

# Scottish Government

Report on the 2008/09 audit



 AUDIT SCOTLAND

October 2009



Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

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# Key messages

In 2008/09 we looked at the key strategic and financial risks being faced by the Scottish Government. We audited the financial statements and we also reviewed the use of resources and aspects of performance management and governance. This report sets out our findings.

## **Financial statements**

We have given an unqualified opinion on the financial statements of the Scottish Government for 2008/09. The signed accounts were laid in the Scottish Parliament and published on 29 September. The Scottish Government has made significant improvements over recent years in both the timing of production and quality of the draft accounts.

## **Financial position and use of resources**

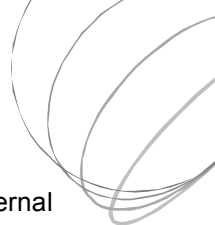
The final outturn for 2008/09 was £29,958 million against the Scottish Parliament approved budget of £30,212 million, representing an underspend of £254 million or just under 1%. All Portfolios remained within their Budget Act limit. The provisional underspend against the Departmental Expenditure Limit (DEL) of £27,975 million amounted to £31 million.

These results represent a major achievement in aligning expenditure against budgets overall, especially given the constraints placed on the Scottish Government in accessing any underspends against DEL until the next spending review period. The 2007 spending review was the tightest financial settlement since devolution, but the outlook for public finances has worsened significantly since then and maintaining this position will be extremely challenging. In response to the economic downturn, the Scottish Government has brought forward capital expenditure to 2008/09 and 2009/10. This needs to be recovered from the 2010/11 budget, increasing pressure on an already tight position.

Our 2008/09 audit found evidence of a more strategic and corporate approach to the management of the Scottish Government's finances, with Directors General part of a developing culture of cooperation which includes a greater willingness to manage expenditure programmes in the interest of corporate objectives. While these significant developments are welcome, the future pressures on public finances and the need to make substantial efficiency savings suggest that now may be a good time to review the strategic capacity going forward of the finance function. For example, there is scope to further enhance the role of the Finance Directorate in challenging budget assumptions and expenditure plans.

## **Governance and accountability**

Last year we highlighted that the Scottish Government was going through a period of considerable change and that governance arrangements were still evolving. We have since received a comprehensive response and update on developments demonstrating that substantial progress has been made and representing a significant step forward.



We reviewed the Internal Audit Division and concluded that it continues to comply with Government Internal Audit Standards and that we are able to place reliance on their work for the purposes of our audit. With the specific exception of the payroll system, we have concluded that the Scottish Government's financial systems operate adequately. With respect to payroll, encouraging progress is being made in addressing previously identified weaknesses and we anticipate placing adequate reliance on the system for 2009/10.

Over the past three years we have drawn attention to significant weaknesses in the Scottish Government Rural Payments Inspections Directorate's key controls and preparation of accounts detailing the Scottish element of expenditure funded by the European Agriculture Guarantee Fund and the European Agricultural Fund for Rural Development. Although good progress is being made to address these weaknesses, it is critical that the planned improvements are achieved in order to minimise the risk of any disallowance.

## **Performance**

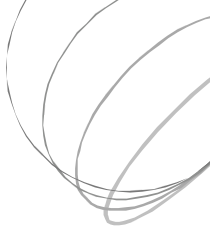
The Scottish Government's vision and strategic direction is set out in the National Performance Framework (NPF). Improved performance is currently being reported in four out of 11 purpose targets contained in the NPF, while performance is being maintained in a further four. Reported performance is declining for three purpose targets and it is likely that the current economic climate is having an adverse impact on two of these, concerning GDP growth and labour participation. Of the 35 national indicators where a performance assessment is provided, performance is improving in 20, being maintained in seven, and declining in eight. This is a slight improvement on this time last year.

We undertook an initial review of the Scottish Government's Business Planning tool introduced in mid-2007 and concluded it has the potential to link the contribution of planned activity to the achievement of national outcomes. Although it is too early to say how much of a contribution the BPT is making to the monitoring of performance against the NPF, the Directorates we reviewed were aware of the need to ensure their work contributes to the achievement of national outcomes and that plans in the BPT are closely linked to directorate objectives.

## **Looking forward**

The final part of our report notes some key risk areas for the Scottish Government going forward. Among the risks not previously mentioned above are the impact of the public service reform programme and the shaping up review, the potential financial uncertainty surrounding equal pay claims in the NHS and the impact of swine flu, and planning for the Commonwealth Games.

The assistance and co-operation given to us by officials and non-executives of the Scottish Government during our audit is gratefully acknowledged.



# Introduction

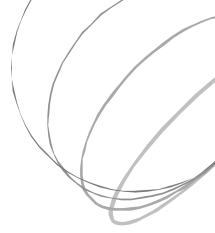
1. This report summarises the findings from our 2008/09 audit of the Scottish Government. The scope of the audit was set out in our Audit Plan, which was presented to the Scottish Government Audit Committee (SGAC) in March 2009. This plan set out our views on the key business risks facing the organisation and described the work we planned to carry out on financial statements, performance and governance.
2. We have issued a range of reports this year, and we briefly touch on the key issues we raised in this report. Each report set out our detailed findings and recommendations and the Scottish Government's agreed response. Appendix A sets out the key risks highlighted in this report and the action planned by the Scottish Government to address them.
3. Best Value duties apply across the public sector and, in central government, best value is a formal duty on all accountable officers. Audit Scotland has adopted a generic framework for the audit of best value across the public sector and throughout this report we comment on aspects of the Scottish Government's arrangements.

## Exhibit 1: Framework for a best value audit of a public body





4. Our comments are made on the basis of information made available in the course of the annual audit. We do not make an overall best value judgement because we do not have enough evidence to conclude on all relevant areas. Our intention is to build up the corporate assessment over time. This report is the first step towards that goal.
5. Another building block for our assessment of best value is the national study programme carried out by Audit Scotland on behalf of both the Auditor General for Scotland and the Accounts Commission. We mention the key findings from all relevant reports, and the implications for the Scottish Government, throughout this report. Full copies of the study reports can be obtained from Audit Scotland's website, [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).
6. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officials and non-executives of the Scottish Government during the course of our audit. This report will be submitted to the Auditor General for Scotland and will be published on our website.



# Financial Statements

7. In this section we summarise key outcomes from our audit of the Scottish Government consolidated financial statements for 2008/09 and the accounting issues faced. The financial statements are an essential means by which the organisation accounts for its stewardship of the resources available to it and its financial performance in the use of those resources.

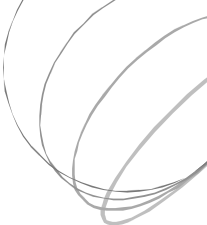
## Our responsibilities

8. 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 Government and its expenditure and income for the period in question
  - whether they and the part of the Remuneration Report to be audited were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements
  - the consistency of the information which comprises the Introduction/ Background, details of Ministers and Senior Officers and the Operating and Financial Review, included within the Annual Report, with financial statements
  - the regularity of the expenditure and receipts.
9. We also review the statement on internal control by:
  - considering the adequacy of the process put in place by the Permanent Secretary as Principal Accountable Officer to obtain assurances on systems of internal control
  - assessing whether disclosures in the statement are consistent with our knowledge of the Scottish Government.

## Overall conclusion

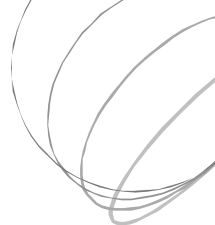
10. The Auditor General for Scotland issued an unqualified auditor's report on 24 September.
11. The draft schedules for the core accounts and the draft consolidated account were submitted in line with agreed plans. The good standard of the supporting papers and the timely responses from Finance staff allowed us to conclude our audit within the agreed timetable and provide our opinion to the Scottish Government Audit Committee (SGAC) on 22 September.
12. The Scottish Government has made significant improvements in both the timing of production and quality of draft accounts. The 2008/09 consolidated accounts were signed-off four weeks earlier than in 2006/07 and clear audit certificates have been issued in each of the four years since 2005/06.



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13. A small number of adjustments for financial misstatements were made to the draft consolidated accounts. The accounts were not adjusted to correct other 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 SGAC and the Principal Accountable Officer in our International Standards on Auditing (ISA) 260 report.

## Issues arising from the audit

14. We reported the main issues arising from our audit of the financial statements to SGAC on 22 September 2009 and the most significant of these are set out below. A separate report will be provided to the Director of Finance to provide details of more minor matters which do not need to be reported here. We also prepare summary reports for each Portfolio on specific issues relating to them.
15. The financial statements of the Scottish Government consolidate the accounts of the core Scottish Government, the Crown Office and Procurator Fiscal Service, executive agencies and health boards. A number of issues arose from the audits of agencies and health boards which have been reported to these bodies by their auditors. Those that are considered significant or material to the consolidated accounts are highlighted in this report.
16. **Equal Pay** – all territorial health boards and some special health boards disclosed unquantified contingent liabilities within their accounts for claims made under the Equal Pay Act 1970, mainly from women seeking compensation for past inequalities with male colleagues under the pay arrangements that preceded Agenda for Change. Some of the cases also include a challenge to the Agenda for Change pay evaluation system on the basis that it perpetuates discrimination. The Scottish Government accounts include a provision of £2.25 million for the estimated legal costs arising from these claims.
17. There have been some developments in this area over the past year. The challenge to Agenda for Change was recently heard at an Employment Tribunal in England and the outcome was that the challenge was unsuccessful. This ruling lessens the possibility of successful claims for any period after 1 October 2004. In relation to claims for the period prior to this, claimants still have to establish that they were paid less than appropriate comparators due to the sex of the employee and that their jobs were of equal value to these comparator jobs. The NHS Central Legal Office has stated that claims currently submitted do not provide sufficient detail about comparator jobs to allow an estimate to be made of the likelihood of success of the claims or of any financial impact that they may have.



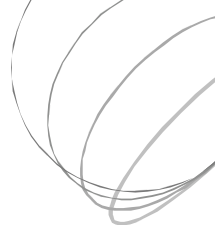
18. Health board auditors have accepted that disclosure as an unquantified contingent liability remains appropriate for the 2008/09 financial statements of affected boards. Given the potential significance of the issue, however, and without qualifying their opinion, auditors have drawn attention to the current position in their audit reports on boards in receipt of a significant number of claims. As the challenge to Agenda for Change has now been resolved, the Scottish Government should continue to work with NHS bodies to assess any potential impact they may have as soon as possible.

#### **Action point 1**

19. **Transport Scotland** – following publication of the Auditor General for Scotland's report '*The First ScotRail passenger rail franchise*' in November 2008, Transport Scotland's Director of Finance and Corporate Services left the organisation. The terms of his departure are covered by a compromise agreement including a confidentiality clause covering compensation payments made. As a result, Transport Scotland's draft remuneration report does not include details of the payment. The external audit of Transport Scotland has still to be finalised.
20. In response to some of the issues raised by the rail franchise report, the Scottish Government has made a number of changes to improve processes to prevent potential conflicts of interest. These are highlighted in the Statement of Internal Control and include more consistent systems for identifying potential conflicts of interest during recruitment and a more systematic process to register and manage potential conflict of interests for the senior civil service.

### **International financial reporting standards (IFRS)**

21. Government departments and other public sector bodies will report using International Financial Reporting Standards (IFRS) from 2009/10. The Scottish Government announced on 25 April 2008 that the Scottish Government, its executive agencies, and all Health Bodies and Non-Departmental Public Bodies (except charitable NDPBs) would be required to produce shadow IFRS based accounts for financial year 2008/09. This was to include a restated balance sheet as at 1 April 2008 to be presented to auditors for dry-run audit by the end of November 2008.
22. The Scottish Government submitted its opening balance sheet and supporting documentation by the deadline. Overall, the quality of both was satisfactory and discussions held with Scottish Government staff were positive and constructive. No significant errors were identified and we concluded that the Scottish Government had made good progress to date. We made some recommendations for the delivery of the next stage of reporting – the production of the shadow accounts for 2008/09.
23. On 30 September 2009, again in accordance with the agreed timetable, the Scottish Government provided us with the core shadow accounts for audit. The consolidated shadow accounts are due to be received on 29 January 2010, with completion of our audit by 28 February 2010.



## Regularity

24. 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 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 Principal Accountable Officer as to his view on adherence to enactments and guidance. No significant issues were identified for disclosure.

## Scottish Consolidated Fund and Non Domestic Rating White Paper Account

25. We have given an unqualified opinion on the 2008/09 financial statements of the Scottish Consolidated Fund. There is, however, one issue which we wish to highlight. Up until 2008/09 it had been the practice that designated receipts in the fund due to be paid over to the Ministry of Justice were substantially paid over in the same year they were received. In 2008/09 no payments were made during the year (in 2007/08 £100 million was paid). The reason for this change was that a new piece of legislation, the Designated Receipts Order 2009, was due to come into force on 31 March 2009. Until that time the Scottish Government could not be sure of the exact sums due to the Ministry of Justice. A sum of £40.9 million has since been paid over.
26. We have also given an unqualified opinion on the Non Domestic Rating financial statements for the year ended 31 March 2009.

## Auditor General Reports on Accounts

27. The Auditor General has concluded that there are no matters arising from the 2008/09 audit of the Scottish Government's accounts which require to be reported to Parliament under Section 22(3) of the Public Finance and Accountability (Scotland) Act 2000.

# Use of Resources

28. Sound management and use of resources (people, money and assets) to deliver strategic objectives is a key feature of best value. This section sets out our main findings from a review of the Scottish Government's:

- financial position
- financial management and budgetary control
- management of people, assets and procurement arrangements
- management and use of information and communications technology (ICT).

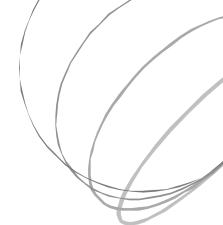
## Financial position

### Outturn 2008/09

29. The Budget (Scotland) Act 2008, as amended by the spring and autumn revisions, prescribed both the financial limits on the use of resources by the Portfolios of the Scottish Government and how these resources can be used. The final approved budget for the Scottish Government was £30,212 million. The net outturn for the year ended 31 March 2009 was £29,958 million, resulting in an overall underspend of £254 million (2007/08 £275 million). The split of the underspend between resource and capital was £225 million and £29 million respectively. The Scottish Government met all Portfolio expenditure limits prescribed in the Budget (Scotland) Act 2008. The net outturn by Programme is highlighted in Exhibit 2.

**Exhibit 2 – Performance against Budget 2008/09**

<b>Portfolio</b>	<b>Resource Outturn</b>	<b>Capital Outturn</b>	<b>Total Outturn</b>	<b>Budget</b>	<b>Variance</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
Office of the First Minister	248	1	249	251	2
Finance and Sustainable Growth	2,784	420	3,204	3,272	68
Health and Wellbeing	11,038	485	11,523	11,533	10
Local Government	9,759	0	9,759	9,760	1
Education and Lifelong Learning	2,587	121	2,708	2,824	116
Justice	1,591	121	1,712	1,714	2
Rural Affairs and the Environment	443	2	445	479	34
Crown Office and Procurator Fiscal Service	103	5	108	110	2
Administration	234	16	250	269	19
<b>Total</b>	<b>28,787</b>	<b>1,171</b>	<b>29,958</b>	<b>30,212</b>	<b>254</b>



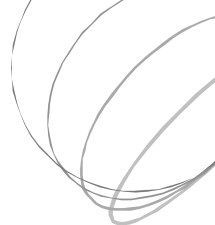
30. The Scottish Government has agreed a mechanism with HM Treasury whereby it can drawdown previously unspent Departmental Expenditure Limit (DEL) balances totalling £1.5 billion at 31 March 2007 over the period ending 31 March 2011. This agreement is conditional on the understanding that while underspends arising during the current Spending Review period are potentially available for drawdown in the following Spending Review period, further drawdown in the period ending 31 March 2011 would only be considered in “exceptional and genuinely unforeseeable circumstances”.
31. The agreement means that it will not normally be in the Scottish Government’s interests to underspend against its DEL budgets. This reinforces the need for sound financial management and for Directorates to be able to promptly report potential underspends to allow other Directorates to bring forward existing spending plans or to develop new plans in accordance with existing priorities so as to utilise any unspent balances created. In June 2009, the Cabinet Secretary Finance and Sustainable Growth reported to the Scottish Parliament that the provisional level of underspend against the 2008/09 DEL budget of £27,975 million was £31 million. HM Treasury will publish the Scottish Government accumulated underspend in July 2010.

## **Spending plans 2009/10 and 2010/11**

32. The Scottish Government’s Spending Review published in November 2007 set out its expenditure plans for the three years 2008/09 to 2010/11. This was the tightest financial settlement for Scotland set by the UK Government since devolution, however the outlook for public finances has worsened significantly since 2007.
33. In response to the economic downturn the Scottish Government has brought forward capital expenditure of £53 million to 2008/09 and £294 million to 2009/10. This needs to be recovered from the 2010/11 budget, increasing the pressure on an already challenging budget process. Plans for 2009/10 and 2010/11 include:
  - a target to generate 2% cash-releasing efficiencies each year
  - access to end year flexibility balances held at HM Treasury across the two years of £400 million and £134 million respectively
  - an over-allocation of spending plans of £100 million in 2009/10 and £24 million in 2010/11.
34. Although the over-allocation is intended to accommodate possible slippage in programme spend, it is not without risks. Under this scenario it is possible that budgets for individual programmes may not be exceeded but total outturn could still exceed resource availability. All portfolios are being required to identify savings to cover the over-allocation. Good financial monitoring will therefore be needed to ensure that outturn does not exceed the total resources available to the Scottish Government.

## **Financial management and budgetary control**

35. Our 2008/09 audit included a review of financial management and budgetary control in the Scottish Government. The audit included the extent to which action has been taken to address issues

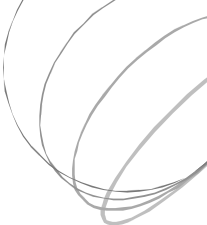


identified in earlier reviews and concentrated on financial governance and leadership, financial monitoring and reporting. Our work was also used to inform colleagues conducting a review on behalf of the Auditor General for Scotland on the financial challenges facing the public sector and Scottish Government financial management. This report, *'Scotland's Public Finances: preparing for the future'* will be published in November.

36. The key findings of our earlier reports related to the need for senior management to adopt a more strategic and corporate approach to the management of the Scottish Government's finances. The Director of Finance is now a member of the Strategic Board at which regular finance reports are presented. Directors General are part of a developing culture of cooperation which includes a greater willingness to manage expenditure programmes in the interest of corporate objectives. Consideration of the financial position is also a key feature at levels below the Strategic Board, such as at 'DG family' management team meetings.
37. The significant developments in financial governance and leadership are welcome. In addition the future pressures on public finances and the need to make substantial efficiency savings suggest that now may be a good time to review the capacity going forward of finance skills across the Scottish Government. There is also scope to further enhance the level of challenge exercised over financial matters involving both the Finance Directorate and non-executive directors. The Shaping Up<sup>1</sup> Review provides a timely opportunity for this work.
38. The Scottish Government has been successful at keeping within budget while reducing the level of underspends which were a feature of the earlier years of the Scottish Executive. Regular budget monitoring reports are now prepared for each Portfolio which detail forecast outturn to the year-end, outturn to date and budget. Policy divisions consider these reports to be useful to help them manage financial resources.
39. The Finance Directorate and Health Finance Directorate are highly regarded by the operational units they support. The Accountancy Services Unit and Financial Reporting Unit are widely seen as centres of expertise. Portfolio Finance Teams are seen as helpful and a good source of formal and informal advice on most financial matters, although they could take a more proactive role in assessing the value for money of programmes and analysing trends to assist budget monitoring.
40. The Scottish Government has made significant improvements in both the timing and quality of draft accounts, with clear audit certificates issued in the four years since 2005/06. The annual accounts, however, could provide more information on how financial resources have been used to achieve objectives including, for example, analysis against the objectives and performance indicators included

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<sup>1</sup> Shaping Up was announced in September 2009 as a review into the shape and working practices of the Scottish Government including its executive agencies. Initially, the review will examine the efficiency and effectiveness of the current organisational structures and resources. It will also include a series of specific reviews of a number of business areas across the Scottish Government.



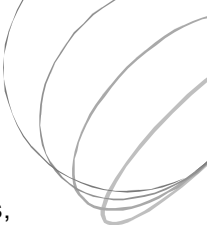
in the National Performance Framework. The Scottish Government could also publish more information on financial outturn to allow comparison against the Level 3 budgets which are published as part of information to support the Scottish Parliament's consideration of annual Budget Bills.

## Management of people

41. The Strategic Board has recognised that good workforce planning is essential to support the Government to deliver its Purpose and national outcomes. Significant initiatives underway include:
  - an Organisational Development Strategy outlining the challenges faced, the kind of organisation needed in the future and how staff will be supported to work effectively in that structure
  - a corporate commitment to improve the use of the skills of the workforce, including a review of feedback from staff and development of a new Skills and Learning Plan
  - actions in response to an employee survey, including embedding more effective and regular communication within the organisation and reinforcing the responsibilities of managers to deal with poor performance
  - establishment of a unit to assist with the redeployment of any staff as a result of the Government's simplification programme to reduce the number of public organisations in Scotland.
42. We intend to monitor the progress of these varied initiatives during 2009/10.
43. In January 2009 Audit Scotland published a national study on central government's use of consultants which highlighted that better value for money could be achieved through improved planning and management.
44. The Scottish Government published revised guidance on the use of consultants in December 2008, following its own review of best practice and reflecting emerging findings from our report. The Scottish Government expects that, once implemented, the revised guidance and other initiatives will address many of the reports' recommendations.
45. The Scottish Government is also developing a managers' toolkit to support decisions on purchasing and using consultants and a new supplier contracts register to collect details of all contracts registered across Scottish Government. This should improve control of spending, help share best practice and promote the introduction and use of more collaborative contracts. The Central Government Centre of Procurement Expertise (CGCoPE) is responsible for leading these developments. The Scottish Government Internal Audit Unit will be reviewing progress as part of a wider review of CGCoPE operations. We will consider Internal Audit's findings as part of our 2009/10 audit.

## Management and use of assets

46. In June 2008 Audit Scotland published a review of major capital projects in Scotland. This report highlighted that those involved in decision making must be able to properly scrutinise and challenge



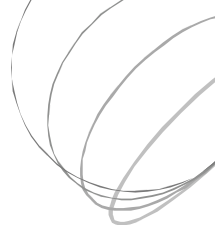
proposals for major projects and that this needs clearer and more accurate information about costs, value for money and timescales.

47. The Scottish Parliament's Public Audit Committee subsequently conducted an inquiry into the issues raised by the report and the Scottish Government has pledged to review, make improvements and report outcomes to the Committee in several areas. A brief update was provided to the Committee in June 2009, with further progress reports planned by the end of the year or early 2010. Ultimately, improvements in cost and time estimates for major projects can only be tested against changes in performance over the medium term. As a result, Audit Scotland is planning a follow up study that may help to measure such improvements.
48. A joint study on behalf of the Auditor General for Scotland and the Accounts Commission (reported in December 2008) looked at how public sector bodies are improving energy efficiency in their buildings. The report concluded that there is a need for stronger leadership by the Scottish Government to ensure the necessary cultural and behavioural changes are made to improve energy efficiency and that there is a lack of formal monitoring and reporting of progress.
49. The recommendations in the report are being taken forward by the Scottish Government's Leading by Example programme focused on improving environmental performance. The Scottish Government is also piloting a formal monitoring and reporting system in a number of public bodies.

## Procurement

50. Effective public procurement can make a key contribution to 'doing more for less' and is more important than ever in the current challenging economic climate. An Audit Scotland report in July of this year assessed the impact of the Public Procurement Reform Programme aimed at improving purchasing practice and making annual savings of around 3%. The review concluded that the Programme is ambitious and challenging and that significant progress has already been made, with around £327 million saved in the first two years. However, some changes are taking longer than planned to implement and performance measures are largely incomplete. For example, it is unclear how progress towards the third year target of £400 million will be monitored.
51. Since publication of the report, the Director General for Finance and Corporate Services has confirmed that the Public Procurement Reform Board welcomes the findings and the report's emphasis on implementing a revised plan for the Programme. The Scottish Government has also developed a Procurement Capability Assessment as an improvement tool to help organisations strengthen their approach through a detailed evaluation of their procurement capability. Public sector bodies are being encouraged to participate over the next six months.
52. Audit Scotland is undertaking further work on the five designated centres of expertise (central government, local government, health, further and higher education and a national centre leading purchasing of goods and services common to all sectors) and plans to report in 2011.





## Management and use of ICT

53. Last year we highlighted that the Scottish Government had carried out a review of data handling arrangements in response to failures in UK government bodies' procedures and practices. A final report was published in June 2008 and, following publication, a Chief Security Officer was appointed with specific responsibilities for data handling and wider information assurance matters. This role is supported by a data handling team providing central guidance and information dissemination across the Scottish Government and the wider public sector in Scotland.
54. Welcome developments include a Security Policy Framework which is proportionate and has been refined specifically for NDPBs (non departmental public bodies) and associated bodies. Annual reporting arrangements for the management of information risk have also been introduced.
55. In conjunction with the Scottish Government, we are undertaking a survey of Scottish Government staff using the *Your Business @ Risk* audit tool to assess how well information risks are understood across the organisation. We expect to report the results of this work in November.



# Governance and Accountability

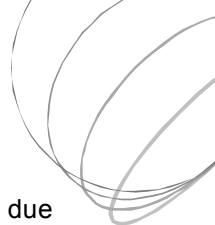
56. High standards of governance and accountability, with effective structures and processes to govern decision-making and balanced reporting of performance to the public, are fundamental features of best value. This section sets out our findings arising from a review of the Scottish Government's arrangements.
57. Increasingly services are being delivered across the public sector through partnership working, sometimes involving complex governance and accountability arrangements. Best value characteristics also include effective partnership working to deliver sustained improvements in outcomes.

## Overview of arrangements

58. This year we reviewed:
- governance arrangements
  - key systems of internal control
  - internal audit
  - arrangements for the prevention and detection of fraud and irregularity, including standards of conduct
  - partnership working.
59. Our overall conclusion is that arrangements within the Scottish Government are sound and have operated through 2008/09.

## Governance arrangements

60. Last year we reviewed the Scottish Government's revised governance and accountability arrangements introduced following the Taking Stock review and the election of a new government. The review recognised that the Scottish Government was going through a considerable change process and that a significant amount had been achieved. We also recognised that arrangements were still evolving and highlighted areas requiring further development.
61. We received a comprehensive response and update on current developments, demonstrating that substantial progress has been made and representing a significant step forward. For example:
- a policy document has been developed to clarify the roles and responsibilities of groups and individuals, allowing individuals to see how they contribute to the achievement of the Government's Purpose and national outcomes
  - information on each directorate's purpose and objectives are to be included on the Scottish Government's website to provide an overview of each directorate's business



- a review of the role of non-executive directors has been undertaken, with all actions arising due to be implemented by the end of the year
  - work has started on the development of links between financial/resource information and work to achieve national outcomes (linking inputs, outputs and outcomes).
62. The Permanent Secretary has recently announced '*Shaping up*', a major strategic review of the shape and working practices of the Scottish Government and its agencies. The intention is to look at how the Scottish Government is currently organised and resourced, if that fits with changing expectations of government and is the most affordable and effective way of delivering better outcomes and priorities going forward. The review has been given added impetus by future reductions in public spending. Although short-term options will be identified for implementation in 2010/11, the main focus will be on longer-term and potentially more radical options.
63. We intend to monitor developments in these significant areas during 2009/10.


## Systems of internal control

64. We reviewed the high level controls in a number of the Scottish Government's systems that impact on the financial statements. Excluding payroll, our overall conclusion is that key controls are operating adequately. With respect to payroll, we have obtained sufficient assurance for our audit opinion. As in previous years, we increased transaction testing as we were only able to place limited assurance on the key controls operating within the system. The Scottish Government has made progress in addressing areas of weakness and we anticipate being able to place reliance on the system next year.
65. Over the past three years we have drawn attention to significant weaknesses in the Scottish Government Rural Payments Inspections Directorate's key controls and accounts preparation process for the Scottish element of expenditure funded by the European Agricultural Guarantee Fund and European Agricultural Fund for Rural Development. These problems required the Directorate to seek an extension to the deadlines for submission of accounts to the EU. We are pleased to report that significant progress is now being made in addressing previously identified weaknesses. While much remains to be done, the foundations for improved control and efficiency are being put in place. It is particularly important that the Scottish Government continues to make progress with these actions as there is a risk that EU auditors may disallow certain scheme expenditure such that the EU may not fully fund its share of the costs.

### Action point 2

## Statement on internal control

66. The Principal Accountable Officer is required to provide a Statement on Internal Control which he signs as part of the Scottish Government Consolidated Accounts. The Statement for 2008/09 reflected the Certificates of Assurance provided by Directors and Directors General, the report from



the Head of Internal Audit and the main findings from external audit work. Our review concluded that the statement complies with relevant guidance and is not inconsistent with other information we are aware of from the audit.

## Internal audit

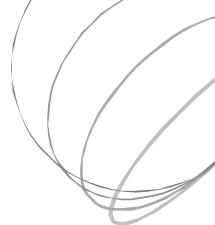
67. The establishment and operation of an effective internal audit function forms a key element of effective governance and stewardship. We seek to rely on the work of internal audit wherever possible and as part of our risk assessment and planning process for the 2008/09 audit we assessed whether we could place reliance on the Scottish Government Internal Audit Service (IAS). We concluded that the IAS continues to comply with Government Internal Audit Standards and were able to place reliance on the work of IAS for the purposes of our audit of the Scottish Government.

## Prevention and detection of fraud and irregularities

68. The annual report on fraud in the Scottish Government was presented at the June 2009 meeting of SGAC. The report outlined the Scottish Government's arrangements for preventing, reporting and responding to fraud. The main purpose of the report is to address instances of internal fraud arising during 2008/09. The report noted that the Fraud Response Group had not been called on to consider any instances of potential fraud in the year.
69. The Student Awards Agency for Scotland (SAAS) is the executive agency responsible for administering student award payments. However, the payments themselves are accounted for in the Scottish Government's financial statements. During 2008/09 SAAS discovered that it had been the target of an organised fraud ring which was using false identities to claim student support. At the request of the Agency's senior management, a review of its procedures for administering student awards was undertaken by the Scottish Government Internal Audit Service. A full report was submitted to the Education and Lifelong Learning Audit Committee and a robust action has been agreed. We intend to monitor the implementation of planned improvements in 2009/10.

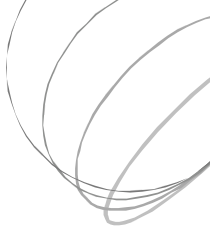
## Partnership working

70. The effective public bodies programme, overseen by the Strategic Board, has been underway for nearly a year and is a key part of the Scottish Government's developing relationship with other public bodies. This programme seeks to promote and support performance improvement across the public sector, with joint working seen as a key contributor to the process. Developments include:
- work to revise and streamline the suite of guidance for both public bodies and sponsor teams in the Scottish Government on all aspects of the relationship between the Government and public bodies
  - preparation of a revised edition of "On Board" setting out refreshed guidance on the roles and responsibilities of Chairs, Chief Executives, Board Members, Ministers and Scottish Government sponsors



- issue of a joint assessment toolkit in April 2009 to help sponsor teams, Director General business units and public bodies jointly review and assess their corporate plans and processes against set criteria. This aims to ensure that all public sector bodies put in place an outcomes based approach aligned to the National Performance Framework
- development of a strategy and implementation plan for aligning key spending programmes with an outcomes based approach.

71. The Scottish Government's partnership with local government is founded on the Concordat agreed in 2007 and the system of 32 Single Outcome Agreements (SOAs) between the Scottish Government and community planning partnerships. The SOAs provide a framework by which community planning partnerships can establish a set of local outcomes. These local outcomes should be based on the Scottish Government's national outcomes but also take account of local priorities.
72. We will monitor progress on developments in these areas in 2009/10.



# Performance

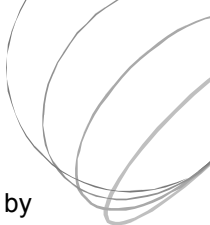
73. Public audit is more wide-ranging than in the private sector and covers the examination of, and reporting on, performance and value for money issues. Key features of best value include:
- setting a clear vision of what the organisation wants to achieve, backed up by plans and strategies to secure improvement, with resources aligned to support their delivery
  - a performance management culture which is embedded throughout the organisation and a performance management framework which is comprehensive and supports the delivery of improved outcomes.
74. In this section we comment on:
- vision and strategic direction
  - performance and performance management arrangements
  - public performance reporting
  - efficiency
  - risk management.

## Vision and strategic direction

75. The Scottish Government's vision and strategic direction is set out in the National Performance Framework.

**Exhibit 3 – National Performance Framework**



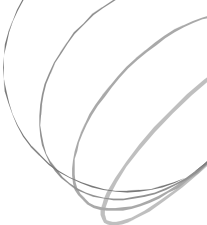
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76. The single overarching Purpose is focused on increasing economic sustainable growth, supported by five strategic objectives: wealthier and fairer, smarter, healthier, safer and stronger, and greener. In turn, these are supported by 15 national outcomes which outline in more detail what the Scottish Government wants to achieve over a 10 year period. The Government Economic Strategy sets out the approach to delivering the Purpose to ensure all of the Government's resources and policies are focused on its achievement. 11 purpose targets and 45 national indicators have also been designed to track progress.

## Performance overview

77. Currently the Scottish Government is reporting improved performance in four out of 11 purpose targets, while performance is being maintained in a further four. In particular, the Scottish Government is reporting improved performance in respect of reducing emissions. Reported performance is declining for three purpose targets and it is likely that the current economic climate is having an adverse impact on two of these, concerning GDP growth and labour participation.
78. Of the 35 national indicators (out of 45) where a performance assessment is provided, performance is improving in 20, being maintained in seven, and declining in eight. This is a slight improvement on this time last year (the corresponding figures were 18, five and nine) although the availability of additional information now allows progress to be reported on more indicators.

## Performance management

79. Our 2008/09 audit included an initial review of the development and operation of the Scottish Government's Business Planning Tool (BPT). The BPT was introduced in mid- 2007 and is still subject to ongoing development and improvement.
80. The BPT has the potential to bring several advantages to the Scottish Government, including the development of a consistent approach to planning across directorates and raising the profile of risk management across the organisation. In particular, as part of an integrated planning system, the BPT has the potential to allow the contribution that planned activity makes to the achievement of national outcomes to be monitored.
81. It is too early to say how much of a contribution the BPT is making to the monitoring of performance against the National Performance Framework or making a positive impact on the achievement of national outcomes. However, our review indicated that in the six Directorates we examined there is awareness of the need to ensure their work contributes to the achievement of national outcomes and that plans in the BPT are closely linked to directorate objectives.
82. There are some issues which the Scottish Government should consider addressing to maximise the value of the BPT and to help take its business planning to the next level:
- provision of further guidance on what business activity should be included in the BPT

- 
- better alignment of risks recorded in the BPT with the classifications used in risk registers
  - review of the reporting facility to ensure that it meets user's needs
  - review of the Performance Division's role in the ongoing development of the BPT and the level of resources provided to it
  - development of a more integrated performance management tool which would combine elements of the BPT with workforce planning, financial and performance management systems such as the balanced scorecard.

83. The Scottish Government also uses a 'balanced scorecard' approach to internal performance management. This shows at a glance how the organisation is performing on four key areas: people, finance, quality and stakeholder relations. Quarterly reports are produced for the Strategic Board providing an overview of performance against a range of corporate business indicators such as vacancy rates, payment performance and ministerial correspondence. This approach allows the Strategic Board to track changes in performance, explore relationships between performance on different indicators, and to pinpoint major achievements and areas for action. Work is currently underway to refine and further develop the data reported.

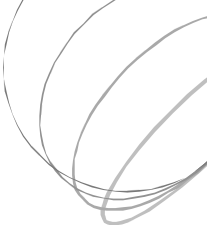
## Public performance reporting

84. The Scottish Government is continuing to develop its approach to reporting performance to the public through its *Scotland Performs* website. For example:
- a Scotland Performs Technical Assessment Group has been established to look at the validity of data before performance against the purpose targets and national indicators is updated
  - risks to the delivery of each target and national indicator have been established and the Strategic Board now has an agreed reporting format to allow performance and progress to be considered
  - the Scottish Government is beginning to review the continuing validity of some indicators as several expire in 2010 and 2011.

## Efficiency

85. In March 2008, the Scottish Government published a new efficiency delivery plan covering the period 2008-2011. The plan calls for public sector bodies to make cash-releasing savings of 2% per annum amounting to £1.6 billion in 2010/11. Reported efficiencies in 2008/09 are above target at £600 million compared to a plan of £534 million. Delivery plans for 2009/10 are on target with identified potential savings of £1,097 million against £1,069 planned. The position for 2010/11 is showing a small shortfall with identified potential savings of £1,559 million against a plan of £1,603 million. Given current financial pressures, it is essential that efficiency targets are met or exceeded.



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86. Reported efficiencies for 2008/09 have not been audited, although a national study is underway to review how well prepared public bodies are to deliver the 2% target, highlight good practice and identify areas for improvement. This work will be reported in winter 2009.

## Risk management

87. Last year we highlighted that, during the period of transition in the Scottish Government's governance and accountability arrangements, risk management arrangements may not have been applied consistently and that there was a need to review and communicate the role of the Scottish Government Audit Committee, Portfolio Audit Committees and Programme Boards within overall risk management arrangements.
88. Since then, the Scottish Government has undertaken further work to embed the process of risk management in the organisation and to clarify the responsibilities of those involved in managing risks. Significant developments include:
- establishment of a risk management hierarchy which gives, for example, Directorates chief responsibility for managing risks to the delivery of a particular policy or work stream
  - the creation in April 2009 of a Strategic Board Risk Register with a clear process for escalating risks to it
  - the management of risk now appears as a regular agenda item at each Portfolio Audit Committee, with greater consistency in how risks are presented
  - the creation of a new Capital and Risk Division within the Finance Directorate with responsibility for the financing and delivery of the capital programme and strengthening the management of major capital projects.

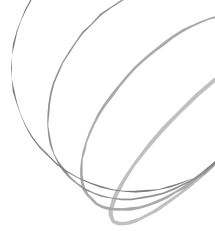
# Looking Forward

89. The Scottish Government faces a number of challenges in 2009/10, which include:

- **Financial management** – There is recognition across Scotland that there are serious financial challenges ahead. It is therefore critical that high standards of financial management and budgetary control are maintained across the Scottish Government. A potential risk is in capacity, as the Finance Directorate is called on more frequently to deal quickly with specific major issues arising from the wider economic and private sector impacts of the recession. A report '*Scotland's Public Finances: preparing for the future*' is being prepared by the Auditor General, and will be presented to the Parliamentary Audit Committee in November 2009. The report seeks to contribute to the debate on the impact of the recession on the Scottish public sector in the coming years.
- **2009/10 financial position** - Spending plans for 2009/10 have been over-allocated by £100 million to accommodate possible slippage in programme spend. This means that it is possible that budgets for individual programmes may not be exceeded but that total outturn could still exceed resource availability. All portfolios have been required to identify savings.
- **Public service reform** – The Public Sector Reform (Scotland) Bill is expected to complete Stage 1 by December 2009. Along with the Children's Hearing Bill, it is expected to complete parliamentary passage by June 2010. This will facilitate a reduction in the number of public bodies from 162 to fewer than 120 by April 2011. There is also a proposal to replace the 32 Children's Panels by nine new Scottish Children's Hearings Tribunals. As with any structural change, good planning will be required to ensure continuity of service and that the anticipated benefits are realised.
- **Equal Pay in the NHS** – The NHS may incur additional costs in settling equal pay claims at a time when extra costs are also being incurred in areas such as prescribing, energy and in tackling ill-health, particularly as a result of obesity and the misuse of drugs and alcohol.
- **Swine flu (H1N1 Influenza)** - In terms of clinical activity a key risk for the NHS going forward is the potential impact of H1N1 Influenza. The full extent of the situation is still emerging, and all boards are putting plans in place to deal with the local impact of further outbreaks. In terms of operational risks all public sector bodies should have plans in place to cover essential services.
- **Shaping Up review** – The Shaping Up review has potentially far reaching implications for the organisation of the Scottish Government, the agency model and the interaction with Ministers, other public sector bodies and stakeholders. It will be important that any changes are properly planned and risks managed.

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- **Common Agricultural Policy Market Support** – It is important that the Scottish Government continues with its plans to improve controls and accounts preparation procedures associated with expenditure funded by EAGF and EAFRD. Given the current pressures on public sector spending, efforts need to be maintained to reduce the risk of potential disallowance.
  - **International Financial Reporting Standards (IFRS)** – The introduction of full IFRS accounts with effect from 2009/10 has implications for both the budget setting and accounts preparation process. While the Scottish Government has made good progress to date in introducing IFRS, it is important that it continues to manage closely the transition and to maintain close liaison with us.
  - **Whole of Government Accounts (WGA)** – The WGA programme led by HM Treasury continues to progress towards the production of accounts covering the whole of the UK public sector, consolidating the accounts of about 1,300 bodies. Following three years of dry-run accounts being prepared, the first year of publication of WGA will be for financial year 2009/10, coinciding with the first year of accounts prepared under IFRS. We will continue to work with the Scottish Government to deliver the audit of Scottish data.
  - **Commonwealth Games** – The Scottish Government is the principal funder of the 2014 Glasgow Commonwealth Games (£238 million of the £298 million public sector contribution). In addition, it has agreed to help meet any potential economic shortfall of the Organising Committee arising from the preparations for and the hosting of the games. The Organising Committee is responsible for raising the balance of the funding of £75m from other sources (such as broadcasting rights, licensing, ticket sales and sponsorship). During 2009/10 the Scottish Government and its partners will need to finalise their programme plans for the Games. Risk management arrangements will also need to be embedded in the process.

# Appendix A: Action Plan



Action Point	Issue	Response and agreed action
1	<p><b>NHS Equal Pay</b></p> <p>The unsuccessful legal challenge to Agenda for Change lessens the possibility of successful claims being made for pay discrimination experienced for any period after 1 October 2004. The Scottish Government should continue to work with NHS bodies to assess any potential impact they may have.</p>	<p>The Scottish Government will continue to work with NHS Boards through the NHS Scotland Equal Pay Unit and the NHS Scotland Central Legal Office to assess any potential financial impact of equal pay claims as they develop.</p>
2	<p><b>European Agricultural Funds</b></p> <p>The Scottish Government is making good progress with its plans to improve controls and accounts preparation procedures associated with expenditure funded by the European Agriculture Guarantee Fund and European Agricultural Fund for Rural Development. It is important that this progress is maintained to reduce the risk of potential disallowance.</p>	<p>The Scottish Government is cognisant of the need for continued improvement in the accounts preparation process and in controlling the risk of disallowance generally and will continue to further improve and refine processes as necessary to help mitigate such risks.</p>



# Appendix B: Auditor General for Scotland published reports

## Accounts Commission and Auditor General for Scotland

### **Improving energy efficiency (published 11/12/2008)**

This study looks at how councils, the NHS and central government bodies are improving energy efficiency in their buildings and transport use. Further details can be found at paragraphs 51 to 52 of this report.

### **Improving public sector purchasing (published 23/07/2009)**

The public sector in Scotland is improving its purchasing and estimates it has saved more than £300 million since 2006 as a result. It could now make further savings through increased collaboration and better management. Further details can be found at paragraphs 53 to 55 of this report.

### **Improving civil contingencies planning (published 6/08/09)**

Key organisations are working well together to plan for dealing with emergencies such as severe weather and the current flu pandemic. However there is still more they could do to improve their arrangements.

## Auditor General for Scotland

### **Review of NHS diagnostic services (published 20/11/2008)**

The NHS in Scotland has significantly cut patients' waiting times for diagnostic tests through use of targeted additional government funding and changes to how it manages and delivers services.

### **The First ScotRail passenger rail franchise (published 28/11/2008)**

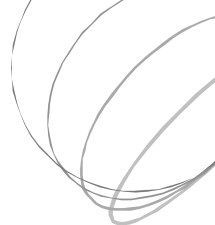
This report looks at how the Scottish Government's national transport agency, Transport Scotland, is managing the rail franchise.

### **Financial overview of the NHS in Scotland (published 4/12/2008)**

The financial position in the NHS continues to improve overall but the service faces challenging times in the near future.

### **How government works: central government's use of consultancy services (published 15/01/2009)**

Scotland's central government bodies could provide better value for money through better planning and management. Further details can be found at paragraphs 46 to 48 of this report.



## **Asset management in the NHS (published 29/01/2009)**

This report examines the way the health service strategically manages its £5 billion worth of land and buildings, vehicles, medical and IT equipment.

## **Drug and alcohol services in Scotland (published 26/03/2009)**

The new contract for GP practices should have been better planned and will take time to improve care for patients. However, there is evidence of improvement in the care of some patients. In the first three years of the new contract, general medical services cost £160 million more than was allocated to NHS boards to pay for these services.

## **Managing the use of medicines in hospitals: follow-up review (published 16/04/2009)**

The NHS in Scotland is doing more to make sure that medicines are used safely in hospitals and to plan for new medicines. It now needs better information on how medicines are used in order to further improve patient care.

## **Overview of mental health services (published 14/05/2009)**

Mental health problems cause considerable poor health in Scotland and much has been done to move services from institutions into the community. There now needs to be a better understanding of the care people receive and how resources to support this are best used.

# Scottish Government

## Report on the 2008/09 audit

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