

Scottish Qualifications Authority

Report on the 2006/07 Audit



Contents

Executive Summary	2	Governance	10
Introduction	4	Looking Forward	12
Financial Statements	5	Appendix A: Action Plan	13
Performance	8		



Executive Summary

Introduction

In 2006/07 we audited the financial statements of the Scottish Qualifications Authority (SQA) and we looked at aspects of performance management and governance. This report sets out our key findings.

Financial Position

We have given an unqualified opinion on the financial statements of the SQA for 2006/07.

The SQA had an excess of expenditure over income of £21.347 million in 2006/07 (2005/06: £16.926 million). The excess of expenditure over income for 2006/07 was set against revenue Grant in Aid of £16.005 million (2005/06: £15.906 million), contributing to a decrease on the general fund of £2.607 million. SQA's net asset position in 2006/07 decreased to £10.106 million (2005/06 £20.214 million). This decrease is primarily attributable to a decrease in tangible fixed assets due to the sale of Hanover House and an increase in pension liabilities.

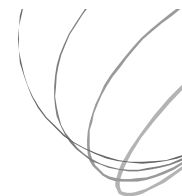
Funding Arrangements

Additional grant in aid funding has been reducing and income from entry charges and commercial activities has been increasing. SQA is currently discussing a new three year funding model with the Scottish Government, against a backdrop of falling candidate numbers due to demographic changes. SQA aims to expand its commercial activities to reduce the funding gap. A business case has been submitted to the Scottish Government for the creation of a trading subsidiary which will manage and operate SQA's commercial activities and identify commercial opportunities.

Performance

Performance against SQA's five high level corporate objectives during 2006/07 was satisfactory with the exception of the implementation of SQA's modernisation business plan where no funding was approved by the Scottish Government during 2006/07 to support the plan.

A recent study was carried out by Audit Scotland, on behalf of the Auditor General, to assess the extent to which the SQA has recovered from its position in 2000 and assessed SQA's risk and performance management framework, governance arrangements and commitment to best value. The study concluded the SQA has made good progress in its recovery from the problems it faced in 2000 and it now has a better understanding of its key business activities and is demonstrating an ongoing commitment to continuous improvement.



In response to the recommendations contained in the performance management study, SQA has reviewed its performance indicators and introduced a balanced scorecard approach to performance management.

SQA has also commenced a review to consider the efficiency and effectiveness of its committee arrangements with a view to develop a more strategic focus based on the key risks facing the business. We will continue to monitor developments during 2007/08.

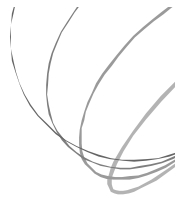
Governance

Corporate Governance is concerned with the structures and process for decision making, accountability, control and behaviour at the upper levels of an organisation. Overall the corporate governance and control arrangements for the SQA operated satisfactorily during the year, as reflected in the Statement on Internal Control.

Looking forward

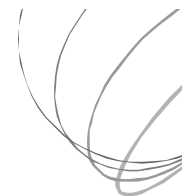
In 2007/08, we intend to continue our audit work on internal control systems and the financial statements, as well as continuing to monitor progress with SQA's modernisation and development plans. We also intend to review the progress SQA has made in strengthening Best Value arrangements since our baseline review of this area in 2005/06.

Audit Scotland
October 2007



Introduction

1. This report summarises the findings from our 2006/07 audit of the Scottish Qualifications Authority. The scope of the audit was set out in our Audit Plan, which was presented to the Audit Committee on 21st February 2007. This plan described the work we planned to carry out on financial statements, performance and governance.
2. Appendix A of this report sets out the key risks highlighted in this report and the action planned by management to address them.
3. This is the first year of a five year audit appointment. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officers and members of the Scottish Qualifications Authority during the course of our audit. This report will be submitted to the Auditor General for Scotland and will be published on our website, www.audit-scotland.gov.uk.



Financial Statements

4. In this section we summarise key outcomes from our audit of the Scottish Qualifications Authority's financial statements for 2006/07, and comment on the key financial management and accounting issues faced.

Our Responsibilities

5. We audit the financial statements and give an opinion on whether:
 - they give a true and fair view of the financial position of the Scottish Qualifications Authority 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 Chief Executive as accountable officer to obtain assurances on systems of internal control; and
 - assessing whether disclosures in the statement are consistent with our knowledge of the Scottish Qualifications Authority.

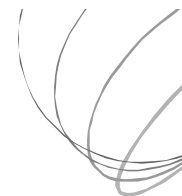
Overall Conclusion

7. We have given an unqualified opinion on the financial statements of the Scottish Qualifications Authority for 2006/07.

Financial Position

2006/07 outturn

8. The Scottish Qualifications Authority had an excess of expenditure over income of £21.347 million in 2006/07 (2005/06: £16.926 million). The excess of expenditure over income for 2006/07 was set against revenue Grant in Aid of £16.005 million (2005/06: £15.906 million), capital funding released of £1.751 million, revaluation realised on disposal of £1.583 million, movement on the pension deficit of (£1.068 million) and excess depreciation of £0.469 million, contributing to a decrease on the general fund of £2.607 million. SQA's net asset position in 2006/07 decreased to £10.106 million (2005/06 £20.214 million). This decrease is primarily attributable to a decrease in tangible fixed assets due to the sale of Hanover House and an increase in the pension liability.

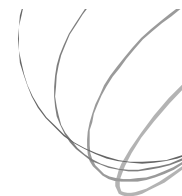


9. A change in the Financial Reporting Manual (FReM) for 2006/07 has required a restatement to the 2005/06 figures. The FReM no longer allows Grant in Aid to be treated as income. Grant in Aid is now treated as a contribution from a controlling body, taken directly to the general fund on the balance sheet. The result of this change is that SQA is no longer required to hold a liability in respect of deferred government grants.

Funding Arrangements

10. SQA is expected to 'flat-line' its core costs, with additional grant funding covering development costs. In 2006/07 additional revenue grant funding of £8.710 million was received (2005/06:£10.638 million).
11. SQA's self generated income increased to £42.606 million in 2006/07 from £34.677 million in 2005/06. (The non-recurring gain on sale of Hanover House accounts for £2.845 million of this increase.) The increase in operational income is mainly due to increases in entry charges agreed with the Scottish Government as part of funding arrangements and increased student entries for national courses and units and SCE standard grades and the award of a new commercial contract for dangerous goods driver training.
12. SQA is currently in discussion with the Scottish Government on a new three year funding model. Income and expenditure projections have identified that due to changing demographics there will be a gap in funding which will not be fully off-set by savings on expenditure. For this reason, SQA aims to expand its commercial activities in order that commercial surpluses will off-set the core deficit rather than relying on increasing grant in aid. SQA substantially achieved its commercial targets in 2006/07.
13. SQA have developed a proposal to create a separate trading entity to manage and operate SQA's commercial activities and identify alternative sources of income. The business case was submitted to the Scottish Government in 2005/06. Following comments received from the Minister and SQA's decision to incorporate international awarding and consultancy services into the business case, a revised business case was approved by the Board at its meeting of 8th August 2007 and re-submitted to the Scottish Government. Approval is awaited to progress the creation of a trading subsidiary.
14. A temporary Director post has been created to focus on the commercial and international activity in preparation for the trading subsidiary. Failure to adequately scope core, commercial and international projects to ensure that projects are sustainable and viable could impact on SQA's ability to operate within its agreed funding arrangements and reduce its reliance on grant in aid.

Action Point 1



2007/08 budget

15. The SQA has been allocated additional funding of £9.100 million for running costs in 2007/08 (2006/07: £8.710 million), and a further £0.750 million for capital expenditure (2006/07: £2.290 million). The increase in grant in aid is primarily due to changing funding arrangements for Skills for Work from specific grant funding to grant in aid funding.

Issues Arising from the Audit

16. We reported the following issues to the Audit Committee on 4th July 2007:

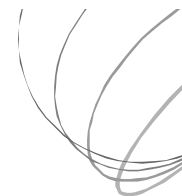
- **Accrual of expenditure** - A general accrual for expenditure of £100,000 has been included in the accounts based upon officers' previous experience of the level of year-end accruals. As the accrual does not related to any specific liability at the year end it should not be included in the accounts. It was agreed that no adjustment would be made to the accounts for this and officers have agreed to revised procedures in relation to year end accruals for future years.
- **Year-end cash balance** – At 31st March 2007, SQA held a cash balance of £65,000. It is a requirement of the Management Statement agreed with Scottish Ministers that SQA should not hold a cash balance at the year end. The Scottish Government have agreed that this cash balance can be retained by SQA without affecting the grant-in-aid to be drawn down in 2007/08 on condition that SQA provides assurance that it has taken action to ensure that cash and bank balances will be more accurately managed for future years.

Statement on Internal Control

17. The Statement on Internal Control provided by the SQA's Accountable Officer reflected the main findings from both external and internal audit work. Neither Audit Scotland, nor the Internal Audit function (provided by PricewaterhouseCoopers) raised any issues which required to be disclosed in the Statement on Internal Control.

Regularity Assertion

18. The Public Finance and Accountability (Scotland) Act 2000 imposes a responsibility on auditors that requires us to certify that, in all material respects, the expenditure and receipts shown in the accounts was 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 Accountable Officer as to her view on adherence to enactments and guidance. No significant issues were identified for disclosure.



Performance

19. 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 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.
20. Accountable officers also have a duty to ensure the resources of their organisation 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.

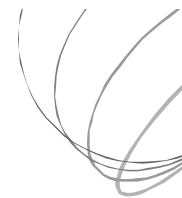
Modernisation business plan

21. Performance against SQA's corporate objectives during 2006/07 was satisfactory with the exception of the implementation of SQA's modernisation business plan which was modified as no funding was approved by the Scottish Government during 2006/07 to support this. As a result, SQA's core budget was re-prioritised to ensure that essential tasks were undertaken to maintain momentum on key developments during 2006/07.
22. During 2007/08 SQA has received approval from the Scottish Government for one year's funding of £875,000 towards the programme. There is, however, a gap of £4 million funding to cover the next 3 years of the programme. Failure to secure this funding continues to be a significant strategic risk for SQA, impacting on its ability to match the pace of competitors in improving processes and meeting the organisation's efficiency agenda.

Action Point 2

Performance Management in the Scottish Qualifications Authority

23. A study was carried out by Audit Scotland, on behalf of the Auditor General, to assess the extent to which the SQA has recovered from its position in 2000 when inaccurate and incomplete results were issued to candidates. The study considered whether the SQA's current risk and performance management framework is appropriate, whether the organisation displays the principles of good governance and whether it demonstrates a commitment to best value through continuous improvement.
24. A report setting out the key findings from the study was published in November 2006. It highlighted that since 2000, the SQA has been successful in re-establishing customer and



stakeholder confidence in its core functions. The key recommendations arising from the study were:

- The SQA should use its review of staffing, qualifications portfolio and business areas to provide a more critical challenge of its products and processes.
 - The board and senior management of SQA should continue to develop a more strategic focus based on the key risks facing the business.
 - The SQA should develop its key performance indicators, linked to key objectives, as part of its development of a balanced scorecard.
 - SQA should continue to explore the scope for efficiency savings including opportunities presented by the SQA's modernisation agenda.
 - The SQA should continue to refine its work linking costs with activities, to further improve its understanding of its cost base and to inform the setting of charges for qualifications.
 - The SQA should explore the opportunities for greater use of benchmarking to inform performance management activity.
25. The SQA reviewed its performance indicators and translated its five high level objectives and 15 business plan objectives into eight outcome statements, from which 19 measures have been established. Progress against these key outcomes and measures will be reported to the board on a quarterly basis.
26. SQA has commenced a review to consider the efficiency and effectiveness of its committee arrangements with a view to develop a more strategic focus based on the key risks facing the business. SQA has been advised that a quinquennial Policy & Financial Management Review (PFMR) will take place during 2007/08. The outcome of SQA's review of committee arrangements will be made available to the PFMR reviewers.
27. Audit Scotland will continue to monitor progress made against the recommendations in the performance management study.



Governance

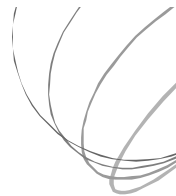
Overview of arrangements

28. This section sets out our main findings arising from our review of SQA's governance arrangements. This year we reviewed:
- key systems of internal control;
 - the internal audit function, and
 - aspects of information and communications technology (ICT).
29. We also discharged our responsibilities as they relate to the prevention and detection of fraud and irregularity; standards of conduct; and the organisation's financial position. Our overall conclusion is that governance arrangements within SQA are sound and have operated throughout 2006/07.

Systems of internal control

30. Key controls within systems should operate effectively and efficiently to accurately record financial transactions and prevent and detect fraud or error. This supports a robust internal control environment and the effective production of financial statements. In their annual report for 2006/07, PricewaterhouseCoopers (PwC) provided their opinion that their work did not identify any significant control weaknesses that they consider to be pervasive in their effects on the system of internal control. In addition, PwC have not identified any weaknesses from their audit work during the year that they consider should be included as 'Significant Internal Control Issue(s)' in SQA's Statement on Internal Control.
31. As part of our audit we reviewed the high level controls in a number of SQA's systems that impact on the financial statements. Our overall conclusion was that key controls were operating effectively.
32. Early in 2007/08, Internal Audit (PwC) concluded a review of Risk Management in SQA. The review highlighted that the Corporate and Certification Planning Group risk registers are well developed. However, further progress was required to ensure that risk management at an operational level is being consistently and robustly implemented across each Business Area. This is an area we will consider further in 2007/08.

Action Point 3

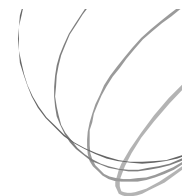


Internal audit

33. The establishment and operation of an effective internal audit function forms a key element of effective governance and stewardship. We therefore seek to rely on the work of internal audit wherever possible and as part of our risk assessment and planning process for the 2006/07 audit we assessed whether we could place reliance on SQA's internal audit function. Our review concluded that the internal audit service operates in accordance with the Government Internal Audit Manual and we were therefore able to place reliance on those areas set out in our Audit Plan.

Information and Communication Technology

34. Our Audit Plan highlighted risks relating to ICT that could impact on the financial statements, these included:
- There is a risk of both the operational and financial status of SQA should Project IRIS fail;
 - There could be a loss of information resulting from deterioration in SQA's tape back-up system, and
 - Under-specification of SQA's disaster recovery power supply and growing complexity of SQA's applications means that the organisation is unable to guarantee complete and accurate data storage in the event of a power loss.
35. The core systems for human resources, finance and payroll were replaced under Project IRIS and went live in December 2006. The Project continues to be rolled out to include additional functions such as employee self service and management self service. An Internal Audit post implementation review is to be undertaken during 2007/08, and we will continue to monitor progress in this area.
36. The risks relating to SQA's tape back-up system and disaster recovery power supply have been successfully managed with funding being secured to replace and upgrade the systems as necessary.



Looking Forward

37. The Scottish Qualifications Authority faces a number of challenges in 2007/08, which impact on our audit. These include:

- **Funding arrangements** – SQA anticipate that candidate numbers will fall in future years due to demographic changes, leading to a shortfall in income that cannot be covered by savings on expenditure. Part of the strategy for dealing with the funding gap and reducing SQA's reliance on additional grant funding is to expand its commercial activities through the creation of a separate trading subsidiary and utilise commercial surpluses to offset core deficits. A funding agreement for 2008/2009 to 2010/2011 is currently being discussed with the Scottish Government.
- **Modernisation agenda** – Uncertainty over the availability of Scottish Government funding in the longer term, to support the modernisation business plan continues to be a significant strategic risk to SQA and may impact on SQA's ability to maintain and improve market share, keep pace with customer expectations and deliver value for money
- **Best Value** – As part of the 2007/08 audit we will be reviewing the progress that the SQA has made in strengthening their arrangements for securing Best Value since our baseline review work in 2005/06. Over the next year we will also be developing and refining our approach to the audit of public bodies' arrangements to secure economy, efficiency and effectiveness in the use of resources, as this is one of our key objectives as auditors, set out within the new Code of Audit Practice approved by the Auditor General. This will inform our ongoing work to develop an approach to the audit of Best Value across the Scottish public sector. We intend to consult with both clients and stakeholders at key stages of these initiatives.
- **International Financial Reporting Standards** – The introduction of IFRS's from 2008/09 is likely to significantly change some accounting policies. SQA will need to review their accounting policies to ensure that appropriate disclosures are made in the financial statements.
- **Charitable Status** – SQA lost its charitable status in April 2007 and is therefore no longer required to comply with the requirements of the Accounting and Reporting by Charities, Statement of Recommended practice. This will impact on the disclosures made in the Annual Report and Financial Statements for 2007/08.

Appendix A: Action Plan

Key Issues and Planned Management Action

Action Point	Issue Identified	Planned Action	Responsible Officer	Target Date
1	Failure to adequately scope core, commercial and international projects to ensure that projects are sustainable and viable could impact on SQA's ability to operate within its agreed funding arrangements and reduce its reliance on grant in aid.	<p>A decision on funding approval from the Scottish Government to support the business case for creation of the trading subsidiary is awaited.</p> <p>Following approval and establishment of the planned trading subsidiary a method of prioritising activity and resources effectively across core, commercial and international projects will be agreed.</p>	Ron Sylvester	March 2008
2	Failure to secure funding from the Scottish Government to support SQA's modernisation business plan commitments to improve processes will impact on the organisation's ability to match the pace of competitors and other national developments. It will also impact on the organisations efficiency agenda.	<p>Funding has been secured for 2007/08 and the business case targets and milestones have been reviewed and prioritised. The progress will be monitored throughout 2007/08.</p> <p>No funding commitment has been secured for future years. Dialogue to continue to ensure ongoing funding is secured.</p>	Karen McCallum & Ron Sylvester	March 2008
3	Further progress is required to ensure that the risk management framework is embedded at an operational level and is consistently and robustly implemented across each Business Area.	<p>A standard template will be available to Business Managers and further training on the risk management framework will be provided to Business Managers to support the use of the standard template.</p> <p>Assurance will be sought on a quarterly basis from Business Managers on the implementation of agreed action plan.</p>	Jean Blair	March 2008