

Scottish Executive Report on the 2005/06 Audit

November 2006



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 Executive 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

This report provides the Executive, the Auditor General and the Scottish Executive Audit Committee with a summary of the key messages arising from our audit of the Scottish Executive in 2005/06. In particular, the Scottish Executive Audit Committee should consider the outcomes from our audit in supporting a recommendation to the Permanent Secretary on the certification of the Consolidated Accounts.

We have reviewed the Executive's governance and financial position in the year to 31 March 2006. As part of our audit approach we have also assessed how the Executive is managing some of the main strategic priorities and risks that it currently faces.

Financial Statements

Audit Report on Accounts

We have concluded that the financial statements of the Scottish Executive give a true and fair view of the state of affairs of the Scottish Executive and the consolidation of the entities within the departmental accounting boundary at 31 March 2006 and of the consolidated net resource outturn during the year.

We have also concluded that in all material respects, the expenditure and receipts shown in the accounts were incurred or applied in accordance with applicable enactments and relevant guidance, including the limits authorised by the Budget (Scotland) Act 2005.

We have also reviewed the other issues we are required to consider as part of our audit opinion, such as the Annual Report, the Remuneration Report and the Statement on Internal Control. We can confirm that there are no further matters that we need to bring to the Executive's attention.

The accounts and the audit were completed one month earlier than last year, which represents a significant achievement by all parties.

Section 22(3) Reports

The Auditor General considers whether there are issues relevant to the audit of the Scottish Executive that should be reported to Parliament under Section 22(3) of the Public Finance and Accountability Act 2000.

The Auditor General has concluded that there are no such matters arising from the 2005/06 audit.

Financial Position

The final outturn for the 2005/06 financial year was £23,547 million, against a net resource budget of £23,843 million, representing an underspend of £296 million (just over 1% of the Executive's overall budget). This compares with a final outturn for last year of £21,990 million, and an underspend of £188 million.

Governance

Corporate Governance

This review recognised the unique position of the Scottish Executive and that no single good practice model existed which would be fit for purpose. It also recognised that the Executive has undertaken significant developments since devolution and is continuing to develop its governance arrangements still further. The report identified a number of areas where governance could be improved, including: making targets more specific, measurable and outcome focused; further improvements in the performance management systems; and, further embedding of effective risk management processes.

Financial Management and Budgetary Control

During the year we finalised and reported on the Financial Management and Budgetary Control review which was started in 2004/05. Good financial management in modern organisations has shifted from simply controlling expenditure and accounting for transactions. There is now a greater emphasis being placed on achieving best value and reporting achievement of business outcomes. Our report identified that the Executive has a strongly defined stewardship function and does well in meeting this role. However a number of improvement areas were identified, including:

- there is scope to improve financial planning including budget setting, phasing and monitoring arrangements;
- the quality and content of financial reporting varied across Departments;
- the limited role of finance in supporting good decision making and assessing the financial consequences of policy choices; and
- the availability of financial management skills across the Executive is limited.

Internal Control Framework

The establishment and operation of an efficient and effective internal audit function forms a key element of effective governance and stewardship. We have followed up our 2004/05 review of Scottish Executive Audit Services and concluded that they continue to comply with Government Internal Audit Standards and we are able to place reliance on their work for the purposes of our audit of the Scottish Executive.

We examined the key financial systems which underpin the Executive's control environment. With the specific exception of the payroll system we have concluded that the Executive's financial systems and procedures operate sufficiently well to enable us to place reliance on them and to limit the risks of material misstatement of the accounts, error or fraud. With respect to the Executive's payroll we concluded that only limited reliance could be placed on the system due to a number of weaknesses in key controls, including the control environment of the new payroll provider, the absence of regular reconciliations, and insufficient segregation of duties. However it should be noted that no material substantive errors were identified.

Performance

Best Value

During 2005-06 Audit Scotland carried out a baseline review to establish the arrangements in place across the central government and NHS sectors to support Best Value and continuous improvement. The review also sought to identify areas of good practice. Within this a separate review has been carried out at the Executive covering corporate functions and all departments. The results of this work will be reported to the Executive shortly.

Efficient Government

The Efficient Government Initiative is a 5 year programme with the aim of reducing waste, bureaucracy and duplication in Scotland's public sector. The primary objective is to deliver the same services with less money or to enable frontline services to deliver more or better services with the same money. The Efficient Government Plan sets targets to achieve of £745 million (rising to £900 million) of cash-releasing savings and £300 million (rising to £600 million) of time-releasing savings, by 2007-08.

During 2005-06 Audit Scotland completed a management arrangements review of Efficient Government activities across the public sector. Our aim was to obtain baseline information on arrangements across a range of Efficient Government related topics. We also carried out an assessment of the management of the overall programme by the Delivery Division and an evaluation of claimed savings within Efficiency Statements.

The findings from this work are currently being analysed and will be made available to the Executive in the near future. The Auditor General has indicated his intention to issue a report incorporating the key messages from our review under Section 23 of the Public Finance and Accountability Act 2000 later this year.

e-Procurement

A follow-up of our 2004/05 review of the e-Procurement programme was undertaken in the year. This sought to update our technical assessment of the risk areas in the control environment and also to monitor

progress in the roll out of this key project across the public sector. We concluded that progress has been made in addressing the risk areas identified although there are a number of areas where further work is required. This is especially evident in the area of achieving the Efficient Government target, where the level of spend using the ePS facility is behind expectation.

Looking Forward

The final part of our report notes some specific key risk areas for the Executive going forward. These issues will be considered further as part of our risk assessment and audit planning process for the 2006/07 audit.

Introduction

1. This report summarises the findings from our 2005/06 audit of the Scottish Executive. The scope of the audit was set out in our Departmental and Summary Audit Plans which outlined the key business risks facing the Executive and individual Departments and described the work we planned to carry out on:
 - financial statements;
 - governance; and
 - performance.
2. This report completes our audit by giving an overview of the work we carried out and a summary of our key findings. We have structured the main body of the report to cover the three topics listed above, as well as our view on emerging risk areas for 2006/07.
3. During the year we undertook a range of reviews including finalisation of our reviews of financial management and corporate governance, a review of management arrangements in place to support best value and our substantial work on the financial statements. Other risk areas and related planned management actions have or are being separately reported to the Executive in the relevant topical reports.
4. We are grateful for the assistance and co-operation provided by the staff of the Executive during the course of our audit.

Financial Statements

Our Responsibilities

5. Our audit plan sets out our responsibilities in detail. In summary, we audit the consolidated financial statements of Scottish Executive and give an opinion on:
 - whether they give a true and fair view of the financial position of the Scottish Executive and its expenditure and income for the period in question;
 - whether they have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements; and
 - the regularity of the expenditure and receipts.
6. We also review the statement on internal control by considering the adequacy of the process put in place by the Principal Accountable Officer to obtain assurances on the overall system of internal control and assess whether disclosures in the statement are consistent with our knowledge of the organisation.

Overall Conclusion

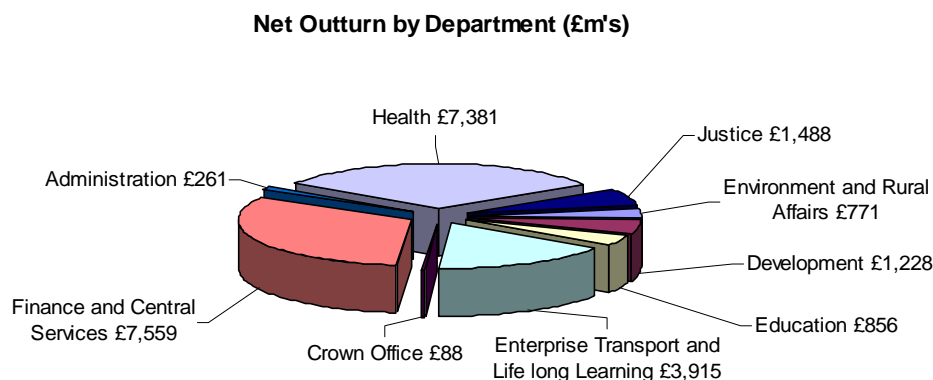
7. We have concluded that the financial statements of the Scottish Executive give a true and fair view of the state of affairs of the Scottish Executive and the consolidation of the entities within the departmental accounting boundary at 31 March 2006.
8. We have also concluded that:
 - the expenditure and receipts shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers, the Budget (Scotland) Act covering the financial year and sections 4 to 7 of the Public Finance and Accountability (Scotland) Act 2000; and
 - the sums paid out of the Scottish Consolidated Fund for the purpose of meeting the expenditure shown in the financial statements were applied in accordance with section 65 of the Scotland Act 1998.
9. A small number of adjustments for financial misstatements were made to the draft Consolidated Accounts presented for audit on 31 August. The Accounts were not adjusted to correct a number of financial misstatements which, individually and cumulatively, were not sufficiently material to impact on the audit opinion. In accordance with auditing standards, the unadjusted errors have been

separately reported to the Audit Committee and Principal Accountable Officer in our International Auditing Standards (ISA) 260 report.

- Our review of the Statement on Internal Control concluded that it complies with the relevant guidance and is not inconsistent with other information we are aware of from our audit. The Statement identifies that there was scope for improvement in the internal controls in the governance and business processes operating within the Human Resources (HR) function.

The Financial Position

- The Budget (Scotland) Act 2005 prescribes, for the financial year 2005/06, both the financial limits on the use of resources by the Departments of the Scottish Executive and how these resources can be used. The final approved net resource budget for the Scottish Executive was £23,843 million. The net outturn for the year ended 31 March 2006 was £23,547million (2004/05: £21,990 million), resulting in an overall underspend of £296 million (2004/05: £188 million). The split of net outturn between resource and capital was £22,681 million and £866 million respectively. The net outturn by Departments is highlighted in the following chart.



- The Scottish Executive met all nine departmental expenditure limits prescribed in the Budget (Scotland) Act 2005. 'End Year Flexibility' (EYF) arrangements enable the Executive to carry forward unspent provision from one year to the next. The element of the underspends shown in the Executive's Consolidated Accounts within the departmental expenditure limits will contribute to the EYF entitlement.
- The most significant underspends were incurred by the Enterprise, Transport and Lifelong Learning Department (ETLLD) and Health Department which incurred underspends of £126 million and £71 million respectively.

14. With respect to ETLLED the underspends relate mainly to the transport portfolio and in particular the roads network depreciation and the departmental cost of capital charge. There were also some delays in projects and a late rebate for track access charges. These underspends were offset by higher than expected capital expenditure for the purchase of land for the M74 extension. For the Health Department the underspend almost entirely relates to capital expenditure and is represented by slippage on capital projects and unexpected receipts at the year end.
15. Total operating income generated by the Scottish Executive was £2,895 million of which £120 million could not be used and required to be surrendered to the Scottish Consolidated Fund. Of this, £105 million was for designated receipts, such as fines, fees and forfeitures, which require to be surrendered under the Designated Receipts Order. The remaining £15 million related to excess receipts being generated which were not covered by Budget (Scotland) Act 2005 authority, and therefore by default require to be surrendered to the Scottish Consolidated Fund.
16. The consolidated net assets of the Executive as at 31 March 2006 are £18.9 billion, an increase of just over £1 billion on the previous year. The majority of the assets of the Executive are categorised under 3 main areas; Land and buildings £4.6 billion (2004/05: £4.5 billion) the majority of which comprises the NHS and Prisons Estate; the Roads Network £12.5 billion (2004/05: £11.6 billion); and, investments £3.8 billion (2004/05: £3.4 billion) of which 43% is represented by Student Loans. With respect to liabilities the most significant individual items are instalments due in over one year on National Loans Fund Loans and the provisions made against the student loans. These were £807m and £592m, a decrease of 4% and increase of 8% respectively on the prior year.

Wider Financial Management

17. In June 2006 the Minister announced that the Executive had unspent balances of some £1.454 billion which were held by the Treasury on Scotland's behalf. This balance comprises accumulated underspends against the Scottish budget block carried forward using the EYF process since devolution. This balance includes earmarked funding for individual portfolios which is held within the Central Unallocated Provision (CUP).
18. Balances are held in the CUP to avoid the practice of 'drawing down budgets in full' from Treasury and to ensure that annual budgets approved by the Scottish Parliament are taut and realistic. The CUP was established in September 2004 to provide a more flexible mechanism for managing resource spend between financial years. The balance as at 31 March 2006 was £965m (31 March 2005: £575m).
19. All balances held in the CUP are allocated to specific spending plans which have not yet been brought before Parliament for approval. They form part of the Executive's financial management processes

and cannot be used without Parliamentary approval. As balances in the CUP relate to financial planning activity, they are not disclosed within the Executive's consolidated accounts and are not covered by our audit opinion. The balances held in the CUP and as part of the wider EYF total are, however, reported through Budget documents which are subject to parliamentary scrutiny.

Issues Arising from the Audit

Accounts Preparation

20. The draft schedules for the core Scottish Executive Departments were submitted for audit on 30 June and the draft consolidated account was received on 31 August, both in line with the agreed timetable. The accounts presented by Finance Group continue to demonstrate a commitment to the continuous improvement in the preparation of the Executive's financial statements including timeliness, management review and approval, and reduced incidence of error. The Executive should be commended for the presentation of draft consolidated accounts a month in advance of the previous year, which is a significant achievement.
21. However there is scope to review the timing of the provision of the draft Statement on Internal Control which was received by audit on 5 October 2006.
22. The preparation, presentation and audit of the NHS sub-consolidation is a significant and material element of the Executive's Consolidated Accounts. In 2004/05 we reported a number of issues in its preparation that delayed its receipt and audit, and presented risks to the timetable for the certification of the Consolidated Accounts. We are pleased to report that the Health Department has taken appropriate action with improved processes in place and that this year's NHS sub-consolidation was received in line with the planned timetable.
23. The compressed timetable has created pressures in the completion of audit and in particular the review of the consolidated accounts. Our overall targets have been achieved through effective partnership working in particular with colleagues in the Executive's Financial Reporting and Accountancy Services Units.
24. There were, however, significant revisions and delays in finalising the roads valuation information which is described in more detail in paragraph 31 and we experienced some delays in obtaining sufficient, appropriate, and timely explanations from parts of the Executive in response to audit queries.

Faster Closing

25. The accounts and the audit were completed one month earlier than last year, which represents a significant achievement by all parties. However, a key issue for the Executive and Audit Scotland going forward will be our ability to jointly meet the demands of the 'faster closing' agenda which aims to bring forward the timetable further for reporting the financial accounts. The Treasury launched the initiative to accelerate the production and audit of resource accounts in 2002 in response to calls from the Committee of Public Accounts for faster accounts closure and a desire to replicate what is accepted as general commercial best practice.
26. This agenda is an important initiative as the earlier that financial statements are finalised the greater the benefit that can be derived by the Executive, by Parliament and, ultimately by the taxpayer. The key benefits of this agenda are:
- Demonstrating sound financial management – timely financial statements with clean audit opinions provide those charged with governance with evidence that the Executive has a sound system of financial management and governance;
 - Better resource management – the systems, processes and procedures that are required to achieve faster closing help to ensure that a body has effective and efficient systems which are capable of monitoring and managing a body's expenditure and use of resources. Crucial within this is the timely and regular production of management accounts which allow in-year decisions to be based on actual performance;
 - Better risk management - Good quality in-year financial management will enable senior management to better manage financial risks. Regular reviews of monthly accruals-based financial statements will provide early warning signs of possible over and underspends;
 - Informing Stakeholders - The earlier that audited information is made available the greater relevance that it will have to the users of the accounts; Parliament and the taxpayer can make informed assessments of the Executive's performance and the Executive can make forward looking operational decisions based on confirmed data;
 - A more motivated finance section - The demands placed on the Executive's staff will be less subject to seasonal fluctuations as the initiative requires a more balanced work programme and places greater emphasis on in-year financial management. It should help to create a forward looking, efficient department supported by a motivated finance section; and
 - Preparing for Whole of Government Accounts - The timely production of departmental information becomes even more critical as we move towards the first published set of Whole of Government Accounts in 2006-07. This process is dependent on departments being able to submit prompt and accurate returns to the Treasury.

27. The Executive has demonstrated their support for this agenda during 2005/06, with the drive to lay the Executive's financial statements in Parliament a month earlier this year indicative of this. However at present the production of accruals based financial information is an annual exercise reliant on manual processes specifically undertaken for the production of the financial statements. To achieve further significant change in the timescales for the effective production and audit of the financial statements, significant changes in processes and culture will be required. It will also require the Executive to ensure that executive agencies and other bodies within the consolidated group have the processes and systems in place to support the initiative.
28. Efficient and effective early auditing is only possible when the audited body has sound and consistent systems and controls operating throughout the year which produce regular accurate management accounts on an accruals basis, consistent with the financial statements. If this is achieved it is possible for significant elements of audit work to be completed prior to the year end and reduce the amount of audit testing required during the final accounts audit.
29. The Executive should take stock of what has been achieved so far and consider the extent to which it wishes to progress faster closing in the short and longer term, as well as developing a clear project plan for taking forward the initiative internally and across its consolidated bodies. It is worth noting that Westminster Departments have taken forward this initiative with audited accounts being laid for the majority of departments prior to the summer recess.

Roads Valuation

30. The Roads Asset Valuation System (RAVS) model is used as a basis for determining the valuation of the roads network assets of £12.5 billion. These represent 66% of the Executive's net assets in the consolidated balance sheet. The initial model provided to audit was found to contain a number of material errors and it required to be run a further three more times before the final position could be agreed. This required additional resource input from both the Executive and Audit Scotland in order to reach a satisfactory conclusion, which had a knock-on effect to the completion of other audit work and was a contributing factor to the pressures on the audit process highlighted in paragraph 24.
31. This issue was raised in last year's audit but the situation does not appear to have improved. The Executive performed quality checks on the information received from the consultants who provide the data on behalf of Executive, which along with our audit identified significant issues in the information provided in the initial runs. With the establishment of Transport Scotland the importance of this issue is heightened as responsibility for the roads network and its accounting will fall to the agency in 2006/07, with the transactions and balances only brought to account in the Executive's accounts on consolidation. Such delays or issues impacting on Transport Scotland would impact on the clearance of their financial statements with the consequential knock on effect to the clearance of the Executive's

Consolidated Accounts. This issue also needs to be considered if the Executive wish to take forward the faster closing agenda.

Disclosure and Other Issues

32. In line with normal practice a number of issues were discussed and resolved with officers during the course of the audit. A separate report to the Director of Finance has been prepared which provides details of a number of disclosure and other lower level matters arising from the financial statements audit which it is considered do not need to be reported here. We are in the process of preparing reports for each Department on the audit and the specific issues relating to them.
33. There are two further matters though that we would wish to highlight. These relate to the content and disclosure contained within the Annual Report, Operating and Financial Review (OFR) and Public Interest Report, and the disclosure of related party interests.
34. Whilst the Annual Report, OFR and Public Interest Reporting meets the basic requirements of the Financial Reporting Manual and Reporting Standard 1 there are a number of good practice areas that the Executive should consider developing within the document or other corporate reporting mechanisms to ensure that requirements are met comprehensively. These include:
 - a more detailed review of the Executive's business, including description of activities, objectives and strategies for achieving them, details of risks and uncertainties and future developments;
 - the disclosure of performance against key performance indicators and whether the present cross reference to other reports is sufficient on an annual basis;
 - increased analysis on significant movements on operating costs and assets and liabilities in the OFR;
 - details of the executive policies on sustainability, including the policies on social and community issues, and environmental issues; and
 - the action taken to maintain or develop the provision of information to, and consultation with employees.
35. The Ethical Standards in Public Life etc (Scotland) Act 2000 requires that relevant public bodies maintain a register of members' interests. This supports the promotion of the highest standards in public life and helps to ensure that potential conflicts of interest are avoided. Whilst the Act does not specifically cover the Scottish Executive, and in particular its non-executive members, good practice would be to maintain a register of interests covering the management group. The maintenance of a register of interests would provide transparency in the Executive's governance arrangements and support compliance with Financial Reporting Standard 8 Related Party Transactions which requires

the disclosure of material transactions with related parties, which include senior managers or non-executives.

Statement on Internal Control

36. The Principal Accountable Officer is required to provide a statement on internal control which he signs as part of the Scottish Executive Consolidated Resource Accounts. He is supported in this by Departmental Accountable Officers who provide Certificates of Assurance covering their portfolio responsibilities. The Certificates of Assurance are themselves based on an assurance framework which is detailed in the Scottish Public Finance Manual.
37. As reported in paragraph 22 the draft statement of internal control was not received by audit until 5 October 2006. The key factor in this was a number of delays in the receipt of Certificates of Assurance from divisions throughout the Executive. In respect of shared services provided by the Executive these delays also impacted on the timely signing and certification of some Executive Agency accounts. We also identified that in a number of instances the certificates of assurance have not been completed with sufficient care and consideration in a manner that supports a robust control environment including, standard paragraphs not removed if not applicable, limited or little evidence of consideration of the issues within the supporting checklists, and certificates not signed.
38. The Statement on Internal Control provided by the Principal Accountable Officer reflected the certificates of assurance provided by the Departmental Accountable Officers, the report from the Head of Internal Audit and the main findings from external audit work. The Statement refers to areas of internal control that need to be strengthened or developed further including the need to strengthen internal controls around the governance and business processes within the Human Resources function, including payroll.

Regularity Assertion

39. The Public Finance and Accountability (Scotland) Act 2000 imposes a responsibility on auditors to certify that, in all material respects, the expenditure and receipts shown in the accounts were incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers. We have been able to address the requirements of the regularity assertion through a range of procedures, including written assurances from the Executive as to their own views on adherence to enactments and guidance. No significant issues were identified for disclosure.

Auditor General Reports on Accounts

40. The Auditor General has concluded that there are no such matters arising from the 2005/06 audit of the Executive's accounts which require to be reported to Parliament under Section 22(3) of the Public Finance and Accountability (Scotland) Act 2000.

41. Appendix B contains a brief summary of the Auditor General's Section 22(3) reports on the accounts of the Executive's bodies which have been laid this year, and one item that is currently under consideration.

Governance

42. This section sets out our main findings arising from our review of the Executive's governance arrangements. We focused on:

- review of the key systems of internal control;
- our corporate governance arrangements report;
- finalising our financial management and budgetary control report;
- review of internal audit; and
- two specific joint reviews with other inspectorates.

43. We also discharged our audit responsibilities as they relate to prevention and detection of fraud and irregularity; standards of conduct and the Executive's financial position.

Corporate Governance

44. In 2004/05 we carried out a review of the governance arrangements in operation in the Scottish Executive. The work was undertaken against a background of significant developments in corporate governance in the United Kingdom. The review recognised that the Executive operates in the unique environment of devolution and that no single model of best practice in corporate governance will necessarily fit exactly with its needs.

45. The main areas of consideration are:

- **Aims, objectives and target-setting** - the Executive has developed a strategic framework designed to establish a clear organisational purpose and set of objectives through the Partnership Agreement, Building a Better Scotland and portfolio plans. This framework, although still evolving, represents a fundamental building block of corporate governance. There is scope for the Executive to make its targets more SMART (specific, measurable, attainable, realistic and timely) and outcome focussed.
- **Performance reporting** - performance management arrangements are improving, with an early focus on developing an agreed set of strategic objectives and targets aligned to the Partnership Agreement. While the process is evolving, the development of performance management systems is limited and is an area for potential improvement within the Scottish Executive.
- **Financial monitoring and reporting** - the accounting arrangements within the Scottish Executive meet professional standards and legislative requirements. There is scope to develop the value of the accounting and reporting regime to improve the visibility, value and impact of the accounts. A

major challenge remains the implementation of improvements consistently across the organisation and achieving greater alignment between the financial and performance management arrangements.

- **Audit Committees**- the role and effectiveness of the Executive's Audit Committee arrangements continue to develop and these have been strengthened through greater involvement of Non-Executive Directors.
- **Internal control and risk management** - formal risk management processes are in place and further work is underway to embed and develop risk management below Departmental and Group levels. Arrangements to provide assurances in support of the statement of internal control are also now well established in the organisation and the appropriate hierarchy of assurance appears to be working well. There is a need to continue to embed effective risk management and internal control throughout the Executive.

Financial Management and Budgetary Control

46. During the year we finalised and reported our review of Financial Management and Budgetary Control. The hallmark of good financial management in modern organisations has shifted from simply controlling expenditure and accounting for transactions. There is now a greater emphasis being placed on performance improvement, achieving Best Value and supporting the achievement of business outcomes. The purpose of this review was to assess the effectiveness of the Executive's arrangements for financial management and budgetary control.
47. Our review focussed on the finance function in the following areas:
 - securing stewardship;
 - supporting performance; and
 - enabling transformation.
48. In reviewing all of these elements, we considered whether the Executive had in place the right people and skills to deliver effective financial management.
49. The Finance Group has a strongly defined stewardship function and does well in meeting this role. However, organisational, structural and accountability barriers impact on the ability of the Finance Group to operate more strategically and effectively across the Executive. There are some overlapping financial management systems across the Executive. The Director of Finance does not have overall responsibility for the delivery of financial services across the Executive and some Departments have set up separate financial teams independently of the Finance Group.

50. The quality and content of the financial reports varies across Departments, as do the management monitoring arrangements. The Finance Group has a specific objective to promote economy, efficiency and effectiveness, but does not have a clearly defined role in this area and is currently not well placed to deliver on it.
51. The Finance Group (working with Department based finance staff) needs to develop its role to support good decision making and assist managers to assess the financial consequences of policy choices. It should also support other parts of the Executive to better align future financial strategy with business objectives.
52. Overall we found that the Scottish Executive has taken steps to develop its financial management skills in recent years and it is at present undertaking a financial management review which is in line with the HM Treasury financial management agenda. However our review indicates that there is more to be done if the Executive is to professionalise its finance function in line with the Skills for Success programme.

Internal Audit

53. The establishment and operation of an efficient and effective internal audit function forms a key element of effective governance and stewardship. During 2004/05 we carried out a comprehensive review of Scottish Executive Audit Services (“Audit Services”). The review covered:
 - the extent of internal audit’s compliance with Government Internal Audit Standards (GIAS) in planning and undertaking their work; and
 - a detailed evaluation of specific internal audit work to determine the extent to which we can rely on this work for the purposes of our audit.
54. Our overall conclusion was that Audit Services complies with Government Internal Audit Standards in adopting a risk based audit approach in planning and undertaking their work. However our audit identified some areas for improvement in the management and governance arrangements for the internal audit function. As part of our 2005/06 audit we have assessed Audit Services’ progress in implementing the agreed Action Plan from 2004/05 and the extent to which we could continue to place reliance on the work of Audit Services.
55. Our review of Audit Services indicated that they had made progress in implementing the key recommendations made and confirmed that they continue to comply with Government Internal Audit Standards in adopting a risk based audit approach in planning and undertaking their work. Therefore we were able to continue to place reliance on their work for the purposes of our audit of the Scottish Executive.

Systems of Internal Control

56. As part of our audit we reviewed the high level controls in a number of the Scottish Executive's systems that impact on the financial statements. Key controls within systems should operate effectively and efficiently to accurately record financial transactions and prevent and detect fraud or error. This supports a robust internal control environment and the effective production of financial statements. Our audit covered central financial systems, specific departmental systems and Information and Communication Technology.

Central Financial Systems

57. We reviewed the internal control framework operating for the key central financial systems in place within the Scottish Executive which impact on the financial statements. This review covered the following systems:

- the operation of the main accounting system (SEAS);
- accounts payable systems (including the operation of EASEbuy);
- cash and banking systems (including the reconciliation of the main bank account);
- the central aspects of the operation of the Britannia fixed asset system; and
- the central aspects of the operation of the payroll system.

58. Our overall conclusion is that, with the specific exception of the payroll system, key controls are operating adequately across the Executive's central systems and procedures. With respect to Executive's payroll system (ePayFact), we concluded that only limited reliance could be placed on the key controls operating during the 2005/06 financial year for the purposes of our audit opinion. As a result we were required to carry out additional detailed testing to gain the appropriate assurances.

59. The contract with the previous payroll service provider was discontinued as at 31 March 2005 and a new service provider was put in place under the umbrella of a Consortium led by HM Treasury. Our review identified a number of weaknesses in key controls operating in the payroll system during the 2005-06 financial year including the design and application of controls at the new payroll provider, segregation of duties and authorisation controls within the ePayfacts system, and the lack of regular reconciliations between the payroll system, SEAS, and the bank account.

60. Whilst we could only take limited assurance from the control environment we undertook additional specific substantive testing and gained sufficient assurance for our audit opinion.

Departmental Systems

61. We reviewed the high level controls for a range of key departmental programme expenditure areas and their underlying systems within the Scottish Executive which impact on the financial statements.

This included:

- Student Awards, Graduate Endowment and Individual Learning Accounts (excluding controls operated by Learndirect Scotland);
- European Structural Funds;
- Regional Selective Assistance;
- Supporting People;
- Common Agricultural Policy Market Support; and
- Trunk roads maintenance expenditure.

62. Our review of controls over Common Agricultural Policy Market (CAPM) Support expenditure was carried out in order to provide assurance for both the audit of the Scottish Executive's consolidated accounts and the European Guarantee Account audit. The results of this work are reported in detail separately to the European Commission. However in respect of the CAPM expenditure incurred since October 2005 (£347m as at 31 March 2006) a number of significant issues were identified in relation to the transition to the Single Farm Payment Scheme (SFPS).

63. Our audit work on the SFPS focused on the systems and procedures operated by the Environment and Rural Affairs Department to support payments under the 2006 European Guarantee Account ¹, and to carry out substantive testing of a sample of payments made to producers. This work has so far focused on payments up to 31 March 2006 which impact on both the Scottish Executive's Consolidated Accounts and the 2006 European Guarantee Account.

64. The SFPS is a complex scheme which presented significant administrative challenges and a number of associated risks in the development of robust systems and processes. The priority was to make payments as soon as practicable, and they were, in fact, made well in advance of other parts of the UK. However our testing identified system and control weaknesses in the audit trail relating to payments made under the SFPS, lack of reconciliations to the SEAS and problems and delays in the provision of transaction data. These impeded the audit process and required additional audit testing to

¹ EAGGF 2006 accounting year - 16 October 2005 to 15 October 2006

be undertaken to gain the appropriate assurances. The required assurances were obtained and it should be noted that no material substantive errors were identified.

65. Trunk roads maintenance is carried out under contract by BEAR and AMEY. Performance Audit Group (PAG), a consortium of Halcrow, PriceWaterhouseCoopers and Scott Wilson audit, monitor and review the technical, financial, quality management and environmental aspects of the trunk roads contracts on behalf of the Scottish Executive. Our review of the controls operating over trunk roads maintenance expenditure therefore included a review of the work carried out by PAG and we concluded that we could place reliance on their work in line with the requirements of International Auditing Standard 620 'Using the work of an expert'.
66. Apart from the issues noted above in relation to SFPS we concluded that key controls across departmental programme expenditure areas and their underlying systems operated satisfactorily to enable us to place reliance on them and to mitigate the risks of material misstatement of the accounts, error or fraud.

Information and Communication Technology

67. As part of our 2005/06 audit our specialist computer auditors have undertaken Pathfinder Diagnostic reviews of information systems and a number of reviews of ICT controls at the Scottish Executive including:
- Payroll;
 - SEAS;
 - the e-Procurement Scotland programme;
 - electronic Records and Document Management (eRDM) – support of data protection and freedom of information requirements follow up;
 - Review of eRDM Scanning Solutions within Executive Business Areas; and
 - Information security.
68. The Scottish Executive is in the process of finalising the implementation of an electronic Records and Document Management system (eRDM) across its business areas. During the 2003/04 audit year we carried out a review of the Scottish Executive eRDM implementation. The review sought to establish how eRDM would be able to support the requirements placed upon the Executive in light of its responsibilities under the Data Protection Act 1998 and the Freedom of Information (Scotland) Act 2002. As part of our 2005/06 audit work these areas have been revisited to assess progress in implementing the agreed recommendations.

69. The Executive has made good progress in implementing the recommendations that were made during the initial review. However a number of recommendations have been deferred or await formalisation. These include:
- marking of documents that have been published, either under the Publication Scheme or as the result of a request for information, will be addressed when the next version of the application is rolled out;
 - Data Protection in relation to Executive business will be addressed in a paper to be presented to the Management Group on the overall information management strategy;
 - disciplinary procedures, making specific reference to inappropriate use of information systems, are still to be formalised by the Human Resources Division; and
 - procedures are still to be introduced whereby user details on eRDM are updated automatically on the basis of user profiles registered for the SCOTS III network.
70. As part of our 2004/05 audit we carried a high level initial review of eRDM central scanning and rollout. In 2005/06 we have carried out a detailed review of scanning and implementation across a sample of divisions and within the Central Scanning Unit. This review examined the effectiveness of internal controls over the integrity and authenticity of scanned document images within the eRDM system and also sought feedback on how well eRDM has been implemented into business areas. We interviewed staff in ten business areas throughout the Executive to obtain a wide range of views on all aspects of the eRDM system.
71. A number of areas of good practice were identified throughout the implementation of eRDM within the Executive's business areas. However, we also identified some significant challenges and risk exposures where there may be opportunities to improve current administration and operational practices including:
- inconsistent working practices and application of scanning across Divisions;
 - no independent review of business areas' risk assessments are undertaken to ensure that a consistent and comprehensive approach has been carried out and the correct assessment concluded; and
 - a number of business areas have indicated only limited confidence in the eRDM system's security and ability to search and find documents quickly. As a result, there is a general reluctance to destroy manual documents with staff reverting back to working with the hard copy documents.
72. As part of our audit work to support the European Guarantee Account audit and also the audit of consolidated accounts we are required report annually on IT Security within the Environment and Rural Affairs Department. To a large extent this effectively means that we are required to consider IT

security across the Executive as the Department is subject to corporate IT security arrangements and use corporate financial systems for processing European Guarantee Account payments.

73. The relevant EC regulations stipulate that information systems security shall be based on the criteria laid down in a version applicable in the financial year concerned of one of the accepted international standards which in the case of the Environment and Rural Affairs Department is BS ISO/IEC 17799: 2002 (Transitional arrangements are currently in place with full compliance with the relevant standard required by 2008).
74. We are specifically required to report for the purposes of European Guarantee Account using a scoring mechanism (the Capability Maturity Model), as to the information systems security measures put in place by SEERAD. We are required to indicate the extent to which the effective measures were in place.
75. We reviewed the work of both management and internal audit and performed appropriate tests on the completeness and robustness of their compliance status. The detailed results from our work are recorded in the formal European Guarantee Account ICT 2005 Statement. However the overall results indicated that the information systems security of the Environment and Rural Affairs Department is generally well organised and maintained. Strong central controls and guidelines are available, designed to provide appropriate security protection. However, day to day pressures result in minimal documentary evidence that could provide assurance. Therefore further work is required to demonstrate full compliance under each domain specified in ISO 17799.

Other Specific Reviews

76. As part of our audit of the Executive we have also carried two specific reviews in conjunction with other Agencies. These reviews were:
 - European Structural Funds Irregularities; and
 - Youthlink Scotland

European Structural Funds Reviews

77. The National Audit office, working with other EU Supreme Audit Institutions (SAIs) and the European Court of Auditors, has been undertaking a review of the processes in place for identifying, reporting and following up on irregularities in European Structural Funds. The purpose of this work is to identify those controls that are working well and those which need to be improved, and seek to identify best practice in respect of compliance with EC regulations. Audit Scotland was asked to contribute to this work as the management of structural funds in Scotland is devolved. As part of our 2005/06 audit of

European Structural Funds we have therefore reviewed the control environment for the management of irregularities

78. Our audit work reviewed the processes in place for identifying, reporting and following up on irregularities carried out by the European Structural Funds Division in the Enterprise, Transport and Lifelong Learning Department in respect of the European Regional Development Fund and the European Social Fund, and two divisions in the Environment and Rural Affairs Department in respect of the European Agricultural Guidance Fund. We specifically examined the Agricultural Business Development Scheme (ABDS) and Process and Marketing Grant Scheme programmes.
79. Our review concluded that although there are a number of areas where controls are operating satisfactorily, there are also a number of weaknesses which require to be addressed. In particular with respect to ABDS, the recording of potential irregularities was incomplete and limited information held on the ABDS spreadsheets makes the extraction of meaningful data difficult.

Youthlink

80. In September 2005, the Education Department commissioned Her Majesty's Inspectorate of Education to undertake a review of YouthLink Scotland, a voluntary sector organisation in receipt of Scottish Executive funding. Audit Scotland was asked to support this inspection by reviewing the arrangements for financial governance and management and to minimise the regulatory burden. The review work examined:
- to what extent the organisation fulfilled its obligations to the grants scheme;
 - the effectiveness of the services and programmes offered within the context of the grants scheme;
 - the extent to which the organisation operated in a professionally competent manner;
 - its business and financial planning; and
 - its financial management and reporting.
81. The joint review concluded that overall, YouthLink Scotland effectively delivered a range of projects which clearly related to the mission and strategic objectives of the organisation; it successfully influenced policy in line with the interests of young people and of the youth work sector; the Step it Up and Walk the Talk projects identified and successfully promoted good practice in youth work in areas relating to training and health; and, staff in YouthLink Scotland had played an effective role in developing the Youth Work Modern Apprenticeship in Scotland.
82. However, there was still further work to do , including developing a fully systematic and corporate approach to programme development, management, monitoring and financial outcomes.

83. Further joint reviews of voluntary sector organisations will be carried out at the end of 2006 including Young Scot and the Scottish Youth Parliament as well as a follow up of the work at Youthlink.

Performance

84. Public audit is more wide-ranging than in the private sector and covers the examination of, and reporting on, performance and value for money issues. As part of our annual audit we are required to plan reviews of aspects of the arrangements to manage performance, as they relate to economy, efficiency and effectiveness in the use of resources.
85. Accountable Officers have a duty to ensure the resources of their Department, and the Scottish Executive as a whole, are used economically, efficiently and effectively. These arrangements were extended in April 2002 to include a duty to ensure 'best value' in the use of resources.

Best Value

86. There is no statutory duty of Best Value in the wider public sector in Scotland (the Scottish Executive and its Executive Agencies, Executive NDPBs, and the NHS). Instead, the Scottish Executive issued high level guidance in May 2003, followed by more detailed draft secondary guidance in August 2003. This duty can be described as:
- to make arrangements to secure continuous improvement in performance (while maintaining an appropriate balance between quality and cost);
 - to have regard to economy, efficiency and effectiveness, and the equal opportunity requirements; and
 - to contribute to the achievement of sustainable development.
87. In May 2005, Ministers decided that they would not bring forward legislation which extends Best Value in the wider public sector. However, Ministers do wish to encourage and embed the principles of Best Value across the wider public sector, and further guidance was issued in May 2006.
88. During 2005-06 Audit Scotland carried out a baseline review to establish the arrangements in place across the central government and NHS sectors which support Best Value and continuous improvement, and to identify areas of good practice. Within this a separate review has been carried out at the Scottish Executive covering corporate functions and all departments. The results of these reviews are currently being analysed and will be presented to the Executive shortly.
89. It should be emphasised that this exercise does not represent a best value audit of the Executive, the NHS or Agencies and NDPBs. Audit Scotland is considering what type of audit approach might be suitable for non-statutory Best Value. The results from this review will inform that thinking.

Efficient Government

90. The Efficient Government Initiative is a central part of the government's programme of investment, reform and modernisation. The Initiative is aimed at attacking waste, bureaucracy and duplication in Scotland's public sector. A key feature of the Initiative is that it focuses on the public sector as a whole, rather than individual organisations, with the intention of realising efficiencies through joining up. The primary objective is to deliver the same services with less money or to enable frontline services to deliver more or better services with the same money.
91. In February 2005, the Scottish Executive invited Audit Scotland to audit the performance of the Scottish public sector in achieving the efficiency gains set out in the Efficient Government Plan published in November 2004. The Efficient Government Plan set an aspirational target to achieve efficiency savings of £1,500 million over a three year period to 2007-08.
92. The Minister for Finance and Public Sector Reform published the Outturn Efficiency Report in September 2006 which identified that the Executive had made claimed efficiency savings of £441 million against an in-year savings target of £405 million.
93. As a first step Audit Scotland commented on the Scottish Executive's Efficiency Technical Notes for cash releasing savings in May 2005 and on time releasing savings in July 2005. In both cases we identified a number of areas where improvement was needed if the Notes were to provide a sound basis for the Executive to monitor the achievement of efficiency savings. We informed the Executive that if these changes were not made then it will not be possible for audit to provide assurance on the achievement of savings.
94. During 2005-06 Audit Scotland completed a management arrangements review of Efficient Government activities across the public sector. We also carried out an assessment of the management of the overall programme by the Delivery Division and a review of claimed savings within Efficiency Statements.
95. The findings from this work are currently being analysed and will be made available to the Executive in the near future. The Auditor General has indicated his intention to issue a report incorporating the key messages from our review under Section 23 of the Public Finance and Accountability Act 2000.

eProcurement

96. During 2004/05 we carried out a review of eProcurement. As part of our 2005/06 audit we have followed up this work to assess the progress in implementing the agreed recommendations. Our overall conclusion is that whilst some progress has been made in addressing the risk areas identified

there are a number of areas where further work is required. This is especially evident in the area of achieving the Efficient Government target.

97. Amongst the areas of progress are the appointment of the eProcurement Scotland Advisory Board, the development of a tool to record and report benefits resulting from using the ePS solution and inspection of the provider site in the USA.
98. Remaining risk areas include:
 - although some organisations have made considerable progress on achieving the target spend through the ePS facility, the general spend is still behind expectations;
 - the benefits tracking tool developed by the Procurement Directorate is not used universally by organisations across the ePS user base. This makes the identification of savings as a result of using the facility difficult; and
 - at the time of our review, the upcoming replacement (2008) had not yet been subject of strategic planning and review.

Community Health Partnerships

99. The future model of healthcare envisaged in the Kerr report and endorsed by *'Delivering for Health'* relies heavily on joint working arrangements, and particularly Community Health Partnerships (CHPs), as a means of delivering services and improving health in local communities. As part of our audit within the Health Department we reviewed the progress on developing CHPs and the partnership arrangements in relation to joint services with local authorities.
100. Overall there has been significant progress in establishing CHPs throughout Scotland. Some boards have taken longer than others to set up their CHPs and two island boards do not have a CHP in place. CHPs are a key mechanism for implementing "Delivering for Health". Therefore the two island boards that do not yet have CHPs or where the CHPs are not yet fully effective are likely to find implementing "Delivering for Health" more challenging than other boards.
101. All of the boards surveyed could identify benefits of the new partnership arrangements, even at this early stage in their evolution and whilst our review shows that there is much to be done, progress is being made on developing this model of local service delivery.

Community Planning

102. Audit Scotland undertook a study on community planning on behalf of the Accounts Commission and Auditor General for Scotland. The report reviewed the national context, local arrangements and planning and performance management in community planning partnerships (CPPs). The key findings from this report are:

- community planning can improve services and benefit local communities. However the wide range of national policy initiatives and structural differences in partner organisations make it difficult for partnerships to achieve their full potential (these issues were also identified in the course of our CHP review);
- there is wide variation in the size and membership of CPPs. More needs to be done to rationalise the number and complexity of partnerships and to engage elected members; and
- CPPs need to show how they are improving public services and benefiting communities. Many have still to develop fully their planning and performance management systems.

103. The report made a series of recommendations and these will be followed up in due course.

National Studies

104. The Public Reporting Group within Audit Scotland has carried out a number of studies during the year. Details of those published recently are included at Appendix C.

Looking Forward

105. The Executive is responsible for delivering Government policy and managing public expenditure in a complex and dynamic environment. The Executive's budget is expected to rise from its current level of some £26 billion annually to £30 billion by 2007/2008. This significant increase in resources will further raise expectations of improved performance in securing high quality, customer focused public services and in the achievement of Best Value and efficiency in the use of resources.

106. There are a number of specific challenges facing the Executive over the coming year and beyond including:

- Public service reform – Transforming public service was published by the Executive in June 2006 setting out a vision for reform and how it can be taken forward during the coming years. The Executive has also issued a consultation on a National Strategy for Shared Services. Taking forward these agendas and encouraging the development of our public services is a significant challenge for the public sector.
- Change and improvement programme – The Executive has been undertaking internal reviews including Taking stock: Fit for Future and the Financial Management Review. Taking forward the outcomes from these reviews will be important for the Executive in its efforts to achieve continuous improvement.
- Procurement – The Review of Public Procurement in Scotland report by John McClelland issued in March 2006 contained a significant number of findings and recommendations in respect of procurement in the public sector. It will be important that the recommendations are acted upon to improve performance in the public sector and that the benefits of the e-procurement strategy are fully realised.
- Best Value – Revised guidance on best value in the wider public sector has now been issued. The Executive will need to ensure that it has mechanisms in place that enable it to demonstrate continuous improvement and that the principles of best value are embedded. Audit Scotland will be developing its approach to Best Value in the wider public sector in due course.
- Efficient Government - the Efficient Government Plan sets targets to achieve £745 million (rising to £900 million) of cash-releasing savings, and £300 million (rising to £600 million) of time-releasing savings, by 2007/2008. There are a number of risks associated with the project management and measurement of these efficiency savings and the achievement of these targets continues to represent a significant challenge for the Executive and its partner organisations.
- Transport Scotland – The Agency commenced on 1 January 2006 with responsibility for managing approximately £1.3 billion of the Executive's budget and £12 billion of its assets. It will be important that the risks associated with the transfer of functions are appropriately managed and that the

Agency has processes in place to ensure effective governance and financial management arrangements, and for the production of financial statements.

- European Structural Funds closure and restructure –The forthcoming restructuring of the Structural Funds for the programming period 2007 to 2013, and the closure of the 2000-2006 programme period, will present the Executive with a number of challenges and risks which it will require to manage.
- Common Agricultural Policy (CAP) Reforms – Further CAP reforms will occur during 2006/07 with the creation of two new EU funds (a Guarantee and a Rural Development Fund) to replace the previous EAGGF and which will fund future spending on CAP support and Rural Development. As a result there are a significant number of risks and challenges faced by the Executive. A specific risk to be highlighted is that under the Treasury’s revised budgetary arrangements for European funds any potential disallowance on CAP expenditure – beyond a margin of £8m a year provided by Treasury - will now be borne by the Executive itself in the first instance.
- Demand led policies – The Executive implements a number of significant demand led policies, including free personal care and concessionary fares. There are risks that demand may outstrip the estimated take up and funding provided, creating risks to service delivery and increased financial pressure on the Executive. Audit Scotland will continue to monitor the impact of such policies.
- Grants to Local Authorities – The Scottish Executive provides a significant number of grants to local authorities. Through our work at the Scottish Executive and local authorities it is becoming apparent that there are inconsistencies in the accounting treatment of grants between the Executive and local authorities and also between local authorities. We will liaise with the Executive during 2006/07 to examine this issue further.
- ICT Systems - The delivery of two IT projects, eHR and Criminal History System have been subject to significant delays, cost overruns and media attention. Progress in the implementation of these projects will be considered during the course of the coming year.

107. Our planning process for the 2006/07 audit will incorporate a review of the effectiveness of the Executive’s arrangements for managing these and other identified risk areas.

Appendix A: Action Plan:

Action Point	Para No	Issue	Response and Agreed Action
1	29	<p>Faster Closing</p> <p>The Executive has taken forward the issue of the faster closing agenda during the financial year 2005/06. However it should take stock of the process so far and consider the extent to which it wishes to take it forward in the short and longer term.</p> <p>The Executive also needs to develop a clear project plan to take forward the Faster Closing initiative, both internally and across the consolidated bodies.</p>	<p>By end December, Finance Group, with Audit Scotland, will conduct a post-event review of the 2005/06 process to assess the scope for accelerating closure processes further in future years.</p> <p>With reference to the current financial year, we will be mindful of the need for Finance Teams to contribute to the Spending Review 2007 exercise which will run concurrently with the preparation of the financial statements and therefore further improvement in 2006/07 may be modest.</p>
2	31	<p>Roads Valuation</p> <p>Transport Scotland needs to ensure that processes are established that enable the effective completion and valuation of the roads network assets, including effective management review of the data output from the valuation process.</p> <p>Transport Scotland also needs to ensure that it discusses with the external consultants the shortcomings in the roads valuation information they provided during 2005/06 and ensure that actions have been taken to ensure that there is no repeat in 2006/07.</p>	<p>Transport Scotland's Corporate Finance team have recognised the importance and need to improve on the timetable for running the Roads Asset Valuation System and providing information to Audit Scotland. A working group has been established to prepare for the 2006/07 annual accounts, focussing on the issues highlighted from the 2005/06 audit and the need to meet tighter deadlines as an Executive Agency for reporting into the consolidated accounts.</p>

Action Point	Para No	Issue	Response and Agreed Action
3	34	<p>Annual Report</p> <p>The Executive should consider the disclosures made in its Annual Report, Operating and Financial Review, Public Interest Report and consider developing it or other annual corporate reporting mechanisms to meet more comprehensively the requirements of FReM and Reporting Standard 1. This would include:</p> <ul style="list-style-type: none"> ▪ a more detailed review of the Executive's business including description of activities, objectives and strategies for achieving them, details of risks and uncertainties and future developments; ▪ the disclosure of performance against key performance indicators and whether the present cross reference is sufficient on an annual basis; ▪ increased analysis on significant movements on operating costs and assets and liabilities in the OFR; ▪ details of the executive policies on sustainability, including the policies on social and community issues, and environmental issues; and ▪ the action taken to maintain or develop the provision of information to, and consultation with employees. 	<p>Finance Group will consider, prior to the 2006/-7 financial year end, where the content of the various reports within the Annual Accounts could usefully be improved to provide more information to the public.</p> <p>Any wider reporting of Executive activities requires to be considered corporately.</p>

Action Point	Para No	Issue	Response and Agreed Action
4	35	<p>Register of Interests</p> <p>The Executive should consider maintaining a register of interests for members of the management group, in particular non-executive members, to provide transparency in the Executive's governance arrangements and support compliance with Financial Reporting Standard 8 Related Party Transactions.</p>	<p>A report will be prepared to allow Management Group to consider this proposal.</p>
5	37	<p>Certificates of Assurance</p> <p>The Executive should ensure that the assurance framework is in place to ensure that certificates of assurance are provided which are robust and timely.</p>	<p>There is a framework in place, flowing from the requirements set out in the Scottish Public Finance Manual. Finance will review the guidance for 2006/07, including the communication of requirements and key deadlines.</p> <p>More widely, as part of the follow-up of the accounts process, senior management will be reminded of the importance of robust and timely completion.</p>

Appendix B: Auditor General for Scotland Section 22(3) Reports

108. Paragraphs 109 to 118 present a brief summary of the Auditor General's reports on accounts which have been laid this year. Paragraph 119 similarly highlights one other report on an account that is currently under consideration. These issues have been considered in the context of the audit of the Scottish Executive and it was concluded that no action was necessary in relation to the audit opinion, or the need for a separate reference in a S22 report on the Executive's accounts.

Argyll and Clyde Health Board

109. The Auditor General's report drew attention to the dissolution of Argyll and Clyde Health Board. Responsibility for services was transferred to Greater Glasgow Health Board and Highland Health Board on the 1 April 2006. The £81.7 million accumulated excess of Argyll and Clyde Health Board was cleared, through the enhanced provision within the final Revenue Resource Limit from the Scottish Executive Health Department. The report also highlighted that the successor boards will now require to develop cost savings programmes to address the £28.4 million underlying recurring deficit inherited from the former Argyll and Clyde Health Board.

Highland Health Board

110. Highland Health Board's accounts were qualified again due to a difference of view concerning the accounting treatment for a Private Finance Initiative for a primary care centre. The Board had accounted for a primary care centre off the balance sheet as an operating lease. In the view of the auditors the Board should have accounted for this asset as a finance lease and included a fixed asset and a related liability on the balance sheet. Had the Board adopted this treatment it would have increased the fixed assets by £8.8 million and long term liabilities by a similar amount. The auditors also qualified their opinion as a result of the accounting treatment of the lease of the Mental Health Facility PFI. The auditors have reported that the accounting treatment of the total finance charges relating to the lease has not been accounted for in accordance with Statement of Standard Accounting Practice 21.

Lanarkshire Health Board

111. Lanarkshire Health Board did not achieve its financial target in 2005/06. The failure to meet its target was caused by a brought forward deficit. The Board made an in-year surplus of £11.6 million in 2005/06. The Board has approved a financial recovery plan to eliminate the underlying recurring

deficit and achieve recurrent financial break-even by the end of 2007/08. The Board expects to clear its remaining brought forward deficit in 2006/07 through a capital receipt from the sale of land.

Financial performance, including the underlying reasons for failure to achieve targets, will feature as part of an overview report on the NHS.

Western Isles Health Board

112. Western Isles Health Board did not achieve its financial target in 2005/06. A financial recovery plan has been agreed with the Scottish Executive Health Department, which aims to recover the cumulative excess by 2008/09. The Scottish Executive Health Department has provided assurances to the Board that it will have access to cash throughout the period 2006 to 2009, which will allow the Board to meet its liabilities as and when they fall due. There are, however, a number of significant risks that could impact on the successful delivery of the financial recovery plan.

113. The Auditor General's report also highlights that the board did not have a satisfactory set of internal controls. The Statement on Internal Controls prepared by Western Isles Health Board indicated that the Board had taken action to address the issues but that further work was required to improve risk management arrangements. It also draws attention to the resignation of the Board's chairman and the appointment by the Minister for Health and Community Care of an interim chairman along with support from a senior managerial and clinical team, drawn from other NHS boards and the Scottish Executive Health Department.

Scottish Prison Service

114. The Auditor General reports on the subsequent developments in respect of the financial liability which may accrue to the Scottish Prison Service as a result of potential court cases brought by former and serving prisoners claiming that the conditions in which they were held in prison breached their rights under the European Convention of Human Rights. The report highlights that the proposed scheme for settling out of court injury cases which have been caused or exacerbated by slopping out has now been established and received 220 applications by the end of March 2006.

115. The Auditor General also highlights that as at March 2006 there were 1009 actions raised in the Sheriff Court and 172 cases in the Court of Session in relation to alleged breaches of the European Convention of Human Rights, though the majority of cases have been suspended pending the outcome of a number of "illustrative cases" through the court system to clarify the law and the potential liabilities for the Scottish Prison Service.

116. The report draws attention to the fact that the Scottish Prison Service has continued to make significant progress in improving conditions in prison accommodation throughout the year including the elimination of slopping-out, except at Peterhead and in one hall at Polmont.

Scottish Enterprise

117. Scottish Enterprise has recorded an overspend of £33 million against its overall resource budget for the year. This consisted of an excess against resource budget of £6 million for cash and £27 million for non-cash costs. The overspend occurred during a year when a new planning and resource allocation model was introduced to replace the existing budgetary control framework.

118. The report highlights that there were a number of contributing factors to the overspend and that following a number of internal and external investigations a consolidated action plan has been prepared summarising the recommendations from each of the investigations into the current overspend position, and the action that Scottish Enterprise is taking in response to these recommendations. Given the importance of these issues to Scottish Enterprise progress against this action plan will be monitored and reported as necessary.

Scottish Fisheries Protection Agency

119. The Auditor General is considering issuing a report to bring to the Parliament's attention events surrounding the termination of the procurement of a new fisheries protection vessel.

Appendix C: Auditor General for Scotland published reports

Accounts Commission and Auditor General for Scotland

Public Sector Pension Schemes in Scotland (published 20/06/2006)

120. The report provides a snapshot of the six main public pension schemes in Scotland, the level of unfunded liabilities and the issues affecting future liabilities and contribution rates.

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

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

No hiding place: the National Fraud Initiative in Scotland (published 17/05/2006)

122. Scotland's councils have worked with other public bodies to identify £15m worth of fraud and errors in a national detection exercise.

Auditor General for Scotland

Transport Overview (published 28/09/2006)

123. Spending on transport in Scotland last year was about £1.5 billion and this is expected to rise to £2.3 billion in 2007/08. The Scottish Executive has performed well against most of its transport targets, but more should be done to provide a full picture of what is being achieved with this investment.

Relocation of Scottish Executive Departments, executive agencies and NDPBs (published 21/09/2006)

124. The report found that most of the reviews arose from the creation or restructuring of organisations, or from breaks in property leases. Only two of 38 reviews were the result of potential efficiency improvements identified by the organisations in their business plans. In most cases, it was not clear whether relocation would deliver wider policy objectives.

Performance Management in Scottish Enterprise (published 16/03/2006)

125. The report indicates that the Scottish Enterprise's performance measurement framework provides a limited picture of its achievements. It also highlights that Scottish Enterprise needs to improve how it develops, monitors and evaluates its activities.

Implementing the NHS Consultant contract in Scotland (published 9/3/2006)

126. A new contract for consultants has cost the NHS in Scotland an extra £235m in its first three years but clear evidence of its benefits has yet to emerge. This report indicates the new contract offers an opportunity to improve patient care by planning consultants' work better, but it is not yet being used to its full potential.

Tackling Waiting Times in NHS Scotland (published 16/2/2006)

127. The NHS in Scotland has made significant progress towards meeting waiting time targets over recent years but future targets are likely to be challenging. Tackling Waiting Times in the NHS in Scotland finds that since 2001 the health service has made good progress in reducing the longest waits for inpatient, day case and outpatient care for people with waiting time guarantees.

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

128. The report indicates that the Scottish Further and Higher Education Funding Council is making progress on a number of fronts. It has achieved most progress on initiatives to improve the adequacy and efficiency of further education and improve performance management in areas where it has been able to take direct action, such as the funding of estates capital projects. Progress in areas where strategic influence is required has been slower and there is scope for further improvement.

Scottish Executive: The Northlink Ferries Services Contract (published 22/12/2005)

129. The NorthLink ferry services contract illustrated the difficulty in reconciling the need to ensure continuity of lifeline services with EC guidelines on state-aid to maritime transport if the service provider gets into financial difficulties. This report highlights a number of areas where improvements are being made in tendering arrangements and lessons need to be learned.

Overview of the Performance of the NHS in Scotland 2004/05 (published 8/12/2005)

130. Scotland's health service is achieving better clinical outcomes and cutting most waiting times. This report highlights that the service has improved the availability of treatment and is successfully tackling

prioritised conditions such as cancer, stroke and heart disease. It finds that in other areas performance was mixed and that the NHS needs to improve its financial and workforce management to face future challenges.

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

131. Scotland's public sector has good examples of investment in leadership but many individual organisations do not have clear policies and most are unable to link the spending to improvements in their performance. Public bodies need to do more to track the £5m they invest each year in leadership development and make sure this results in better managed organisations and better public services.

Scottish Executive: |Supporting new initiatives. How Government Works (published 10/11/2005)

132. Last year the Scottish Executive launched new initiatives amounting to £1.4 billion. The reports indicates that the management of these projects is generally sound, but making changes could help to improve control of the funding and allow better assessment of whether the money is helping to achieve policy aims.

Overview of the Water Industry in Scotland (published 13/10/2005)

133. Scottish Water has made a good start in raising the water industry's performance but can make further improvements. The report highlights that since Scottish Water's creation in 2002, the body has improved the efficiency and performance of the water industry and cut operating costs significantly. However Scottish Water can further improve, and it faces a challenging timetable for its £1.8bn capital investment programme.

Scottish Executive Report on the 2005/06 Audit



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