the financial reporting framework (FReM) next year (2011/12) is that grants and donated assets should be recognised immediately, unless there is a condition that the recipient had not satisfied that would lead to repayment. This is unlikely to have much (if any) impact on HMIE as part of the new agency, Education Scotland.
20. Looking further ahead, from 1 January 2013 changes to international financial reporting standards (IFRSs) will become effective. This includes the introduction of:
  - IFRS 9 - financial instruments (replacing IAS39)
  - IFRS 10 - consolidated financial statements (replacing IAS27)
  - IFRS11 - joint arrangements (replacing IAS31)
  - IFRS12 - disclosure of interest in other entities (replacing IFRS12)
  - IFRS 13 - fair value.
21. Revisions to the FReM for 2013/14 are included in the Financial Reporting Advisory Board (FRAB) forward work programme for 1 December 2011.

### Audit appointment for 2011/12

22. Audit appointments are made by the Auditor General, either to Audit Scotland staff or to private firms of accountants for a five year term. 2010/11 is the last year of the current audit appointment. The procurement process for the next five years was completed in May 2011. From next year (2011/12) the auditor for Education Scotland will be the Auditor General for Scotland. As Audit Scotland will be appointed as the auditor for Education Scotland we look forward to continuing the good working relationship that exists and thank officers and members of the board and committees for their assistance during the last five years. We will be meeting with the incoming audit team, later in the year, as part of a managed changeover process.

# Financial position

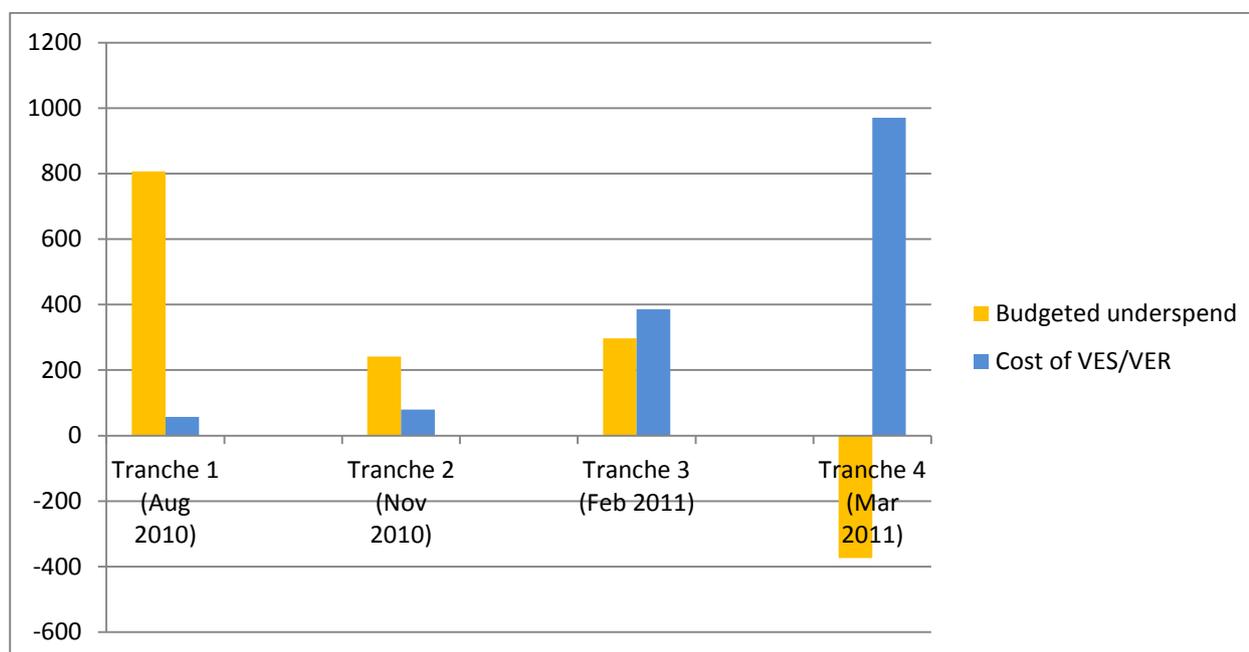
23. Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based.
24. Auditors consider whether audited bodies have established adequate arrangements and examine:
  - financial performance in the period 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.
25. These are key areas in the current economic circumstances. This section summarises the financial position and outlook for the organisation.

## Financial results 2010/11

26. The annual budget approved by the Scottish Parliament was £15.56 million for 2010/11. HMIE had a number of cost saving initiatives in place during 2010/11. As a consequence, the Autumn Budget Revision reduced HMIE's funding by £80k. A further reduction of £20k occurred in the Spring Budget Revision, due to the Scottish Government's decision to remove the cost of capital. HMIE reported a net overspend of £0.410 million for 2010/11 against a revised budget of £15.46 million; being £0.354 million revenue overspend and £0.056 million capital overspend.
27. As a result of the UK Comprehensive Spending Review published in 2010, the Scottish Government committed to a spending plan to 2011-12. A reduction in staffing numbers was regarded as an essential part of the commitment to deliver planned savings by 2012. Staff working in government departments, and agencies, were therefore offered an opportunity to depart early during 2010/11 under one of four schemes (tranches). Exhibit 1 shows HMIE's budgeted outturn after setting aside funding to meet the estimated cost of staff likely to apply for early retirement/voluntary severance under each tranche.

## Exhibit 1

## HMIE budgeted outturns and cost of VES/VER schemes



*HMIE budget monitoring reports and Scottish Government (Human Resources)*

28. Discussions with HMIE officers, and a review of budget monitoring reports, found that HMIE's budget could accommodate the costs of staff applying to leave under Tranches 1 to 3. Given the quantum of the forecast underspend at August 2010, HMIE elected to return £0.3 million of funding to the Scottish Government.
29. Tranche 4 was announced in March 2011 and enabled staff to take account of previous qualifying service for the purposes of calculating severance packages. Of the thirty seven HMIE staff accepting exit packages at 31 March 2011, thirteen officers applied under Tranche 4 at a cost of £0.970 million. HMIE's shortfall in relation to Tranche four was £0.374 million, after offsetting forecast surplus of £0.297 million at February 2011 and applying £0.3 million savings surrendered to the Scottish Government. This was a key factor in HMIE's reported deficit for 2010/11.

### Budgetary control

30. Our review of HMIE's budget setting and monitoring arrangements was satisfactory. We found that senior management were receiving budget monitoring reports on a regular (monthly) basis. Budgets took account of various cost saving measures, and a planned reduction in inspection activity, which allowed HMIE to return £0.3 million of funding to its sponsoring body in November 2010.
31. HMIE were forecasting an underspend of £0.297 million in February 2011 and it was only the late announcement by the Scottish Government of a final severance scheme (tranche 4)

which resulted in the reported overspend for 2010/11. HMIE delivered significant efficiency savings in 2010/11 (see paragraph 66) and identified a number of cost savings. We would encourage Education Scotland to adopt, and build upon, the budgeting and cost saving arrangements developed by HMIE.

### Workforce reduction

32. We are pleased to report that HMIE adopted a rigorous process for assessing applications for early retirement/voluntary severance; affordability was assessed in relation to existing budgets and organisational impact was considered by senior management in relation to forward work plans and the planned formation of Education Scotland.
33. Thirty seven staff at HMIE chose to accept offers of early retirement/voluntary severance at 31 March 2011 at a total cost of £1.795 million. The Scottish Government may seek further reductions to the workforce and we would encourage Education Scotland to adopt the same rigorous approach to assessing any future applications for early departure.

### Financial position at 31 March 2011

34. The Statement of Financial Position shows a net liability position of £0.515 million at 31 March 2011 (net current assets of £0.235 million at 31 March 2010). This overall reduction of £0.745 million is due to a £0.185 million reduction in non-current assets; a £0.392 million increase in net current liabilities and a £0.173 million increase in non-current liabilities. The position at 31 March 2009 was net liabilities of £0.046 million. The volatile nature of HMIE's financial position is largely due to factors which have been outwith the control of the organisation (the first time adoption of IFRS and the cost of VER/VES schemes). However, HMIE's transition to Education Scotland may present a challenge in terms of achieving financial stability and delivering further savings.

### Capital investment and performance 2010/11

35. HMIE has a relatively low capital budget which reflects the nature of the organisation, and its business, and HMIE does not undertake any significant capital projects. The capital outturn was £0.076million compared to a budget of £0.020 million. Expenditure in 2010/11 was on a video conferencing facility and replacement of laptops.

## Outlook

### 2011/12 budget

36. Scottish Ministers have allocated funding of £13.26 million to HMIE for 2011/12, which we understand will be carried forward into the new agency, Education Scotland. Going forward there will however be additional financial risks managing the budget given that Education Scotland is a new body. Robust budget monitoring systems will need to be in place to ensure the new body operates within the tight budget constraints in place for the next financial years.



# Governance and accountability

37. 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.
38. 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.
39. Consistent with the wider scope of public audit, auditors 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
40. In this part of the report we comment on key areas of governance.

## Corporate governance

### Processes and committees

41. The Board is responsible for ensuring that HMIE fulfils the aims and objectives set by Scottish Ministers. The role of the Board includes establishing the overall strategic direction, monitoring performance against agreed objectives and ensuring that statutory requirements for the use of public funds are complied with.
42. The Audit Committee monitors and reviews risk, control and corporate governance and reports to the Board.

### Internal control

43. While auditors concentrate on significant systems and key controls in support of the opinion on the financial statements, our wider responsibilities require them to consider the financial systems and controls of audited bodies as a whole. However, the extent of this work should also be informed by their assessment of risk and the activities of internal audit.
44. As part of our risk assessment and planning process we assessed the Scottish Government Internal Audit Division, HMIE's internal auditors, and concluded that they operate in accordance with the Government Internal Audit Manual. We were therefore able to place reliance on their work in a number of areas as detailed within our annual audit plan.

45. Our audit approach includes a review of the high level controls operating within HMIE's key financial systems. Our overall conclusion from the 2010/11 review was that key controls were operating effectively and that HMIE has adequate systems of internal control in place.
46. In their annual report for 2010/11, Scottish Government Internal Audit Division provided their opinion that, based on the internal audit work undertaken during the year, there was substantial assurance on the adequacy and effectiveness on the systems of internal control.
47. In the interests of an efficient audit approach we also rely on assurances received from the auditor of the Scottish Government on work performed on shared systems that operate at HMIE, hosted by the Scottish Government. This approach ensures we are delivering an efficient co-ordinated audit that avoids unnecessary duplication and expense.
48. The central systems assurance letter provided by the auditor of the Scottish Government concluded that there was adequate assurance for all systems except travel and subsistence payments. Adequate assurance is where key controls and procedures are operating to enable reliance to be placed on the system; limited assurance was provided for the travel and subsistence (T&S) system due to controls concerns. However, HMIE has established procedures to test check T&S claims which we reviewed and found to be operating satisfactorily.
49. The Statement on Internal Control (SIC) provided by the HMIE's Accountable Officer reflected the main findings from both external and internal audit work. The SIC records management's responsibility for maintaining a sound system of internal control and summarises the process by which the Accountable Officer obtains assurances on the contents of the SIC.

## Prevention and detection of fraud and irregularities

50. Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. Auditors review and report on these arrangements.
51. HMIE has appropriate arrangements in place (based on Scottish Government guidance) to prevent and detect instances of fraud and corruption including detailed policies which have recently been reviewed and updated.
52. There were no instances of fraud or corruption reported by HMIE in 2010/11.

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

53. 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 have concluded that the arrangements in HMIE are satisfactory and we are not aware of any specific issues that we need to identify in this report.

## Outlook

54. We are aware through discussions with officers, and attendance at audit committee meetings, that there has been considerable activity directed toward establishing governance arrangements for Education Scotland. Education Scotland has set a date of the 26th August 2011 for its first Audit Committee meeting and we would recommend that Education Scotland agree a framework document at the earliest opportunity.

# Best Value, use of resources and performance

55. Accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value.
56. The Auditor General may require that auditors consider whether accountable officers have put in place appropriate arrangements to satisfy their corresponding duty of Best Value. Where no requirements are specified for auditors in a period they may, in conjunction with their audited bodies, agree to undertake local work in this area.
57. As part of their statutory responsibilities, the Auditor General and Accounts Commission may procure, through Audit Scotland, examinations of the use of resources by audited bodies and publish reports or guidance. Auditors 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.
58. Auditors may also consider the use of resources in services or functions, where the need for this is identified through local audit risk assessments. Audit Scotland has prepared a series of Best Value toolkits to facilitate its reviews in these areas.
59. During the course of their audit appointment auditors should also consider and report on progress made by audited bodies in implementing the recommendations arising from reviews in earlier years.
60. This section includes commentary on Best Value/performance management arrangements within HMIE. We also comment on any headline performance outcomes/measures used by HMIE and comment on any relevant national reports and the body's response to these.

## Management arrangements

### Best Value

61. In March 2011, the Scottish Government issued new guidance for accountable officers on Best Value in Public Services. The new guidance, in essence, required public bodies to take systematic approach to self-evaluation and continuous improvement.
62. The guidance identifies the themes which an organisation needs to focus on in order to deliver the duty of Best Value, but notes that implementation should be appropriate and proportionate to the priorities, operating environment, scale and nature of the body's business.

63. The five themes and two cross-cutting themes (some of which we have commented on earlier in this report) are:
- vision and leadership
  - effective partnership
  - governance and accountability
  - use of resources
  - performance management
  - equality (cross-cutting)
  - sustainability (cross-cutting).
64. HMIE undertook self-evaluation work on best value as an integral part of budget scenario planning undertaken in August/September 2010 and there are plans for a similar exercise to take place within Education Scotland during August 2011. Part of the HMIE internal audit programme for 2010-11 also included a review of aspects of best value, including the approach to identifying and achieving efficiencies and performance on sustainability.

## Overview of performance in 2010/11

65. HMIE's principal activity is to promote improvements in standards, quality and attainment in Scottish Education through first hand independent evaluation. On the 1 July 2011 Education Scotland took over the functions of HMIE and Learning & Teaching Scotland and given these circumstances, HMIE did not update its corporate plan for the period up to 2011, although a business plan setting out its work programme during 2010/11 and the transition to Education Scotland was developed.
66. HMIE's strategic priorities are set out in its Corporate Plan and performance targets, including contribution to national outcomes are expressed in the annual business plan. HMIE's 2010/11 target under the Efficient Government Plan for the three year to 2010/11 was to deliver 2% efficiency savings. HMIE exceeded this target and delivered actual savings of £1.07 million in non cash releasing savings through more efficient school and child protection inspection models and in addition achieved almost £0.3m in cash savings through the use of Scottish Government collaborative contracts. HMIE established a number of internal targets under four strategic priorities which are aligned with qualitative targets set by the Scottish Government. Performance against strategic objectives are analysed in HMIE's published Annual Report.
67. During the year HMIE reported a high degree of success in meeting corporate targets, albeit some were necessarily changed, or deferred, as result of changes to the inspection process and the impending transfer of HMIE functions to Education Scotland.
68. The HMIE Board regularly reviewed performance against the corporate plan through quarterly performance reports. The reports were discussed in Board meetings and action taken and reported to resolve any issues.

## National performance reports

69. Audit Scotland carries out a national performance audit programme on behalf of the Auditor General for Scotland and the Accounts Commission. The findings and key messages of these studies are published in national reports. One report in the last year of direct interest is '*The role of boards*'.

### Role of boards

70. Public bodies and their boards have evolved over time. There is great variety in the size and make-up of boards and the roles they have. Accountability can be complex, with chief executives and boards reporting in different ways to the Scottish Government, ministers and the Scottish Parliament. This risks causing confusion about who leads an organisation and is responsible for its decisions.
71. In response to the key messages in the national report, the HMIE Audit committee agreed that non executive Board members would complete the checklist assessment contained in the report to determine whether there was a need for further action. The findings of this exercise were in accordance with the annual self-evaluation work undertaken by both the HMIE Management Board and the Audit and Risk Committee and resulting recommendations will be taken forward as part of the initial work of the board of Education Scotland.

## Outlook

72. The main issue affecting HMIE going forward relates to change management issues arising from bringing together the functions of the HMIE and Learning & Teaching Scotland. Detailed plans and risk assessment/management arrangements for this are in place.

# Appendix A: Audit reports

## External audit reports and audit opinions issued for 2010/11

Title of Report or Opinion	Date of Issue	Date presented to Audit Committee
Annual Audit Plan	15 December 2010	23 February 2011
Key financial controls assurance report	31 January 2011	23 February 2011
Report on financial statements to those charged with governance	18 May 2011	26 May 2011
Audit opinion on the 2010/11 financial statements	18 May 2011	26 May 2011