
Report To:	Audit Committee	Date:	02.03.10
Report By:	Corporate Director Improvement and Performance	Report No:	AC/02/10/PW/APr
Contact Officer:	Andi Priestman	Contact No:	01475 712251
Subject:	EXTERNAL AUDIT PROGRESS REPORT		

1.0 PURPOSE

- 1.1 The purpose of this report is to present the reports produced by Audit Scotland since the last Audit Committee meeting.

2.0 SUMMARY

- 2.1 Two reports have been finalised by Audit Scotland since the last Audit Committee:-

- Scotland's Public Finances – Preparing for the Future (November 2009)
- Annual Audit Plan 2009/10 (January 2010)

- 2.2 A representative from Audit Scotland will be in attendance at the meeting in order to address any issues arising from these reports.

3.0 RECOMMENDATIONS

- 3.1 It is recommended that Members consider the matters raised in the reports published by Audit Scotland.

Paul Wallace
Corporate Director
Improvement and Performance

4.0 BACKGROUND

- 4.1 Members of the Audit Committee are required to monitor progress by Audit Scotland who are responsible for the external audit of the Council to enable them to discharge their scrutiny and performance monitoring roles.
- 4.2 In practice, audit plans and findings are reported by Audit Scotland to the Council in a series of reports.
- 4.3 Members are provided with copies of each report to support their understanding and knowledge of the matters raised.

5.0 IMPLICATIONS

- 5.1 Legal: None
Finance: None
Personnel: None
Equalities: None

6.0 CONSULTATIONS

- 6.1 Consultations took place with relevant officers throughout the audit process.

7.0 LIST OF BACKGROUND PAPERS

- 7.1 Audit Scotland's External Audit reports
- Scotland's Public Finances – Preparing for the Future (November 2009)
 - Annual Audit Plan 2009/10 (January 2010)

Scotland's public finances

Preparing for the future



Prepared for the Auditor General for Scotland
November 2009

Auditor General for Scotland

The Auditor General for Scotland is the Parliament's watchdog for ensuring propriety and value for money in the spending of public funds.

He is responsible for investigating whether public spending bodies achieve the best possible value for money and adhere to the highest standards of financial management.

He is independent and not subject to the control of any member of the Scottish Government or the Parliament.

The Auditor General is responsible for securing the audit of the Scottish Government and most other public sector bodies except local authorities and fire and police boards.

The following bodies fall within the remit of the Auditor General:

- directorates of the Scottish Government
- government agencies, eg the Prison Service, Historic Scotland
- NHS bodies
- further education colleges
- Scottish Water
- NDPBs and others, eg Scottish Enterprise.

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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Summary



The public sector is coming under the greatest financial pressure since devolution.



Key messages

- Scotland's economy is in recession and the public sector is under the greatest financial pressure since devolution ten years ago. It will be very challenging to maintain current levels of public services and meet new demands when resources are tight.
- The Scottish Government has strengthened its financial management. But more could still be done to evaluate how well money is being spent in delivering against government priorities and improving public services.
- The Scottish Government's annual budget is largely developed on an incremental basis, which involves making adjustments at the margin to existing budgets. This approach is not suitable for budgeting in a financial downturn because it does not easily allow informed choices to be made about priorities.
- The Scottish Government and the wider public sector need to work together to develop better activity, cost and performance information. This information is needed to enable informed choices to be made between competing priorities, and to encourage greater efficiency and productivity.
- The Scottish Parliament has an important role in scrutinising the government's spending plans. Better information linking spending to costs, activities and service performance, and a rolling programme of performance reviews would support the Scottish Parliament in fulfilling this role.

Exhibit 1

The National Performance Framework



Source: The Scottish Government

Introduction

1. Since mid-2008, Scotland's economy has been in recession. The full effects of the recession are not yet known but it is clear there will be major implications for the public sector.
2. The Scottish Government's overall purpose is to promote and sustain economic growth and it has five strategic objectives: a healthier; wealthier and fairer; smarter; greener; and safer and stronger Scotland. In 2007, the Scottish Government introduced a new National Performance Framework (NPF), which sets out a number of performance targets for the public sector to work towards in the form of 15 national outcomes and 45 national indicators and targets (Exhibit 1).¹
3. In 2007, the Scottish Government and local government agreed a concordat which gave councils more local flexibility in the way they spend the money received from the Scottish Government. This was achieved largely through the removal of a substantial number of ring-fenced funding streams. As part of the concordat, the Scottish Government and local government have jointly agreed the development of 32 Single Outcome Agreements (SOAs). The SOAs provide a framework by which councils and their partners, through Community Planning Partnerships, establish a set of local outcomes. The aim is that these local outcomes should be based on the Scottish Government's national outcomes while taking account of local priorities.
4. The public sector reports progress against the national outcomes through a new performance reporting system known as Scotland Performs.² Councils, through Community Planning Partnerships, are responsible for local reporting on progress against the related local outcomes.

1 We have tried to minimise the use of technical language, but in some instances this is unavoidable and we have therefore included a glossary of terms at Appendix 1. We have also included details of the National Performance Framework at Appendix 2, and a breakdown of the Scottish budget at Appendix 3.

2 Performance against the National Performance Framework is reported through the Scotland Performs website: www.scotland.gov.uk/about/scotPerforms

5. In 2009/10, the Scottish budget is £34.7 billion. Annual spending plans are set out in the budget, which is scrutinised and subject to approval by the Scottish Parliament. Around 85 per cent (£29.6 billion) of the budget is allocated to public bodies to deliver public services, with the remaining 15 per cent (£5.1 billion) administered directly by the Scottish Government.

6. The Scottish budget has increased each year since devolution, from £17 billion in 2000/01, with average real term increases of just over five per cent (Exhibit 2).

7. The Institute for Fiscal Studies (IFS) predicts that real term reductions across all UK Government Departmental Expenditure Limits (DEL) will be around 2.3 per cent each year between 2011 and 2014.³ It is also predicting that real term growth will continue to be constrained during 2014 to 2018.⁴ At this stage, it is unclear what the actual reduction in budgets will be. This will depend on the depth of the recession and the length of time the economy takes to recover. It also depends on UK Government policy on reducing debt levels.

8. This squeeze will have a significant impact on the amount of money available to the public sector in Scotland, because Scotland receives most of its funding from the UK Parliament. In turn, the voluntary sector and private sector organisations that rely on public sector funding will also be affected.

9. By 2013/14, the Scottish budget could be between seven and 13 per cent lower in real terms.⁵ Reductions of this size will present a significant challenge for the Scottish public sector in sustaining and improving services.

Exhibit 2

Scottish Government budget growth 2000/01 to 2009/10

The Scottish Government's budget has increased by an average of 5.4 per cent each year since devolution.



Source: The Scottish Government, Public Bodies Conference

10. There is generally limited room for manoeuvre in adjusting the budgets in the public sector, at least in the short term. This is because most of the costs are fixed – such as the costs of salaries and pensions, running costs of buildings, costs of capital and essential supplies. In addition, the ageing population and the effects of the recession are likely to increase the demand for some services. The Scottish Government expects that by 2011, the Efficient Government Programme for the public sector will generate a total of £1.6 billion of cash-releasing savings, based on two per cent of 2007/08 expenditure levels. Given the high proportion of fixed cost in most budgets, it is not clear whether the public sector can continue to deliver two per cent efficiency savings on a cumulative basis beyond 2011, without a fundamental shift in how services are delivered.

11. The Scottish Government has prepared a carbon budget alongside the 2010/11 draft budget, which provides an assessment of the overall carbon impact of the government's proposed expenditure.⁶ This assessment looks only at the emissions associated with buying goods and services – it is anticipated that future assessments will look at wider emissions. This is the first step in the process of developing a carbon accounting system, which will be critical in informing future spending decisions while ensuring that Scotland meets the targets in the Climate Change (Scotland) Act 2009.

12. In addition, the Carbon Reduction Commitment (CRC), which is central to the UK Government's strategy for improving energy efficiency and reducing carbon dioxide emissions, will come into force in 2010. The CRC is an emissions trading scheme, which provides financial incentives to

³ Departmental Expenditure Limit along with other terms used throughout this report are explained further in a glossary at Appendix 1.

⁴ *The public finances and the age of austerity*, Institute for Fiscal Studies, June 2009.

⁵ *Briefing Note*, Centre for Public Policy for Regions, April 2009.

⁶ *Carbon assessment of the 2010/11 draft budget*, Scottish Government, September 2009.

reduce carbon emissions by putting a price on them. The scheme will cover large public and private sector organisations, which will need to buy allowances equal to their annual emissions. Failure to comply with the key obligations of the scheme will lead to financial penalties.

13. In June 2009, the Finance Committee of the Scottish Parliament published two reports that are of significance in responding to the recession. The first of these was a review of the budget process. The Finance Committee commented that Scotland's budget model has improved since devolution and compares well with other countries. However, it also highlighted a number of areas for improvement to support robust budget scrutiny. These include the need for:

- Parliament to complete a strategic scrutiny review of the budget once in each parliamentary session
- improved information to align budget information with performance monitoring information
- improved advice and research for the Parliament that is independent of government.⁷

14. The second report looked at the future for Scottish Government spending. This report considered the impact of the recession on the Scottish public sector budget for 2010/11 and beyond; the pressures and demands in the context of UK public finances; and the likely implications and challenges for the Scottish Government's budget over the longer term. The report made a number of recommendations including the need to connect budget priorities with growing the economy,

improving the evaluation of individual programmes, and providing better links between policy priorities and budgetary choices.⁸

Preparing for the future

15. *Scotland's public finances: preparing for the future* contains an overview of the financial environment in Scotland and the pressures and challenges facing the public sector. The report also looks at the Scottish Government's financial management arrangements. It suggests some key questions for the Scottish Government, the Parliament and the wider public sector to consider when planning the delivery of public services in a time of severe resource constraints.

16. There is a recognition across Scotland that there are serious financial challenges ahead. This is clearly seen, for example, in the Finance Committee's two reports.

17. There are some key questions that need to be addressed in planning for the financial challenges that lie ahead. The aim of this report is to help to inform the debate on the future of public finances in Scotland.

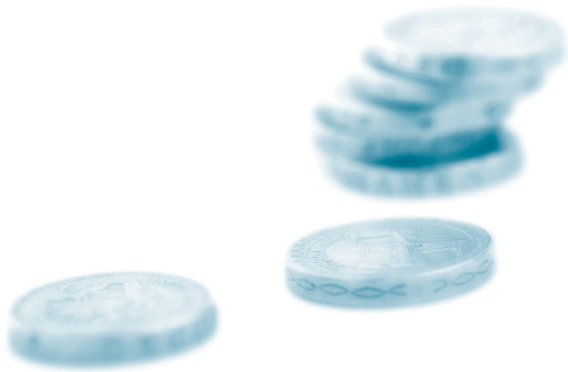
Key questions for the Scottish public sector:

- How are decisions made between competing priorities within the National Performance Framework when resources are limited? What will success look like in relation to service delivery on the ground?
- Is there sufficiently good information on the cost, quality and quantity of services to support evidence-based priority setting?
- What needs to be done to improve understanding of the links between spending, activities, performance and outcomes?
- What contribution beyond the existing two per cent efficiency savings can be reasonably expected? What more could be done to improve understanding of productivity in public services as a basis for further action?
- Are there areas where spending is needed now to deliver significant recurrent savings in the longer term?
- Is the balance right between short-term measures and long-term changes?
- Is enough being done across sector and service boundaries to deliver efficient services that place the needs of users first?
- Are there barriers to delivering joined-up and efficient services (for example, organisational structures) that should be addressed, or can partnerships and shared service arrangements be relied on?

⁷ *Report on the Review of the Budget Process*, Finance Committee, 5th Report, 2009 (Session 3), The Scottish Parliament, June 2009.
⁸ *Strategic Budget Scrutiny*, Finance Committee, 2nd Report, 2009 (Session 3), The Scottish Parliament, June 2009.

- Are partnerships able to use budgets, staff and buildings in a flexible way? Can they empower staff to act while at the same time maintaining clear and robust accountability for use of resources and performance?
- Is the work that goes into partnerships delivering clear improvements in the accessibility, quality and efficiency of public services? What support do partnerships need to make any necessary changes?
- Is the current capital investment programme sustainable in the current economic climate? And what are the priorities?
- What are the implications of an ageing workforce for the staffing of front-line services such as education, health, social work, police and fire services?
- Does the public sector have a sufficiently flexible workforce to allow jobs to be changed? Is there a need for skills development and an improved understanding with the unions and staff about the needs and opportunities for redesigning how services are provided?

Part 1. The current public spending environment



The Scottish Government faces significant challenges in balancing the budget while also delivering on its commitments and meeting increasing demands for public services.



Key messages

- It remains unclear what impact the current recession will have beyond 2010/11. The Scottish budget is likely to reduce in real terms but the full extent of this is not yet known.
- In many cases, the public sector uses income from various sources to pay for services. Income levels anticipated before the recession are unlikely to be realised, reducing the amount available to spend.
- The Scottish public sector faces significant challenges in balancing its budget while also delivering on its commitments. Changes in Scotland's population and rising unemployment rates will increase demand for public services.
- Two per cent efficiency savings will not be sufficient beyond 2011 to bridge the gap between public spending and the smaller budget available.

The recession is having a significant impact on the UK economy

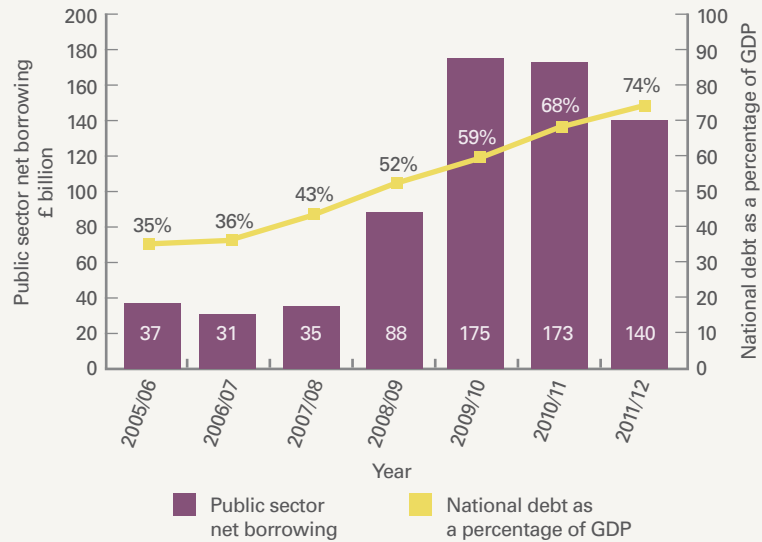
18. The UK economy is currently in recession and has been since the last quarter of 2008 – the first time since 1991. In response to the recession, the UK Government increased borrowing, from £88 billion in 2008/09 to £175 billion in 2009/10, to allow it to increase public spending to support the economy. However, it plans to reduce this level of borrowing to £173 billion in 2010/11 and £140 billion in 2011/12 if the economy recovers in line with its forecasts (Exhibit 3).⁹

19. This level of borrowing means that debt interest payments will increase, reducing the amount of funding available for public services. Over

Exhibit 3

UK public sector borrowing and national debt as a share of Gross Domestic Product (GDP), 2005/06 to 2011/12

UK public sector net borrowing will reach £175 billion in 2009/10, with national debt as a percentage of GDP reaching 74 per cent in 2011/12.



Source: Office for National Statistics/Institute for Fiscal Studies

time, the UK Government will need to reduce public spending, increase taxes or apply a combination of both measures to reduce the national debt.

20. The UK has experienced the worst deterioration in its public sector finances of all OECD countries.¹⁰ In the 2009 UK budget, HM Treasury estimated that the UK's ability to produce goods and services in the long-run has fallen five per cent. This affects the UK Government's ability to raise taxes and therefore reduce debt.¹¹ The IFS estimates that it could take over a decade to reduce the UK national debt as a share of GDP to 50 per cent (to the 2008/09 level).¹²

21. The impact of the recession on public sector spending is likely to be significant. At UK level, real term reductions of 2.3 per cent each year are projected for Departmental Expenditure Limit (DEL) budgets between 2011 and 2014. Current forecasts are that any real term

growth in public spending over the next two spending review periods (2011 to 2018) will continue to be constrained and will not return to the levels seen over the last decade.¹³

22. The UK Government announced in its April 2009 budget that capital budgets would fall from 3.1 per cent of GDP in 2009/10 to 1.3 per cent in 2013/14.¹⁴ This will significantly reduce spending on capital projects. Proceeds from the sale of land, property and other assets also contribute to capital budgets, but in the current economic climate proceeds are falling and it is unlikely that they will be sufficient to cover the shortfall.

The Scottish public sector is facing the biggest squeeze on budgets since devolution

23. The Scottish Government's original spending plans, published as part of the 2007 Spending Review, forecast

⁹ *UK Budget 2009*, Scottish Parliament Information Centre, April 2009.

¹⁰ Organisation for Economic Co-operation and Development. The OECD provides a setting for democratic governments to compare policy experiences, seek answers to common problems, identify good practice and coordinate domestic and international policies.

¹¹ *The 2010/11 Draft Budget, Report to the Finance Committee, Scottish Parliament*, David NF Bell, University of Stirling, September 2009.

¹² *Public finances: two parliaments of pain*, Institute for Fiscal Studies, April 2009.

¹³ *Public Spending*, Institute for Fiscal Studies, April 2009.

¹⁴ *UK Budget 2009*, HM Treasury, April 2009.

increases in DEL over the period 2008/09 to 2010/11 of 4.4, 4.5 and 3.7 per cent (cash terms) respectively.¹⁵

24. In 2008/09, in response to the recession, the Scottish Government increased capital spending with the aim of boosting the economy by bringing forward £347 million of capital spending to 2008/09 and 2009/10 from 2010/11. Latest forecasts for the Scottish Government's DEL budget show a real term increase of 4.7 per cent in 2009/10 followed by a real term reduction of 1.6 per cent in 2010/11.¹⁶ The current financial year – 2009/10 – will be the peak year for public spending for some time to come.

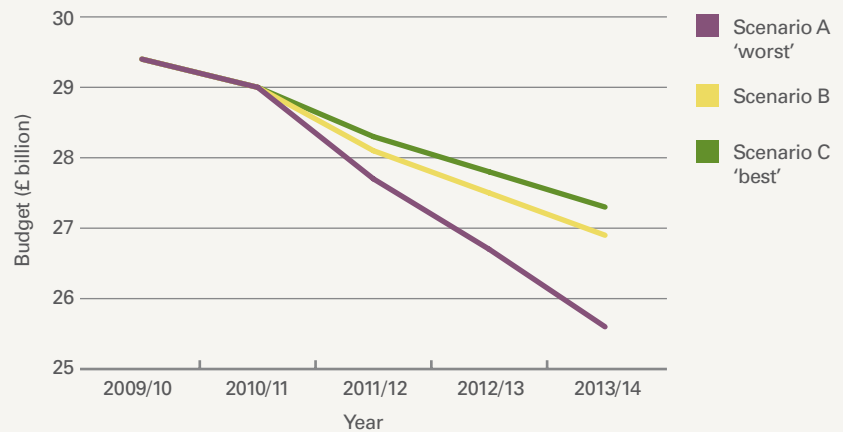
25. Beyond 2010/11, the full impact of the current economic recession is unclear. The Centre for Public Policy for Regions (CPPR) published data suggesting three different scenarios for the three-year period 2011/12 to 2013/14, from the best case through to the worst case projection. This shows real term reductions in the Scottish budget of between seven per cent (£2.1 billion) and 13 per cent (£3.8 billion) in 2013/14, compared to 2009/10 (Exhibit 4).¹⁷ Over the medium term, further real term reductions are forecast, but it is not yet clear what impact this will have on the different parts of the Scottish budget because it is set as part of the UK Spending Review. Experts have suggested various scenarios for public finances in the UK and Scotland. The size of the budget reductions will depend on the depth of the recession and the length of time the economy takes to recover. It also depends on UK Government policy on reducing debt levels.

26. The Scottish Government has implemented an economic recovery programme to support the economy through this period of decline. The programme focuses on five strategic priorities that the Scottish Government believes are essential for

Exhibit 4

Scottish Government budget growth projections (real terms), 2009/10 to 2013/14

Over the five years to 2013/14, the Scottish Government's budget is predicted to reduce by between £2.1 billion and £3.8 billion.



Source: The Centre for Public Policy for Regions (CPPR)

economic growth – infrastructure and place; learning, skills and wellbeing; a supportive business environment; effective government; and equity.¹⁸

Other public sector income is likely to be less than previously forecast

27. The public sector receives non-government income from a variety of sources, which is proportionately small, but is used to help fund spending across a number of areas. Sources of income include non-domestic rates; proceeds from the sale of assets; housing regeneration income; and fees and charges.

28. The Scottish Government's budget includes income from non-domestic rate (NDR) charges made to businesses. The Scottish Government estimated that NDR income would be £2 billion in 2010/11. However, this level of income may not be achieved if some businesses cease to trade as a result of the recession. Although NDR income forms part of the funding package made to councils, it is the responsibility of the Scottish Government to address any shortfalls should income levels not be realised.

29. The Scottish Government and the Convention of Scottish Local Authorities (COSLA) agreed to freeze council tax as part of the concordat in June 2008. The Scottish Government has allocated £70 million to meet this cost annually over the period 2008/09 to 2010/11. If the policy continues, then councils will not be able to raise additional revenue from council tax.

30. The Scottish Government's budget includes other income estimated at £687 million over the period 2008/09 to 2010/11. Most of this income relates to the NHS, including capital from the sale of land and buildings of £141 million. The assumptions underpinning these estimates were developed before the current economic recession.

31. The Scottish Government now estimates that NHS capital income for the three-year spending review period will be around £21 million. This is £120 million less than originally anticipated. In 2009/10, NHS capital income was budgeted at £92 million, but due to the recession, this has been revised downwards to £5 million – a decrease of £87 million.¹⁹ NHS

¹⁵ *Scottish Budget: Spending Review 2007*, Scottish Government, November 2007.

¹⁶ *Impact of Recession on Scotland's Public Finances*, Scottish Parliament Information Centre, April 2009.

¹⁷ *Briefing Note*, Centre for Public Policy for Regions, April 2009.

¹⁸ *Preparing for recovery: update on the Scottish economic recovery programme*, Scottish Government, June 2009.

¹⁹ *Draft Budget 2009/10*, Scottish Government, September 2008.

boards use capital income to offset spending on capital projects. There is, therefore, a significant risk that there will be insufficient funding to deliver the NHS capital programme. This could result in projects being delayed or cancelled.

32. Housing regeneration income (£90 million) is also expected to be less than anticipated during 2008/09 to 2010/11. This income comes from a number of sources, including money from people buying their council houses or part-buying homes through shared equity schemes. With the downturn in the property market, fewer people are likely to buy property and this will reduce the income received.

33. Other bodies, such as Historic Scotland and Registers of Scotland, which charge directly for the services they provide, are seeing a reduction in income levels. Historic Scotland is experiencing a reduction in the amount of commercial income received.²⁰ Registers of Scotland is receiving much lower income from surveyors, solicitors and estate agents because of the decline in the property market. As a result, in 2008/09, Registers of Scotland incurred an operating deficit of around £11 million compared to a budgeted surplus of around £4 million.²¹

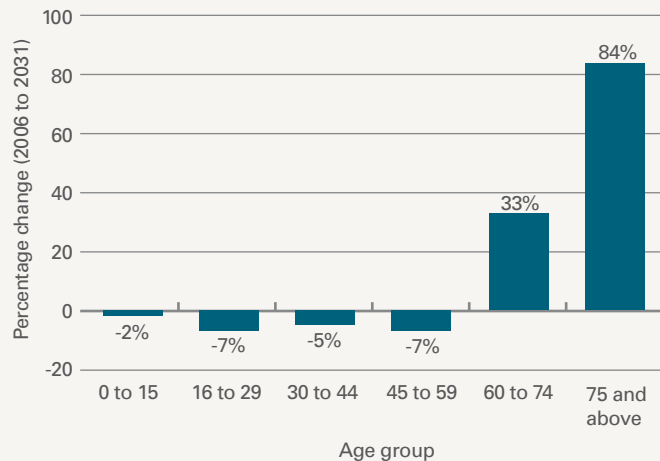
Scotland's funding arrangements may change in the future

34. Scotland is funded by a block grant from the UK Parliament largely determined using the population-based Barnett Formula. The formula, introduced in 1978, is a mechanism for providing Scotland with its share of any changes in comparable UK spending programmes in proportion with population levels. In 2007/08, the Barnett Formula accounted for around £49 billion of UK public spending.²²

Exhibit 5

The projected percentage change in age structure of Scotland's population, 2008 to 2033

By 2033, Scotland will have significantly more older people, particularly in the 75 and over age group.



Source: *Projected Population of Scotland*, General Register Office for Scotland, October 2009

35. The continued use of the Barnett Formula in funding the devolved administrations (Scotland, Wales and Northern Ireland) is the subject of ongoing debate. A House of Lords inquiry into the operation of the formula concluded that it should no longer be used, as there was increasing concern about the fairness of the formula. If the formula were to be reviewed, this may have long-term implications for the size of Scotland's block grant.²³

36. In 2008, the Scottish Parliament and the UK Government established the Commission on Scottish Devolution (the Calman Commission). The purpose of the Commission was to review the provisions of the Scotland Act 1998 and recommend any changes to the existing constitutional arrangements, including consideration of matters that would improve the financial accountability of the Scottish Parliament. Its report made a number of recommendations,

including a partial move away from the current block grant arrangements and the introduction of borrowing powers for the Scottish Parliament. The Commission recommended that any changes be phased in over time.²⁴

Increased demand will affect the affordability of public services

More older people will increase the demand for public services

37. Over the next 25 years there will be a significant change in the make-up of Scotland's population (Exhibit 5).²⁵ Forecasts show that over the period 2008 to 2033:

- the number of older people is projected to rise by 31 per cent from 1.02 million to 1.34 million, with a significant increase (84 per cent) in people aged 75 and over
- the number of people of working age is expected to increase by two per cent from 3.24 million to 3.31 million²⁶

²⁰ *Annual report and accounts 2008/09*, Historic Scotland.

²¹ *Annual report and accounts 2008/09*, Registers of Scotland.

²² *The Barnett Formula*, House of Lords, Select Committee on the Barnett Formula, July 2009.

²³ *Ibid.*

²⁴ *Serving Scotland Better, Scotland and the United Kingdom in the 21st Century*, Commission on Scottish Devolution, June 2009.

²⁵ *Projected Population of Scotland*, General Register Office for Scotland, October 2009.

²⁶ These figures take into account the increases in the state pension age. Were it not for these changes the population of working age would be projected to decrease by around six per cent by 2033.

Case study 1

Demographic pressures on health and social care services

Projections for the changes in Scotland's population highlight a growing older population. This will lead to further pressure on the acute and primary health sectors and social care services:

- While people are living longer the additional years are not necessarily spent in good health. Life expectancy in Scotland has continued to increase, as has healthy life expectancy although this is at a much slower pace.
- Older people account for 40.5 per cent of all emergency admissions to hospital. In addition, the rate per 100,000 population of people aged 65 and over with two or more emergency admissions within one year has risen from 4,200 in 1998/99 to almost 5,000 in 2007/08.
- Older people tend to have more long-term conditions such as dementia, diabetes and chronic obstructive pulmonary disease. As life expectancy goes up then it is likely that a growing number of older people will suffer from one or more long-term condition.
- People with long-term conditions account for 80 per cent of all GP consultations and 60 per cent of hospital bed days. They are also twice as likely to be admitted to hospital compared to people without long-term conditions. As people live longer and have more long-term health problems, pressure on primary care and hospital services will rise.
- Demand for free personal and nursing care and other social care services such as care at home will continue to grow.

Source: Audit Scotland reports: *A review of free personal and nursing care* (2008), *Overview of Scotland's health and NHS performance 2006/07* (2007), *Managing long-term conditions* (2007), *Overview of the performance of the NHS in Scotland 2004/05* (2005), *Commissioning community care services for older people* (2004).

- the number of children under 16 is expected to fall by around one per cent from 910,000 to 900,000.

38. The rise in the number of older people, and specifically people aged 75 and over, will increase the demand for health and social care services. [Case study 1](#) sets out some of the pressures being faced by health and social care services as a result of changing demographics. Fewer children under 16 may reduce the demand for education and children's services including the number of schools needed.

The effects of the recession may increase the demand for some public services

39. Scotland's unemployment rate for the quarter to August 2009 was 7.1 per cent, up 2.5 per cent on the previous year.²⁷ Increases in unemployment will result in more benefit payments along with possible rises in the number of housing repossessions and people seeking debt advice.

40. Higher levels of unemployment are likely to affect services, including health and social work. There may be increases in the level of drug and alcohol abuse, and in mental health problems such as depression and

anxiety. Higher unemployment may also lead to an increase in crime levels and this may bring additional pressures on police, court and community justice services.²⁸ The longer and deeper the recession, the more likely it is that there will be increasing demands for social housing.

41. There are growing demands for further and higher education places which may be partly as a result of higher unemployment levels. Applications for further and higher education places have increased by 5.9 per cent to 35,892 in the 2009 academic year. The largest increase (14 per cent) is in the 25 years and over age group.²⁹ The Scottish Funding Council has provided additional investment of £28 million over 2009/10 and 2010/11 to fund around 3,100 extra full-time places in further education colleges.³⁰

There are more free services and the costs of these will rise

42. The Scottish Government is committed to a number of universal public services, which are not paid for by users and where the costs are increasing. These services are demand led, making it difficult to estimate their future costs. Changes in Scotland's population will increase demand for these services, placing pressure on their long-term affordability.

43. Free personal and nursing care (FPNC) for older people was introduced in July 2002 through the Community Care and Health (Scotland) Act. In 2008, Audit Scotland highlighted a growing shortfall in Scottish Government funding for the policy, which was confirmed in the subsequent review by Lord Sutherland.³¹ The Scottish Government has provided an additional grant of £40 million

²⁷ *Labour market statistics*, Office of National Statistics, October 2009.

²⁸ *What should be done about rising unemployment in the UK*, David NF Bell and David G Blanchflower, Institute for the Study of Labor.

²⁹ Media release, UCAS, July 2009.

³⁰ Press release, Scottish Funding Council, June 2009.

³¹ *A review of free personal and nursing care*, Audit Scotland, January 2008. *An Independent Review of Free Personal and Nursing Care*, Lord Sutherland, April 2008.

to councils for the two years to 2009/10.³² The total cost of providing FPNC increased on average by 15 per cent each year between 2003/04 and 2006/07.³³ If this trend continues, projected costs for 2009/10 and 2010/11 will be around £489 million and £562 million respectively.

44. In December 2007, the Scottish Government announced that prescription charges would be phased out until fully abolished in April 2011. The estimated cost of this is £17 million, £24 million and £32 million, in the three years from 2008/09 to 2010/11. It is estimated that the cost of providing prescriptions free of charge will be £57 million in 2011/12.³⁴

45. In April 2006, free eye examinations were introduced for everyone in Scotland. In 2006/07, the first year of the new policy, eye examinations increased by 53 per cent to 1.5 million with the number of examinations now approximately 1.6 million. The Scottish Government estimates that providing free eye examinations will cost £87.4 million in 2009/10 and £91 million in 2010/11.³⁵

46. The concessionary fare travel scheme was introduced in April 2006 and provides free bus travel throughout Scotland for older and disabled people. The estimated cost is £187.4 million in 2009/10 rising to £189.4 million in 2010/11.³⁶

There are ongoing cost pressures in the public sector

47. Many of Audit Scotland's recent reports have highlighted cost pressures in the NHS and local government (Case studies 2 and 3). These cost pressures are likely to continue into the next spending review period and beyond.

Case study 2

Cost pressures in the NHS

- Recent pay agreements and associated pension costs have added significantly to the total NHS pay bill. The cost of NHS salaries (excluding those associated with independent contractors such as GPs, dentists, pharmacists and opticians) has risen in cash terms from just under £3 billion in 2003/04 to around £5 billion in 2008/09.
- Between 1996/97 and 2008/09, drugs prescribing costs more than doubled in cash terms to just over £1.1 billion. The rate of increase in these costs has reduced but they remain significant.
- Hospital energy costs increased by nearly 75 per cent between 2004/05 and 2007/08, increasing from £41 million to £71 million.
- Existing PFI commitments amount to around £120 million a year and are committed well into the future.
- Pressure will continue to be placed on the health service by levels of ill health in Scotland, and, in particular, illness associated with deprivation, obesity and the misuse of drugs and alcohol.

Source: Audit Scotland

Case study 3

Cost pressures in local government

- The total local government pay bill is around £7 billion. Cost of living pay increases were three per cent and 2.5 per cent in 2008/09 and 2009/10 respectively.
- Equal pay and related legal costs accounted for £181 million in 2007/08 (£233 million in 2006/07 and £280 million in 2005/06). We estimate that the cost of single status implementation adds between one and eight per cent to the overall pay bill.
- There have been increases in some operating costs such as energy use. Councils spent around £79 million on energy in 2004/05. The price of electricity and gas doubled between July 2004 and June 2008.
- National priorities such as reducing class sizes and introducing free school meals, and pressure on social housing and social care services will increase costs.
- In 2007/08, councils spent a total of £340 million on waste management. In order to meet national targets councils will have to spend an estimated £580 million per year by 2020.

Source: Audit Scotland

³² In his review of the FPNC policy, Lord Sutherland recommended additional funding of £40 million based on Audit Scotland's findings.

³³ *Free Personal and Nursing Care, Scotland, 2006/07, A National Statistics Publication for Scotland*, Scottish Government, August 2008.

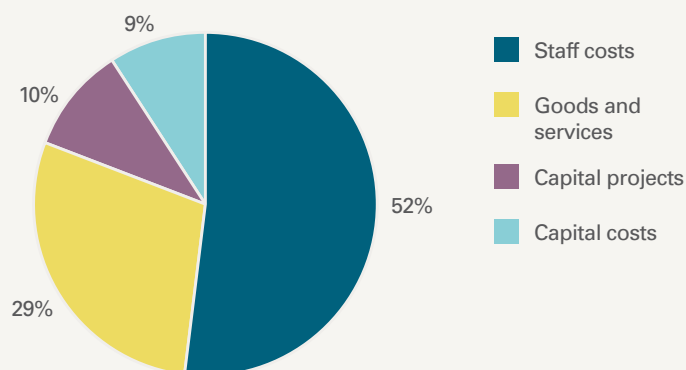
³⁴ *Prescription Charges: Proposed Phased Abolition briefing*, Scottish Parliament Information Centre, February 2008.

³⁵ *Draft Budget 2009/10*, Scottish Government, September 2008. This is the total budget for General Ophthalmic Services. Spending on free eye exams accounts for approximately 80 per cent of this total.

³⁶ *Spending Review 2007*, Scottish Government, November 2007.

Exhibit 6**Scottish public sector expenditure, 2009/10**

Staff costs account for around 52 per cent of Scottish public spending.



Note: Staff costs are taken from 2007/08 annual accounts including salaries; overtime and bonus payments; pensions; National Insurance contributions; temporary staff; and severance payments, adjusted for pay agreements and inflation to 2009/10. Also included is £2.7 billion in respect of NHS and teachers' pensions, based on the 2009/10 budget.

Goods and services spend is taken from Audit Scotland's report *Improving public sector purchasing* (July 2009) and payments to GPs and other independent health contractors in NHS 2007/08 annual accounts, adjusted for inflation.

Capital project costs are taken from the Scottish Government's 2010/11 draft budget.

Capital costs are based on capital charges in 2007/08 annual accounts, adjusted for inflation and expected PFI/PPP payments in the Scottish Government's 2010/11 draft budget.

Costs do not include all payments made by universities or pension payments for some groups of public sector staff including central government, police and fire services.

Source: Audit Scotland

Public bodies will find it difficult to reduce their costs while maintaining front-line services

48. Salaries and pensions, goods and services and the running costs of buildings and equipment make up most of public sector costs. Capital costs also make up a significant element of public spending. Staff costs account for around 52 per cent of Scottish public sector expenditure (Exhibit 6). Without the flexibility to redeploy or reduce staffing levels or rationalise the assets used to deliver services, public bodies have limited discretion to reduce their costs while maintaining the levels of front-line services they provide.

Staff costs account for around half of public sector expenditure and are set to increase

49. The Scottish public sector is proportionately larger than in other parts of the UK and employs more people as a share of all jobs compared to elsewhere in the UK.³⁷ There are currently 579,600 public sector employees in Scotland – representing 23 per cent of total employment in Scotland.³⁸

50. Salary, pension and related employer costs amount to £18.8 billion (around 52 per cent of public sector expenditure).³⁹ Salary costs will continue to increase in the period up to the next spending review because some public sector pay agreements were settled for

three years and were based on higher inflation levels. Many of the pay deals have a number of years to run, with 2010/11 being the final year for several large public sector groups, including police and teachers. The Scottish Government agreed a three-year pay deal for NHS staff as part of the Agenda for Change, with pay increases of 2.75 per cent, 2.4 per cent and 2.25 per cent agreed for 2008/09 to 2010/11.⁴⁰ For local government employees, the pay settlement for 2008/09 and 2009/10 was three per cent and 2.5 per cent respectively. In addition, it is estimated that the rise in the rate of national insurance contribution costs will increase Scottish public sector pay costs by £30 million in 2010/11.⁴¹

51. There are six main public sector pension schemes in Scotland.⁴² Employer contribution rates vary across the schemes, ranging from 13.5 per cent to 22 per cent. With the exception of the NHS Superannuation Scheme, employer contribution rates continue to rise. The pension schemes for police and fire-fighters do not currently have a set employer contribution rate but annual costs are based on pensions paid less employee contributions. The estimated 2009/10 employer contributions for Scottish teachers are £373 million and £559 million for NHS staff.⁴³ The most recent actuarial valuation of the Local Government Pension Scheme resulted in an increase in employer contribution rates for each of the three financial years from 2009/10 to 2011/12. We cannot currently establish employer contributions for police and fire-fighters' pensions but as at 31 March 2008, their unfunded liabilities were £6.3 billion and £1.7 billion respectively.⁴⁴

³⁷ *The size of the public sector*, Scottish Parliament Information Centre, February 2009.

³⁸ Of those 579,600 public sector employees, 82 per cent (509,300) are employed in public bodies devolved to Scotland. Figures from *Public Sector Employment Statistics*, Scottish Government, July 2009.

³⁹ This figure is based on the 2007/08 accounts of 167 public sector bodies and adjusted for known factors such as inflation and pay agreements.

⁴⁰ Evidence to the Scottish Parliament's Finance Committee, April and May 2009.

⁴¹ Evidence to the Scottish Parliament's Finance Committee, April and May 2009. National Insurance Contributions are public sector pay costs covered by the Scottish Government's budget.

⁴² The six public sector pension schemes are: Local government; NHS; teachers; civil servants; police; and fire-fighters. It is not clear what proportion of Principal Civil Service Pension Scheme members in Scotland have their pension costs financed directly or indirectly through Scottish Government budgets.

⁴³ Evidence to the Scottish Parliament's Finance Committee, April and May 2009.

⁴⁴ The annual accounts of police and fire boards do not generally disclose employers' pension contributions.

52. Scottish ministers have given a commitment to no compulsory redundancies across the Scottish Government during the period of the current spending review (until March 2011). The commitment applies to permanent employees working in the Scottish Government, government agencies and non-departmental public bodies.⁴⁵

Planned capital projects and ongoing capital costs account for around a fifth of Scottish public sector spending

53. The Scottish Government plans to spend around £7 billion on capital projects over 2009/10 and 2010/11.⁴⁶ In 2009/10, the level of spend is estimated to be £3.8 billion, representing ten per cent of total public sector spending. This will decrease to around £3.2 billion in 2010/11. This includes funding towards eight national developments, including the replacement Forth crossing (estimated total cost £1.7 - £2.3 billion), and the Edinburgh trams project (£545 million).^{47, 48} Past performance shows that the final cost of many major capital projects often exceeds initial estimates.⁴⁹

54. Despite the planned level of capital investment, cost pressures remain across the public sector estate with at least £3.7 billion in backlog maintenance existing (Case study 4).

55. The public sector has a number of Private Finance Initiative (PFI) and Non Profit Distributing (NPD) commitments that are increasing in cost. Over the period 1997 to 2042, estimated payment commitments for PFI and NPD schemes will be £30 billion. The total payment in 2009/10 will be £723 million, rising to £820 million in 2010/11.⁵⁰ In addition, in 2008/09, the cost of using assets

Case study 4

Cost pressures in the public sector estate

- Of 12,400 property assets owned by councils, 27 per cent are in poor or bad condition, 23 per cent are not sufficiently suitable for the services being delivered from them, and 14 per cent fail in both respects. The cost of maintenance backlog is £1.4 billion and £376 million of this is urgently required.
- The cost of bringing Scotland's roads up to standard is estimated at £1.7 billion and the estimated cost of backlog maintenance for road repairs is around £900 million for councils and £232 million for the Scottish Government.
- Based on the Scottish Government's criteria, interim targets for improving 300 schools by 2006 have been met. However, if progress continues at current rates it could take up to 20 years to remove all schools from poor or bad condition.
- Just over half (55 per cent) of the Scottish higher education estate is in a sound or new condition. However, the maintenance backlog was almost £0.7 billion in 2007 and continues to grow.
- Since 2002, the Scottish Prison Service has spent around £280 million on improving conditions in the prison estate. However, the number of prisoner places has remained largely unchanged. Plans to increase prison capacity by around 1,900 places may not be sufficient to accommodate projected prisoner numbers. By 2016/17, it is projected that prisoner numbers will rise by 20 per cent based on 2007.
- Almost a third of the NHS estate will need major upgrading soon. Information provided by 16 NHS bodies indicated that at least £512 million is required to address all outstanding estate maintenance issues over the coming years.
- An audit commissioned by sportscotland in 2006 found that the estimated cost of upgrading and maintaining Scotland's sports facilities (excluding routine maintenance) was around £110 million each year over the following 25 years.

Source: Audit Scotland reports: *Asset management in local government* (2009), *Maintaining Scotland's roads* (2004), *Improving the school estate* (2008), *Estate management in higher education* (2007), *Managing increasing prisoner numbers in Scotland* (2008), *Asset management in the NHS in Scotland* (2009), *A performance overview of sport in Scotland* (2008).

(capital charges) was £2.3 billion. It is estimated that capital charges will increase to around £2.5 billion in 2009/10. Together, PFI/NPD and capital charges account for around £3.2 billion each year (nine per cent of public sector expenditure).

Spending on goods and services accounts for over a quarter of Scottish public sector expenditure

56. Public sector bodies spend around £8 billion a year on goods and services such as medical and nursing supplies and social and community care services. Local government and health bodies are responsible for three-quarters of this spend. Spending by individual bodies varies significantly

45 *Public Services Reform: Simplification and Improvement Update*, Scottish Government, May 2009.

46 *Draft Budget 2010/11*, The Scottish Government, September 2009.

47 Scottish Government news release, December 2008.

48 *Edinburgh Transport Projects Review*, Audit Scotland, June 2007. Funding is split between the Scottish Government (£500 million) and the City of Edinburgh Council (£45 million).

49 *Review of major capital projects*, Audit Scotland, June 2008.

50 *Draft Budget 2010/11*, The Scottish Government, September 2009.

– with a third of bodies responsible for 92 per cent of spending.⁵¹ In addition, around £2.3 billion is spent on payments to General Practitioners and other independent NHS contractors. In total, this is around 29 per cent of total Scottish public spending and it supports the delivery of all major public services in Scotland.

57. Savings of £327 million from better purchasing are broadly in line with the Scottish Government's target of £340 million up to 2007/08. In the current economic climate, even more emphasis on savings will be needed to reduce the costs of goods and services without affecting quality, especially as many of these goods and services are vital to delivering public services.

The Scottish public sector faces a significant challenge in balancing the cost of public services with a smaller budget

58. The Scottish Government faces significant challenges in balancing the budget while also delivering on its commitments and meeting increasing demands for public services. All of this needs to be done with less money, in real terms, in future years.

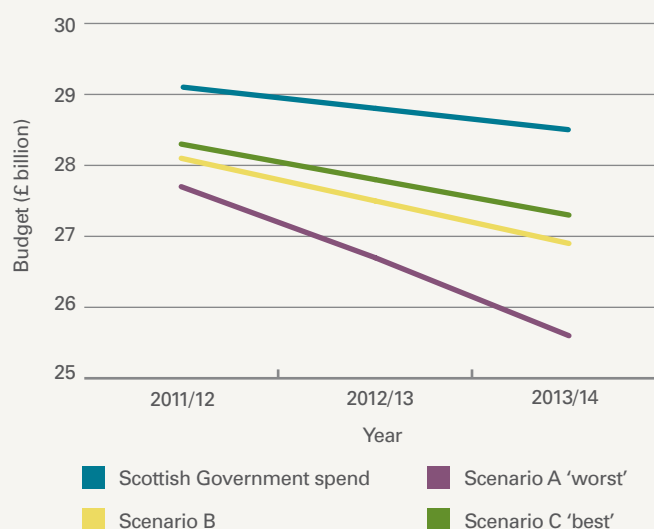
59. In April 2009, the CPPR published projections for the Scottish budget up to 2013/14, based on three scenarios (Exhibit 4, page 9). These scenarios project an overall reduction in Scotland's budget by 2013/14 ranging from, £2.1 billion at best (seven per cent) to £3.8 billion at worst (13 per cent).

60. To determine how a reduction in the budget might affect public services we have used information in the latest Scottish Government budget to project spend to 2013/14 and compared this with CPPR's forecasts for future budget levels. This analysis highlights a gap between budget and spend between 2010/11 and 2013/14, should spending continue at its current level.

Exhibit 7

Projections of Scottish Government spending and budgets to 2013/14 (real terms)

Projected budget reductions will result in a significant gap emerging should the Scottish Government's spending plans continue on the same basis beyond 2011.

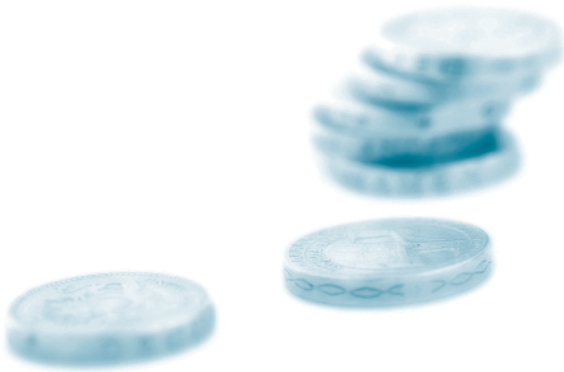


Note: Scottish Government spend includes staff costs, spending on goods and services, capital projects and charges. The assumptions we have used are: staff costs will increase by 1.5 per cent and capital charges will increase by 11 per cent each year. Other spending is assumed to remain at current levels. All figures have been adjusted for the effects of inflation using HM Treasury forecasts – *UK Budget 2009*, HM Treasury, April 2009.
Source: Audit Scotland/Centre for Public Policy for Regions

Comparing spending forecasts to CPPR's best case scenario highlights a gap of around £1.2 billion, but this could be as much as £2.9 billion if CPPR's worst case scenario is realised (Exhibit 7).

61. The Scottish Government has committed to making two per cent annual cash-releasing efficiency savings by the end of 2010/11, which should release around £1.6 billion. It has not yet identified the level of efficiency savings it will require beyond 2011. However, two per cent annual efficiency savings will not be enough to bridge the gap – a more fundamental approach is needed and there is an urgent need to improve the efficiency and productivity of Scotland's public services.

Part 2. Financial management in the Scottish Government



The Scottish Government has strengthened its financial management, but it must continue to develop and improve the skills of staff to meet the challenges ahead.



Key messages

- The Scottish Government reduced its underspend to £31 million in 2008/09 (less than one per cent of the total budget) – the lowest since devolution.
- The Scottish Government has strengthened its financial management. But more could still be done to evaluate how well money is being spent in delivering against government priorities and improving public services.
- The Scottish Government needs to do more to continue developing and improving staff's financial management skills.

The Scottish Government distributes around £26.7 billion to over 200 public bodies each year

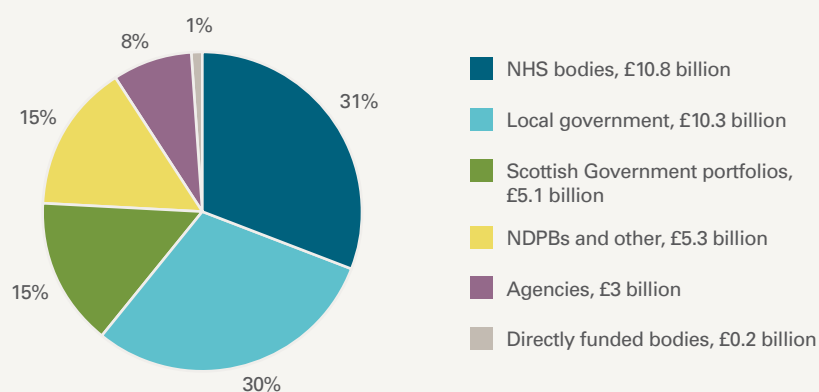
62. In 2009/10, the total Scottish budget is £34.7 billion.⁵² Around 85 per cent (£29 billion) of the budget is known as Departmental Expenditure Limit (DEL) funding – the Scottish Government has responsibility for deciding how to spend this money. A further £5.6 billion is Annually Managed Expenditure (AME) which includes, for example, expenditure on student loans, housing support grants and NHS and teachers' pensions.

63. The Scottish Government distributes most of its budget (£26.6 billion) to over 200 public bodies to deliver public services. NHS bodies and councils receive the largest proportion of this money – around a third each. After distributing the bulk of the budget to public bodies, the Scottish Government is left with around 15 per cent, or £5.1 billion, to administer directly (Exhibit 8).

Exhibit 8

The Scottish Budget 2009/10 (£34.7 billion)

Most of the Scottish budget is distributed to over 200 public bodies to deliver services.



Note: The figures above include DEL and AME. NHS bodies' budget includes income received from National Insurance Contributions.

Source: Audit Scotland from *Scotland's Budget Documents 2009/10: Budget (Scotland) Bill Supporting Document*, Scottish Government, January 2009.

64. The Scottish Government Health Directorates (SGHD) allocate around 70 per cent of the annual health budget directly to NHS boards to enable them to provide acute and community healthcare services and to commission family health services. The remainder is used to fund special health boards; provide capital funding to NHS bodies; and pay for the central administration of the SGHD. The SGHD monitor how NHS boards spend their budgets through monthly financial returns, and monitor performance against local delivery plans agreed with the boards, and through 29 national performance targets.

65. The Scottish Government funds around 80 per cent of local authority expenditure. Council funding is made up of the General Revenue Grant (GRG), General Capital Grant (GCG), non-domestic rates and some specific grants. The remainder of councils' income is made up of council tax and other fees and charges. Councils submit financial returns to the Scottish Government outlining service

expenditure and some activity, for example use of care home places. They also report on performance against their SOAs to both the Scottish Government and their local communities.

66. Partnership working aims to make best use of the resources available to all partners and can involve joint teams of staff; pooled or aligned budgets; shared office space and services; and joint workforce planning. Health boards and councils have increasingly been working together to plan, commission and deliver local services. Some formal structures are in place to support better joint working, including Community Planning Partnerships (CPPs) and Community Health Partnerships (CHPs). Partnership working, both formal and informal, exists across other parts of the public sector including, for example, drug and alcohol partnerships, community justice authorities and community safety partnerships.

⁵² Also known as the 'assigned budget' or the 'Scottish block'. This is the total budget approved by the Scottish Parliament. It includes the budget for the Scottish Government as well as NHS and teachers' pensions plus funding for the Scottish Parliament Corporate Body and other directly funded bodies.

67. SOAs set out jointly agreed outcomes for local communities and progress against these outcomes should be reported locally and through the Scotland Performs reporting system. However, while many examples of partnerships and joint working exist across the Scottish public sector, there is insufficient evidence so far about their success in targeting resources at those most in need; whether they are making the most efficient use of joint resources; and the quality of services they provide. Audit Scotland will be undertaking reviews of CPPs and CHPs during 2010.

In 2008/09, the Scottish Government achieved its lowest underspend since devolution

68. The Scottish Government’s DEL budget for 2008/09 was £27.975 billion. It spent £27.944 billion – an underspend of £31 million – the lowest since devolution (Exhibit 9). The largest underspends were in the Finance and Sustainable Growth; Education and Lifelong Learning; and Rural Affairs and the Environment portfolios.

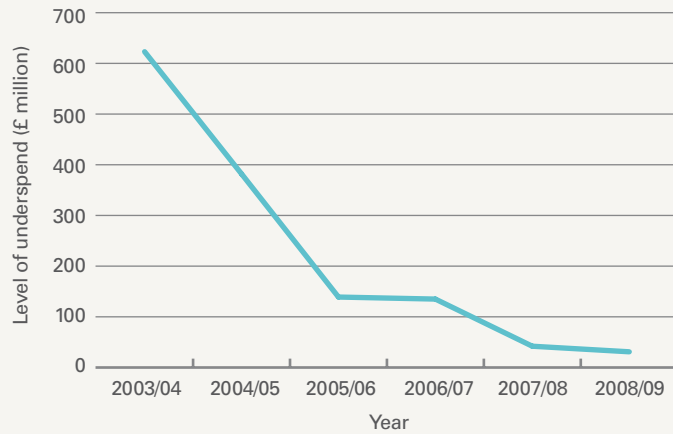
The Scottish Government manages the budget through a range of measures

69. The Permanent Secretary at the Scottish Government is the Principal Accountable Officer and has responsibility for the proper use of public funds and for the economic, efficient and effective use of resources. Six Directors General are accountable officers for their own government directorates. Together, the Permanent Secretary, Directors General, Director of Finance and three non-executive board members form the Strategic Board of the Scottish Government (Exhibit 10).

Exhibit 9

Scottish Government underspends since 2003/04

The Scottish Government has reported underspends against the DEL budget every year since devolution.

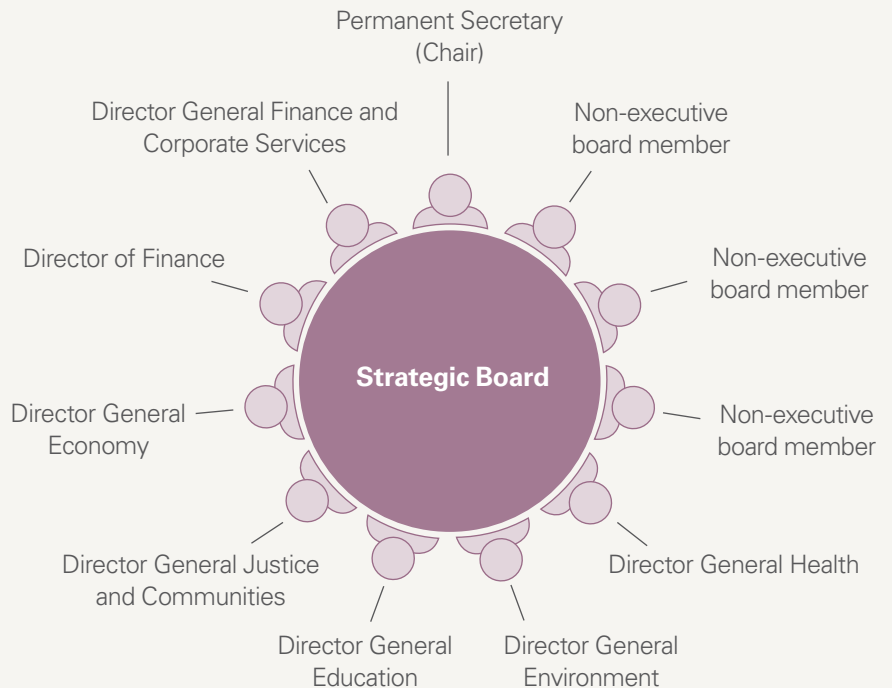


Source: Scottish Government

Exhibit 10

Strategic Board of the Scottish Government

The Scottish Government’s Strategic Board plays a significant role in managing the budget.



Source: Audit Scotland

Financial monitoring should include information on how well money is being used to deliver front-line services and achieve national outcomes

70. At the highest level, the Scottish Government has moved to a more corporate approach to budget management. The Strategic Board plays an important role in monitoring and challenging portfolio spend. It receives monthly finance reports from the Director of Finance that focus on forecast results for the year, together with an assessment of risks that may affect the annual results.

71. The Directors General challenge expenditure plans at both the Strategic Board and within their directorates. This challenge generally focuses on monitoring actual and projected spend against budget. While this is an important aspect of scrutiny, it does not address how well money is being used to deliver results. Further improvements in budget and performance monitoring information would enhance the Scottish Government's ability to monitor the activities and services and their contribution to national outcomes, and to report this performance to the Scottish Parliament.

Money is moved within and across portfolios to alleviate pressures

72. When budget pressures emerge during the course of the year, Directors General are expected to manage these within their portfolio budgets. Where this is not possible, the Strategic Board identifies any available money in other portfolios that can be moved to help alleviate pressures. For example, in bringing forward £100 million of capital spending for the Affordable Housing Investment Programme from 2010/11, the Scottish Government identified areas within the Health and Wellbeing portfolio (£26 million) and from

across other portfolios (Education and Lifelong Learning, Justice, Local Government and Rural Affairs – £74 million) where money could be re-allocated to support the decision.

More money than is available is allocated to budgets, but there are risks to this approach

73. By the end of the financial year 2006/07, HM Treasury held £1.5 billion of unspent Scottish Government money which had built up over a number of years. Until 2006/07, underspends against the DEL budget could be carried forward to future years as End Year Flexibility (EYF). However, since 2007/08, any underspends are retained by the UK Government to be considered as part of the next spending review.

74. The Scottish Government's 2007 Spending Review allocated £224 million more than was actually available in its spending plans. In both 2008/09 and 2009/10, £100 million was allocated above the overall budget. A £24 million over-allocation was planned for 2010/11, but was increased to £100 million in the 2010/11 draft budget. The purpose of this is to reduce the amount retained by the UK Government at the end of the year. In doing this, the Scottish Government took into account previous experience of underspending and slippage in capital projects.

75. This practice has contributed to reducing the annual underspend to £31 million in 2008/09 but there are risks with this approach. It does not address the underlying causes of underspends – slippage in programme and project spend – and there is also a risk that any weaknesses in systems for estimating and controlling spending might continue. It will also be more difficult to operate this approach at a time when resources are severely constrained, leading to

a greater risk of overspending by the end of the financial year. In order to reduce the future need to over-allocate resources, priority should be given to addressing the underlying causes of underspends while continuing to improve the monitoring and reporting process.

The Scottish Government must ensure it has the appropriate skills to meet the challenges ahead

76. In March 2008, the Sector Skills Council for Central Government reported that financial management was one of the top priorities for investment in learning and development across the Scottish Government.⁵³ In July 2008, HM Treasury recommended that the Scottish Government should develop the finance capacity and capability of staff through the Professional Skills for Government (PSG) framework.

77. The PSG framework is designed to provide civil servants with the skills they need for the future, including financial management skills. Other reviews have also highlighted the need to strengthen the financial management skills and the status of the finance function in the Scottish Government and the then Scottish Executive.⁵⁴

78. The Scottish Government has appointed a Director General with responsibility for finance and corporate services. Both the Director General and a professionally qualified Director of Finance sit on the Strategic Board. However, more remains to be done to ensure that the Scottish Government staff have the right financial and analytical skills to prepare for the financial challenges that lie ahead.

53 *Sector Skills Agreement Stages 1, 2 and 3 (Scotland)*, The Sector Skills Council for Central Government, March 2008. The council is sponsored by the UK Department for Business, Innovation and Skills.

54 *Choices for a Purpose, an independent review of Scottish Government budgets*, Scottish Government, July 2006; *Taking Stock – A review of Scottish Government's capacity*, Scottish Government, December 2006; and *Scottish Executive – Financial Management and Budgetary Control*, Audit Scotland, October 2006.

The Scottish Government has fewer professionally qualified finance staff than other comparable UK departments

79. Within the Scottish Government's finance directorate, 12 per cent of staff have a professional accountancy qualification with a further two per cent in training. While it is difficult to make like-for-like comparisons, this is slightly lower than the UK central government average of 14 per cent and considerably lower than the public sector average of 34 per cent.⁵⁵ When compared to UK departments managing large-scale budgets, the Scottish Government has significantly lower levels of financially qualified staff in its finance directorate. The UK Department for Children, Schools and Families and the Department for Communities and Local Government have 25 and 40 per cent respectively of financially qualified staff (Exhibit 11).^{56, 57} The Scottish Government is currently carrying out a benchmarking exercise.

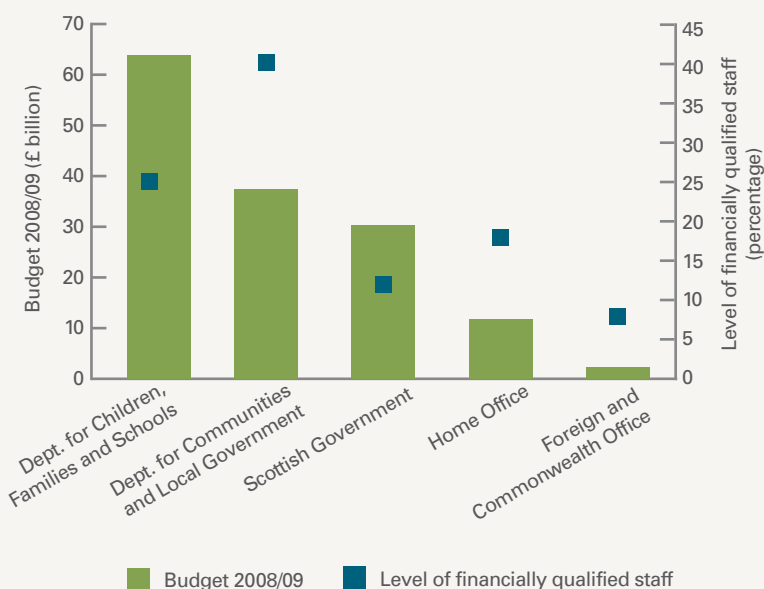
More work is needed to develop financial management skills across the Scottish Government

80. It is important that key staff outside the finance directorate receive the necessary training and support. Training on financial matters is available to all staff, but it is not a mandatory requirement. It is assumed that senior civil servants have adequate knowledge of financial matters in order to fulfill their roles as accountable officers. However, an Audit Scotland survey found some evidence that most other senior staff do not consider that they have received the financial training necessary to provide them with the skills and understanding to do their jobs effectively.⁵⁸

Exhibit 11

Comparison of the level of financially qualified staff in the Scottish Government and selected UK departments

The Scottish Government has fewer professionally qualified finance staff than most other UK departments.



Source: Audit Scotland/National Audit Office

Recommendations

The Scottish Government should improve its budget scrutiny by:

- ensuring that performance information is considered together with financial information when monitoring budgets
- continuing to address underlying causes of underspends
- addressing the low levels of financially qualified staff in its finance directorate
- prioritising financial management training for staff who have responsibility for budgets and policy development.

⁵⁵ *Financial Management in the Department for Communities and Local Government*, National Audit Office, July 2009.

⁵⁶ *Financial Management in the Department for Children, Schools and Families*, National Audit Office, April 2009.

⁵⁷ *Financial Management in the Department for Communities and Local Government*, National Audit Office, July 2009.

⁵⁸ Audit Scotland survey (unpublished), July 2009. We conducted a survey of 19 senior staff chosen from three portfolios – Education and Lifelong Learning, Justice, and Health and Wellbeing. Only 18 per cent agreed that the financial training they had received had given them the necessary skills and understanding required to do their jobs.

Part 3. Scrutinising, agreeing and monitoring the budget



In the current economic climate difficult decisions will have to be made about priority spending programmes.



Key messages

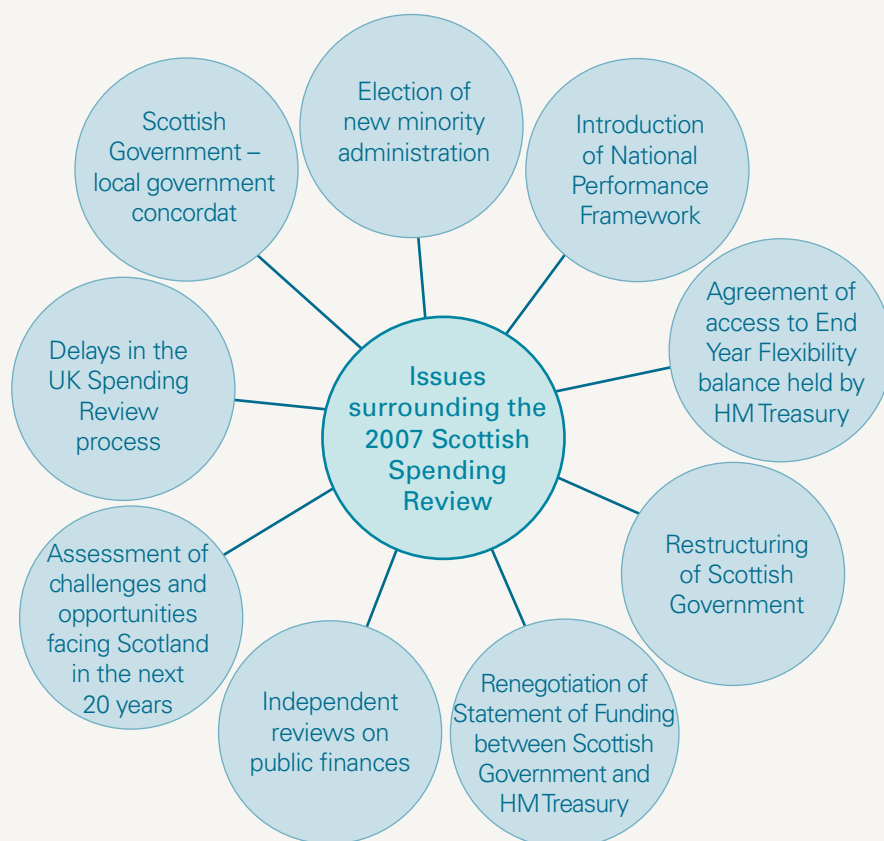
- The Scottish Government's annual budget is largely developed on an incremental basis which involves making adjustments at the margin to existing budgets. This approach is not suitable for budgeting in a financial downturn because it does not easily allow informed choices to be made about priorities, based on robust information about activity, costs and performance.
- The Scottish Government and the wider public sector need to work together to develop better cost, activity and performance information. This is needed to support a budget process that allows informed choices to be made between competing priorities, and provides incentives for greater efficiency and productivity.
- The Scottish Parliament has an important role in scrutinising the government's spending plans. Better information linking spending to costs, activities and service performance, and a rolling programme of performance reviews, would support the Scottish Parliament in fulfilling this role.

The 2007 Spending Review took place in a complex environment

81. The Scottish budget is set as part of the UK Spending Review completed by HM Treasury. The Scottish Government's spending plans for 2008/09 to 2010/11 were determined as part of the Scottish Spending Review process which took place after the UK Spending Review in 2007. The spending plans allocate budgets to portfolios based on agreed policy decisions.

Exhibit 12

Issues adding to the complexity of the 2007 Scottish Spending Review



Source: Audit Scotland

82. The 2007 Spending Review was undertaken in a complex environment, soon after the election of a new minority administration and after a later than normal UK Spending Review (Exhibit 12). The new Scottish Government introduced changes in its structure and accountability arrangements, including replacing departments with portfolios responsible for major spending programmes.

83. At the end of the spending review process, each portfolio was set an agreed three-year budget based on agreed policy decisions. Scottish ministers expected that these would not be renegotiated until the next spending review.

Linking budgets to priorities would provide better information for future spending reviews

84. The next spending review will set the Scottish Government's spending plans for three years from 2011/12 to 2013/14. The climate in which the spending review will take place will be very different to that of 2007 and changes are needed to the budget process.

85. In the current economic climate, difficult decisions will have to be made about priority spending programmes by both the Scottish Government and the wider public sector. In establishing its outcomes-based performance framework (the NPF), the Scottish Government has taken the first step in adopting a priority-based approach to budgeting. The Scottish Government is also developing impact

assessments to analyse the effect of policies on objectives outlined in the NPF. The aim is to show how policies contribute to the Government’s overall purpose of sustainable economic growth.⁵⁹ It is too early to comment on this work.

86. More work needs to be done to demonstrate a clear link between priorities, budgets and the performance of services. The Scottish Government should consider a number of questions before allocating money to each area of spend (Exhibit 13). Other public sector bodies should go through a similar process in managing their own budgets in the current financial climate.

87. To date, Scottish Government budgets have been largely determined on an incremental basis – taking last year’s budget and adjusting for inflation and other known factors such as increasing demand for services. This approach assumes the current pattern of spending is broadly right and that activities will continue on the same basis. Some budgets for new policies or programmes are developed from a zero base. We reviewed a sample of budgets valued at £1.3 billion and found that overall they were developed on the basis of reasonable assumptions and analysis.⁶⁰

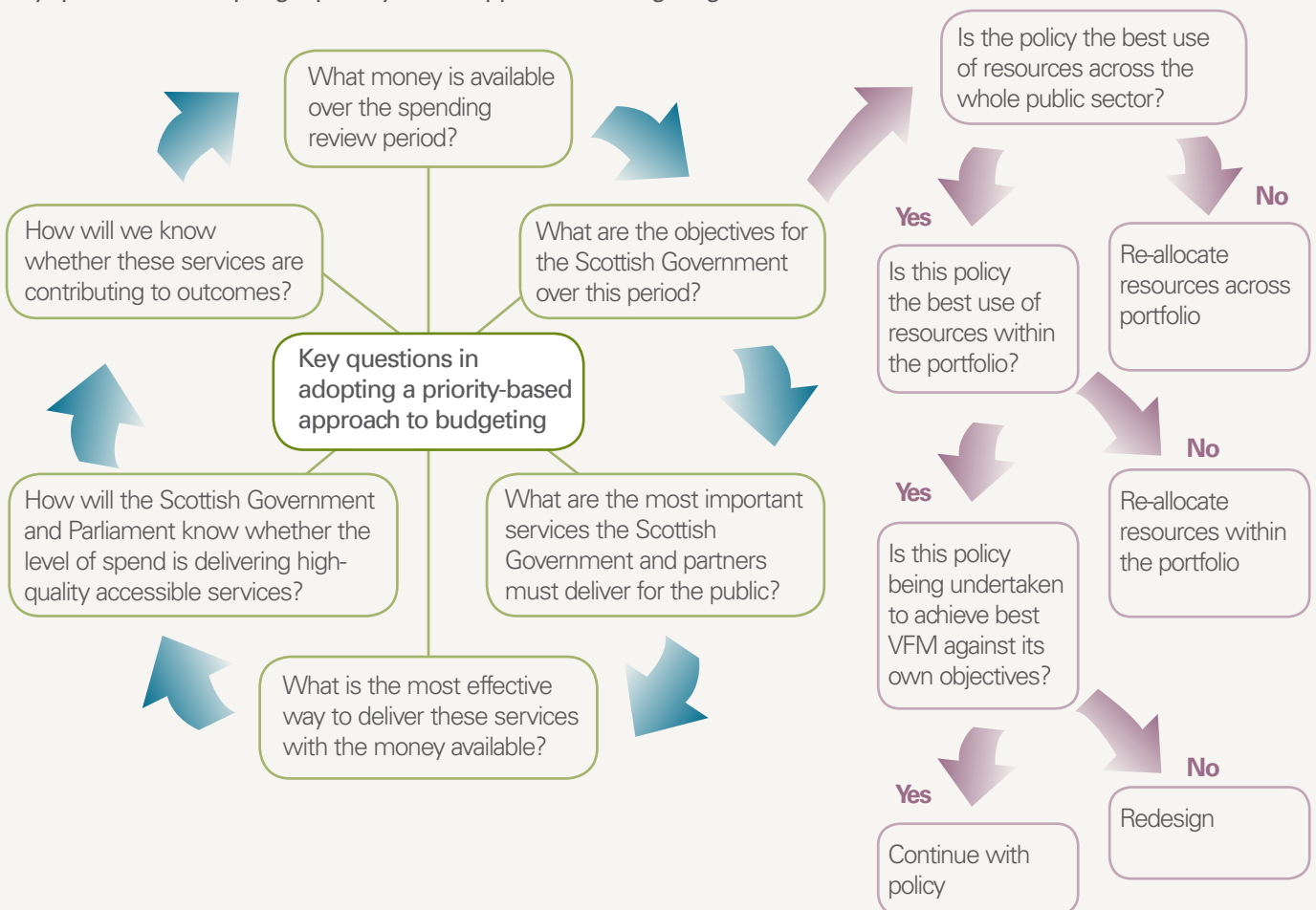
88. An incremental approach to budgeting can work when financial resources are stable and change is gradual and planned. However, it does not help prioritise spend or reduce costs in a time of financial restraint. Nor does it provide adequate incentives to promote better ways of working or new ideas.

89. This has also been highlighted in a report by the Finance Committee’s budget adviser who suggests a strategic review of public services to identify which services:

- the public sector can no longer afford to provide

Exhibit 13

Key questions in adopting a priority-based approach to budgeting



Source: Audit Scotland/National Audit Office

59 One method used to measure the impact is contribution analysis – an approach to assess the performance of programmes towards an outcome or outcomes.
 60 We reviewed the following budgets for 2009/10: Affordable Housing Investment Programme; Community Justice Services; Educational Maintenance Allowances; Fees, Grants and Bursaries; Free Eye Tests; Legal Aid; NHS Capital Income; Phasing out Prescription Charges; and 1,000 Additional Police Officers.

- will have to be charged for
- can provide further efficiency savings.⁶¹

The Scottish Parliament has an important role in scrutinising Scottish Government spending plans

90. The Scottish Parliament authorises government expenditure through the Budget Act. In preparation for devolution, the Financial Issues Advisory Group (FIAG) developed proposals for a budget process which was intended to be as open and accessible as possible. The FIAG recommended that the budget process should allow for greater scrutiny and decision-making by the Scottish Parliament than is the case at Westminster.

91. The Scottish Parliament adopts a three-stage process for scrutinising spending plans.

- Stage one: The scrutiny of the Scottish Government's strategic spending plans and priorities happens in years where there is a UK Government spending review. Subject committees report to the Finance Committee on the relationship between spending plans and policy priorities and the Finance Committee subsequently reports to Parliament. In a recent review of the process, the Finance Committee recognised the importance of having a strategic budget scrutiny phase at least once in each parliamentary session, regardless of the timing of UK spending reviews.⁶²
- Stage two: This occurs each year when the Parliament scrutinises draft spending plans for the following year. Again, subject committees report to the Finance Committee on detailed parts of the draft budget. The Finance

Committee produces a report which is debated by Parliament before the Christmas recess.

- Stage three: Parliament approves the Budget Bill which outlines the Scottish Government's spending plans for the forthcoming year.

92. The Scottish Parliamentary process compares favourably to international best practice. But there are two areas where improvements could be made – improving information from the Government and ensuring that audit findings are systematically fed into the budget process.⁶³

93. In September 2009, the Scottish Parliament announced it would pilot a new Financial Scrutiny Unit to increase the Parliament's capacity to analyse government spending proposals. The new unit reflects a recommendation by the Finance Committee, made in June 2009, to create a parliamentary budget office.

More transparency is needed to support Parliamentary scrutiny

94. Committees receive the draft budget proposals with financial information outlined for each policy or portfolio area and information on key spending priorities. The financial information provided in the draft budget is recorded at three different levels of detail:

- Level one expenditure is recorded at portfolio level, for example justice.
- Level two expenditure is recorded at sub-portfolio level, for example community justice services.
- Level three expenditure records expenditure in greater detail, for example offender services.

95. About two-thirds of the budget is allocated to local government and

health boards. Although committees may request further information, the level three information does not inform Parliament about the levels of service being delivered by health boards and councils, and their contribution to the national outcomes.

Plans to raise the level at which Parliament approves the budget will increase flexibility, but there is a risk it may reduce transparency

96. Currently the Scottish Parliament approves the budget of the Scottish Government for each portfolio. The Scottish Government is currently proposing to introduce a single statutory budget limit by removing individual portfolio budget limits.⁶⁴

97. The move to a single statutory budget limit for the Scottish administration would provide the Government with increased flexibility to manage spending across its portfolios. However, Parliament would no longer be approving the amount allocated to each portfolio, and at the end of the year, it might not be clear whether the actual expenditure in each portfolio has been in line with the amounts provided for in the supporting budget documents. It will be important to ensure that if there is a change to a single statutory budget limit, this does not result in less detailed information being available to support the Parliamentary scrutiny process.

Actual expenditure should be reported on the same basis as the supporting financial information in the approved budget

98. The Scottish Government reports to the Scottish Parliament on how much it has spent against the approved budget through its annual accounts. The FIAG recommended that the accounts should be presented in an accessible manner, be wide-ranging and cover performance as well as financial information.

⁶¹ *The 2010/11 Draft Budget, Report to the Finance Committee, Scottish Parliament*, David NF Bell, University of Stirling, September 2009.

⁶² *Report on the Review of the Budget Process*, Finance Committee Report, 5th Report, 2009 (Session 3), Scottish Parliament, June 2009.

⁶³ *Comparative budget processes*, Scottish Parliament Information Centre briefing, May 2008.

⁶⁴ Individual budget limits will be retained for four directly funded bodies (the Forestry Commission (Scotland), Food Standards Agency, Scottish Parliament Corporate Body and Audit Scotland).

99. The level at which figures are reported in the accounts is inconsistent with published budget documents. For example, in the Health and Wellbeing portfolio, budget documents divide health spending into a number of areas (for example, General Dental Services, Health Screening, Research Costs) whereas the financial statements report health spending as a single entry. This makes it more difficult for the Scottish Parliament to hold the Scottish Government to account, as it is not easy to identify if the money spent was in line with the activity areas and cost headings in the approved budget.

100. The Scottish Government publishes its annual accounts in October each year. This is around six months after the financial year end. By this time, the Parliament and its committees are concentrating mainly on scrutinising the following year's budget. This means that year-end results generally receive little attention or scrutiny other than the reported headline figures. The Parliament should consider whether the Public Audit Committee (PAC) should be asked to scrutinise the accounts of the Scottish Government and make a report on any significant matters arising from the audited accounts. The PAC report would, unavoidably, appear late in the budget process but it could highlight any significant matters for

consideration before the budget bill is finally passed, and the report could be a source of information for the ensuing budget cycle.

There is not yet a comprehensive framework for reporting to Parliament on the accessibility, quality and costs of key public services

101. Financial outturn information linked to activity levels and performance information should be a major source of information to assist the Parliament in scrutinising future budget proposals but this does not happen systematically at present.

102. The Finance Committee noted that the alignment of financial and performance information would improve the information available to Parliament to support the scrutiny process.⁶⁵ It recommended that budgetary information be improved by further developing explicit links between expenditure and policy priorities. In January 2009, the Cabinet Secretary for Finance and Sustainable Growth made a commitment to the Finance Committee to do this.⁶⁶

103. Without good information on the activity and performance of services, it is not possible to identify what difference the spending will make. Delivering many of the outcomes in the NPF will be long term and their achievement is dependent on the year-on-year delivery of services. The

national indicators and targets need to be supported by good information on the cost, activity and performance of services (inputs, activities, outputs and outcomes). While the national outcomes provide important long-term goals, the needs of the Scottish people must be met by the continuing provision of high-quality services. For example, services for people with long-term health conditions such as chronic obstructive pulmonary disease (COPD) should contribute towards increasing healthy life expectancy in the most deprived areas. The impact of these services on health outcomes will only become evident in the longer term, and in the meantime, it is essential to know whether accessible, high-quality services are being delivered to people with an immediate need (Exhibit 14).⁶⁷

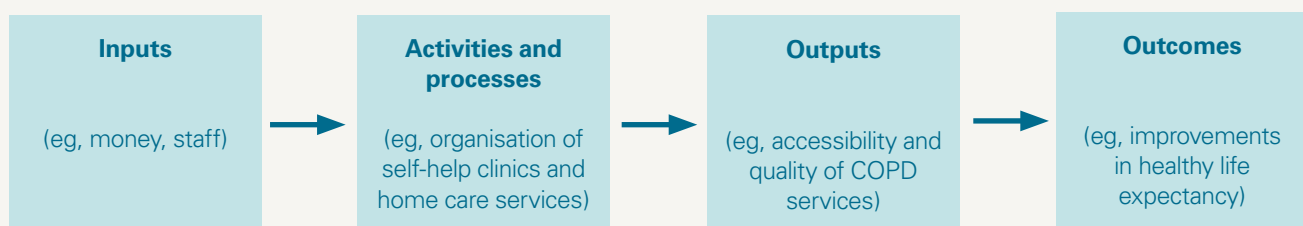
A planned programme of reviews of policy areas and whole systems of service delivery could inform the budget scrutiny process

104. As part of the budget scrutiny process, the Scottish Parliament Finance Committee has recommended that the Scottish Government provides a list of all policy announcements made since the previous draft budget or budget revision which would incur expenditure above a predetermined threshold. This would allow the Finance Committee to consider whether to ask for further information

Exhibit 14

Linking services with outcomes

Good performance monitoring and reporting of accessibility, quality and costs of key public services would better support the Parliamentary scrutiny process.



Source: Audit Scotland

⁶⁵ *Report on the Review of the Budget Process*, Finance Committee Report, 5th Report, 2009, Scottish Parliament, June 2009.

⁶⁶ *Response from the Scottish Government to the Finance Committee's report on the 2009/10 draft budget*, 7th Report 2008, Scottish Parliament, January 2009.

⁶⁷ www.scotland.gov.uk/about/scotPerformans

on any of the policy announcements, thereby improving the effectiveness of Parliamentary scrutiny.

105. To support the improvement of financial scrutiny, the Finance Committee is also considering a number of options to improve the expert analysis and advice that is available to committees.

106. The level of Parliamentary scrutiny could be further enhanced through the introduction by the Parliament of a rolling programme of reviews of policy areas or systems of service delivery. These would be planned in advance jointly by the PAC and the Finance Committee, in consultation with the subject committees. Each review could be supported by input from the Scottish Parliament Information Centre, an expert team of advisers appointed for the duration of the review, and, where appropriate, Audit Scotland's work. The aim would be to review the performance of all major policy areas once in the lifetime of a Parliament, in order to provide detailed information to inform budget scrutiny and decision-making.

Recommendations

The Scottish Government should further support the Parliamentary budget scrutiny process by ensuring that:

- Parliament receives information which demonstrates clear links between the draft budget, Government priorities, and the performance of public services
- the introduction of a single statutory budget limit does not result in less detailed information to support the Parliamentary scrutiny process
- budget and financial outturn information are reported on a similar basis.

The Scottish Parliament should consider:

- inviting the PAC to take evidence on the audited accounts of the Scottish Government and make a report to the Finance Committee
- inviting the Finance Committee and the PAC to plan and implement a rolling programme of performance reviews of systems of service delivery over the lifetime of a Parliament.

Appendix 1.

Glossary of terms

Term	Description
Accountable Officer	Someone who has personal responsibility for the correct use of public spending for which they are accountable and for the economic, efficient and effective use of all available resources. The Permanent Secretary is the Principal Accountable Officer for the Scottish Government, with each Director General acting as accountable officer for their own directorates.
Actuarial valuation	This is an assessment done by an actuary, usually every three years. The actuary will work out how much money needs to be put into a pension scheme to make sure pensions can be paid in the future.
Annually Managed Expenditure (AME)	This is part of the Scottish budget which is outwith the Departmental Expenditure Limit. It accounts for approximately 15 per cent. AME is expenditure that is less predictable and therefore needs to be controlled on an annual basis. Examples of AME include student loans and NHS and teachers' pensions.
Concordat	The terms of relationship between the Scottish Government and local government. It is underpinned by the funding made available to local government until 2010/11.
Departmental Expenditure Limit (DEL)	The majority of the Scottish Government's budget that covers programme expenditure and running costs. DELs are divided into revenue and capital budgets. Overall, DELs account for approximately 85 per cent of the Scottish budget in 2009/10.
Efficiency savings	Delivering the same level and quality of service for less money (cash-releasing savings) or delivering more and higher quality services for the same amount of money (time-releasing savings).
End year flexibility	The money that remains unspent from departmental budgets at the end of the financial year. It was designed to deal with some of the problems arising from the annual focus of the budget process by providing a facility to carry forward unspent budgets.
Financial management	The management of the finances of an organisation in order to achieve financial objectives. There are three key elements to financial management: financial planning, financial control and financial decision-making.
Gross Domestic Product	This is a basic measurement of a country's economic performance. It is defined as the market value of all the goods and services produced by a country.
National debt	This is all outstanding debt held by the UK Government.
Public sector net borrowing	This is how much the public sector owes to the private sector. It includes all financial borrowing including amounts borrowed for capital spending.

Term	Description
Real terms	Money that has been adjusted for the effects of inflation. This allows for a direct comparison of figures across a number of years.
Scottish budget	Also known as the 'assigned budget' or the 'Scottish block'. This is the total budget approved by the Scottish Parliament. It includes the budget for the Scottish Government as well as NHS and teachers' pensions, plus funding for the Scottish Parliament Corporate Body and other directly funded bodies including Audit Scotland.
Scottish Government budget	The Scottish Government budget includes budgets for all Scottish Government directorates, government agencies and non-departmental public bodies. It also includes central government funding for local government and NHS boards. The budget is approved by the Scottish Parliament.
Shared equity schemes	Schemes that allow individuals to own a majority share (approx 60 to 80 per cent) in a property. The remaining share is owned by a local housing association. At a later date, individuals have the option to increase their stake and own the property outright.
Single Outcome Agreements	Agreements between the Scottish Government and each council which set out how each will work in the future towards improving national outcomes for local people in a way that reflects local circumstances and priorities.
Unfunded pension schemes	An unfunded scheme uses contributions from present employees and employers to pay current scheme beneficiaries. This means today's employees will be paid their pensions from future contributions and future taxes, not invested funds.
Value for money (VFM)	The extent to which objectives are achieved in relation to cost. It is often used to describe the achievement of economy, efficiency and effectiveness.

Appendix 2.

The National Performance Framework

As part of the 2007 Spending Review, the Scottish Government introduced a National Performance Framework (NPF) to underpin delivery of the Government's agenda. The NPF has a single overall purpose to promote sustainable economic growth. This is supported by nine purpose targets, five strategic objectives, 15 national outcomes and 45 national indicators and targets.

Purpose	
To focus government and public services on creating a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth.	
Purpose targets (9)	
Economic Growth (GDP): <ul style="list-style-type: none"> To raise the GDP growth rate to the UK level by 2011. To match the GDP growth rate of the small independent EU countries by 2017. 	Population: To match average European (EU15) population growth over the period from 2007 to 2017. Supported by increased healthy life expectancy in Scotland over the period from 2007 to 2017.
Productivity: To rank in the top quartile for productivity against our key trading partners in the OECD by 2017.	Solidarity: To increase overall income and the proportion of income earned by the three lowest income deciles as a group by 2017.
Participation: <ul style="list-style-type: none"> To maintain our position on labour market participation as the top performing country in the UK. To close the gap with the top five OECD economies by 2017. 	Cohesion: To narrow the gap in participation between Scotland's best and worst performing regions by 2017.
Sustainability: To reduce emissions over the period to 2011 and by 80 per cent by 2050.	
Strategic objectives (5)	
Wealthier and fairer: Enable businesses and people to increase their wealth and more people to share fairly in that wealth.	Healthier: Help people to sustain and improve their health, especially in disadvantaged communities, ensuring better, local and faster access to healthcare.
Safer and stronger: Help local communities to flourish, becoming stronger, safer place to live, offering improved opportunities and a better quality of life.	Greener: Improve Scotland's natural and built environment and the sustainable use and enjoyment of it.
Smarter: Expand opportunities for Scots to succeed from nurture through to lifelong learning ensuring higher and more widely shared achievements.	
National outcomes (15)	
We live in a Scotland that is the most attractive place for doing business in Europe.	We realise our full economic potential with more and better employment opportunities for our people.
We live in well-designed, sustainable places where we are able to access the amenities and services we need.	Our children have the best start in life and are ready to succeed.
Our young people are successful learners, confident individuals, effective contributors and responsible citizens.	We have strong, resilient and supportive communities where people take responsibility for their own actions and how they affect others.
We take pride in a strong, fair and inclusive national identity.	We live our lives safe from crime, disorder and danger.
We have tackled the significant inequalities in Scottish society.	We have improved the life chances for children, young people and families at risk.

National indicators and targets (45)				
Increase the percentage of Scottish domiciled graduates from Scottish Higher Education Institutions in positive destinations.	Achieve annual milestones for reducing inpatient or day case waiting times culminating in the delivery of an 18-week referral-to-treatment time from December 2011.	Increase the proportion of school leavers (from Scottish publicly funded schools) in positive and sustained destinations (FE, HE, employment or training).	Reduce the rate of increase in the proportion of children with their Body Mass Index outwith a healthy range by 2018.	Child protection inspection findings: increase the overall proportion of local authority areas receiving positive inspection reports.
Reduce proportion of people aged 65 and over admitted as emergency inpatients two or more times in one year.	Improve public sector efficiency through the generation of two per cent cash-releasing efficiency savings per annum.	50 per cent of electricity generated in Scotland to come from renewable sources by 2020 (interim target of 31 per cent by 2011).	At least halve the gap in total research and development spending compared with EU average by 2011.	All unintentionally homeless households will be entitled to settled accommodation by 2012.
Decrease the estimated number of problem drug users in Scotland by 2011.	60 per cent of schoolchildren in primary 1 will have no signs of dental disease by 2010.	Increase the proportion of journeys to work made by public or active transport.	Reduce the proportion of driver journeys delayed due to traffic congestion.	Reduce the percentage of the adult population who smoke to 22 per cent by 2010.
Increase the percentage of criminal cases dealt with within 26 weeks by three percentage points by 2011.	Increase the percentage of adults who rate their neighbourhood as a good place to live.	Increase to 95 per cent the proportion of protected nature sites in favourable condition.	Reduce number of working age people with severe literacy and numeracy problems.	Increase the average score of adults on the Warwick-Edinburgh Mental Wellbeing Scale by 2011.
Improve the quality of healthcare experience.	Increase the rate of new house building.	Increase the social economy turnover.	Increase the business start-up rate.	Reduce overall ecological footprint.
Decrease the proportion of individuals living in poverty.	Reduce the number of Scottish public bodies by 25 per cent by 2011.	Grow exports at a faster average rate than GDP.	Improve knowledge transfer from research activity in universities.	Reduce alcohol related hospital admissions by 2011.
Improve people's perceptions, attitudes and awareness of Scotland's reputation.	Biodiversity: increase the index of abundance of terrestrial breeding birds.	Reduce overall crime victimisation rates by two percentage points by 2011.	Improve the state of Scotland's historic buildings, monuments and environment.	Increase the proportion of schools receiving positive inspection reports.
Increase the proportion of adults making one or more visits to the outdoors per week.	Increase the percentage of people aged 65 and over with high levels of care needs who are cared for at home.	Ensure 70 per cent key commercial fish stocks at full reproductive capacity and harvested sustainably by 2015.	Reduce mortality from coronary heart disease among the under 75s in deprived areas.	Increase the proportion of pre-school centres receiving positive inspection reports.
Reduce overall reconviction rates by two percentage points by 2011.	Reduce to 1.32 million tonnes waste sent to landfill by 2010.	Increase healthy life expectancy at birth in the most deprived areas.	Improve people's perceptions of the quality of public services delivered.	Increase positive public perception of the general crime rate in local area.

Appendix 3.

The Scottish budget 2009/10

Area	Total £m	DEL ¹ £m	AME ² £m	Other £m
Office of the First Minister	265.1	265.1	–	–
Finance and Sustainable Growth	3,394.5	2,714.5	595.5	84.5
Health and Wellbeing	12,159.8	12,095.4	64.4	–
Education and Lifelong Learning	2,786.9	2,649.7	132.7	4.5
Justice	1,844.7	1,830.0	–	14.7
Rural Affairs and the Environment	545.9	545.8	–	0.1
Local Government	10,300.7	8,173.6	2,127.1	–
Administration	273.3	273.3	–	–
Crown Office and Procurator Fiscal Services	118.7	118.7	–	–
Total Scottish Government budget	31,689.6	28,666.1	2,919.7	103.8
General Registers of Scotland	15.7	15.7	–	–
National Archives of Scotland	10.3	10.3	–	–
Office of the Scottish Charity Regulator	3.7	3.7	–	–
NHS and Teachers' Pensions	2,689.9	–	2,689.9	–
Scottish Administration	34,409.2	28,695.8	5,609.6	103.8
Forestry Commission	93.8	93.8	–	–
Food Standards Agency	11.0	11.0	–	–
Scottish Parliamentary Corporate Body	103.5	103.5	–	–
Audit Scotland	7.3	7.3	–	–
Total Scottish block (pre UK budget)	34,624.8	28,911.4	5,609.6	103.8
UK Budget 2009 Consequential	79.0	79.0	–	–
Total Scottish block 2009/10	34,703.8	28,990.4	5,609.6	103.8

Notes:

1. Departmental Expenditure Limit

2. Annually Managed Expenditure

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Inverclyde Council

Annual Audit Plan

January 2010



 AUDIT SCOTLAND

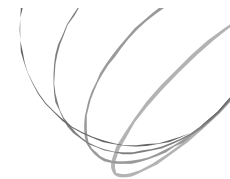


Inverclyde Council

Annual Audit Plan 2009/10

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Summary plan

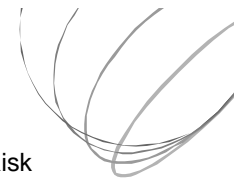
Summary of planned audit activity

Based on our analysis of the risks facing Inverclyde Council (the Council), our planned work in 2009/10 includes:

- an audit of the financial statements and provision of an opinion on whether:
 - they give a true and fair view of the financial position of the Council as at 31 March 2010 and its income and expenditure for the year then ended
 - the accounts have been properly prepared in accordance with the Local Government (Scotland) Act 1973 and the 2009 SORP
- reporting the findings of our audit risk assessment process in an assurance and improvement plan (AIP), highlighting the key risks being faced by the Council, the action under way or planned in response to these and the work we plan to undertake in relation to these. Our risk assessment work is informed by the Priorities and Risks Framework published by Audit Scotland and work undertaken to identify issues and risks which are unique to the local situation
- a review and assessment of the Council's governance and performance arrangements in a number of key areas including: review of adequacy of internal audit, Information Communication Technology, Performance Indicators, Best Value review/follow-up work, and Statement on the System of Internal Financial Control.
- provision of an opinion on a number of grant claims and returns, including Whole of Government Accounts.

Introduction

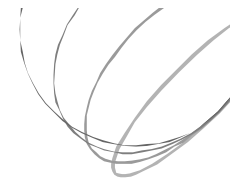
1. Our audit is focused on the identification and assessment of the key challenges and risks to the Council in achieving its business objectives. We also assess the risk of material misstatement or irregularity in the Council's financial statements. This report summarises specific governance and other risks that may affect the financial statements of the Council, and sets out the audit work that we propose to undertake in 2009/10 to address these. Our annual audit plan reflects:
 - the risks and priorities facing the Council
 - current national risks relevant to local circumstances
 - the impact of changing international auditing and accounting standards
 - our responsibilities under the Code of Audit Practice as approved by the Auditor General for Scotland
 - issues brought forward from previous audit reports.



2. In addition to this annual audit plan, the first audit report of the year we will prepare is a Shared Risk Assessment summary and Assurance Improvement Plan (AIP), which will focus on the key performance risks being faced by the Council, along with other governance risks highlighted through our work. The analysis will identify the action under way or planned in response to these risks, and the work we plan to undertake in relation to these. This risk assessment work is informed by the Priorities and Risks Framework published by Audit Scotland, along with work undertaken to identify issues and risks which are unique to the local situation.

Our responsibilities

3. Our responsibilities, as independent auditor, are established by the Local Government (Scotland) Act 1973 and the Code of Audit Practice, and guided by the auditing profession's ethical guidance.
4. Audit in the public sector goes beyond simply providing assurance on the financial statements and the organisation's internal control environment. We are also required to provide a view on performance and the organisation's use of resources. In doing this, we aim to support improvement and accountability.
5. In carrying out our audit, we seek to gain assurance that the Council:
 - has good corporate governance arrangements in place which reflect the three fundamental principles of openness, integrity and accountability
 - has systems of recording and processing transactions which provides a sound basis for the preparation of financial statements and the effective management of its assets and interests
 - prepares financial statements which give a true and fair view of the financial position at 31 March 2010 and income and expenditure for the year then ended, in accordance with the Local Government (Scotland) Act 1973 and other applicable laws and regulations, including the 2009 'Code of practice on local authority accounting in the United Kingdom – A statement of recommended practice' (the SORP)
 - has systems of internal control which provide an adequate means of preventing or detecting material misstatement, error, fraud or corruption
 - complies with established policies, procedures, laws and regulations
 - proactively manages and reviews its performance in line with its strategic and operational objectives
 - has made proper arrangements for securing best value in its use of resources and is complying with its community planning duties.



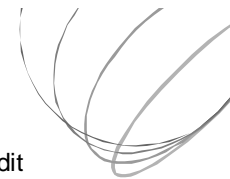
Our approach to the audit of the accounts

6. Our audit approach is based on an understanding of the characteristics, responsibilities and principal activities, risks and governance arrangements the Council, and identification of the key audit risks and challenges in the local government sector generally. This approach includes:
 - understanding the business of the Council and the risk exposure which could impact on the financial statements
 - assessing the key systems of internal control, and considering how risks in these systems could impact on the financial statements
 - identifying major transaction streams, balances and areas of estimation, understanding how the Council will include these in the financial statements and developing procedures to audit these
 - assessing the risk of material misstatement in the financial statements, in conjunction with our evaluation of inherent risk, the control environment and control risk as part of our risk assessment
 - determining the nature, timing and extent of our testing programme to provide us with sufficient appropriate audit evidence as to whether the financial statements are free of material misstatement.

7. Through this approach we have also considered and documented the sources of assurance which will make best use of our resources and allow us to focus testing on higher risk areas during the audit of the financial statements. The main areas of assurance for the audit come from planned management action and reliance on systems of internal control. Management action being relied on for 2009/10 includes:
 - comprehensive closedown procedures for the financial statements accompanied by a timetable issued to all relevant staff
 - clear responsibilities for provision of accounts and working papers being agreed
 - delivery of unaudited accounts to agreed timescales with a comprehensive working papers package
 - completion of the internal audit programme for 2009/10.

8. Auditing standards require internal and external auditors to work closely together to make optimal use of available audit resources. We seek to rely on the work of internal audit wherever possible and, as part of our planning process we carry out an early assessment of the internal audit function. Based on our review of internal audit we plan to place formal reliance on the areas of work set out in Appendix D.

9. Our approach to the audit of the financial statements is based on an integrated assessment of risk across the Code of Audit Practice responsibilities in relation to governance, performance and opinion.



10. At the completion of the audit we will provide the Chief Executive with an annual report on the audit containing observations and recommendations on significant matters which have arisen in the course of the audit.

Responsibility for the preparation of accounts

11. It is the responsibility of the Council and the Chief Financial Officer as Proper Officer to prepare the financial statements in accordance with the SORP. This means:
 - acting within the law and ensuring the regularity of transactions by putting in place systems of internal control to ensure that financial transactions are in accordance with the appropriate authority
 - maintaining proper accounting records
 - preparing financial statements timeously which give a true and fair view of the financial position of the Council as at 31 March 2010 and its expenditure and income for the year then ended
 - preparing an explanatory foreword.

Format of the accounts

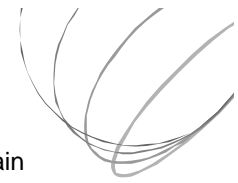
12. The financial statements should be prepared in accordance with the SORP which constitutes proper accounting practice for the purposes of section 12 of the Local Government Scotland Act 2003.
13. The Council prepares a consolidation pack annually for the Scottish Government under the requirements of the Government Resources and Accounts Act 2000. The Act requires the Council to prepare its accounts using common accounting principles and standard formats for summarisation.

Audit issues and risks

14. This annual audit plan focuses on governance and other risks specific to the financial statements of the Council. Our AIP will provide a broader analysis of wider risks and issues your Council faces, setting out our planned work in relation to performance and other governance issues in more detail.
15. Based on our discussions with staff, attendance at committee meetings and a review of supporting information, we have identified the main financial statements risk areas for your organisation.

Financial management

16. The Council, like all public sector bodies, is operating under severe financial pressure due to the economic downturn. The Council reacted positively to the economic downturn by identifying the potential risks, agreeing an action plan and establishing key indicators to assess the impact of the downturn however reductions in central funding and an ongoing requirement to identify, and maintain,



efficiency savings mean it will be very challenging to sustain current levels of services and maintain appropriate levels of reserves. As at December 2009 the Council has estimated a revenue funding shortfall of £28m over the four year period 2011/14.

17. Specific area of financial pressure for the Council are:
 - future Government settlements
 - increased National Insurance contributions
 - carbon accounting and associated costs
 - pensions
 - landfill taxes and potential penalties
 - reductions in investment income
 - increase in demand for key services within Social Care.

18. As was the case in 2008/09 the decline in the property market means the Council cannot rely on the proceeds of asset disposals to help fund their capital programme. In February 2009 the Council agreed a three-year Capital Programme which increased the level of capital expenditure to be funded from Prudential borrowing and also agreed a revised funding model for the Schools Estate Management Plan which removed any reliance on projected capital receipts. The previously approved 2010/13 Capital Programme is to be reviewed to take account of reductions in Government supported capital resources.

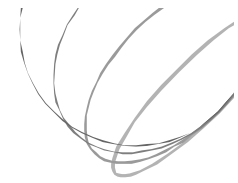
19. The Council's Financial Strategy makes reference to other corporate plans (i.e. the SOA, Corporate Plan and Community Plan) however there are no clear links between these strategic documents to ensure financial resources are clearly directed at achieving the Council's corporate objectives.

20. A Strategic Procurement Framework was presented to the September 2009 Policy and Resources Committee. The Council will need to increase momentum to significantly develop current procurement practices to achieve and embed the approach outlined in the new framework.

Accounts presentation and disclosure

21. The 2009 Statement of Recommended Practice (SORP) introduces a number of changes to accounting practice which Council officers need to consider when preparing the financial statements.

22. The most significant change is the requirement for public sector bodies to account for public private partnership / private finance initiative arrangements in accordance with an interpretation of *IFRIC 12 Service concession arrangements*. A key difference is that IFRIC 12 follows a simpler approach than its predecessor (FRS5) in its approach to determining whether an asset used to deliver services under such arrangements should be recognised as an asset on the balance sheet. FRS5 followed a 'risks and rewards' approach whereas IFRIC 12 seeks to establish which party controls the property. The two control conditions are:



- Control over services – the public body controls or regulates the services the operator must provide with the property, to who it must provide them and at what price.
- Control over residual interest – the public sector body controls any significant residual interest in the property at the end of the term of the arrangement.

23. The other main changes to the 2009 SORP are:

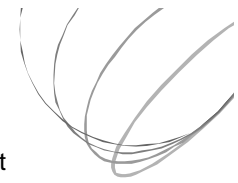
- Accounting for non-domestic rates (NDR) to reflect that billing authorities are acting as agents for the Scottish Government. Authorities should include a debtor or creditor in the balance sheet for NDR to be paid to, or received from, the Government but should no longer show NDR income in the Income & Expenditure account, NDR taxpayer debtor and creditor balances in the balance sheet or the cash received from NDR debtors or payments into the national pool as revenue items in the cash flow statement. The cash flow should reflect the difference between these two amounts as an increase or decrease in liquid resources. As this represents a change in accounting policy a prior year adjustment will be required.
- LASAAC guidance has been reflected by requiring a statement to be disclosed on the face of the balance sheet in the final published financial statements stating the date the unaudited accounts were issued and the date the audited accounts were authorised for issue. This should be consistent with the date the audit certificate is signed.
- SORP paragraph 4.3 has been amended to clarify that authorities should follow FRS2 and FRS9 when accounting for investments in subsidiaries, associates and joint ventures in the single entity accounts, and not just the group accounts.

24. The 2009 SORP also provides clarification on a number of issues including:

- the adoption of FR2 and FRS9 when accounting for investments in subsidiaries, associates and joint ventures in the single entity accounts
- items classified as current liabilities
- presentation of accrued interest within current liabilities in the balance sheet rather than as part of the carrying value of the loan
- disclosure of member's allowances.

25. The prior year audit of financial statements also highlighted a number of matters to be addressed this year. These matters include:

- **Objection:** On 17 August 2009 we received an objection to the accounts under section 101(2)(a) of the Local Government (Scotland) Act 1973. We have considered the objection and enquiries are ongoing on the issues raised in relation to common good assets.
- **Common Good title deeds checks:** the ISA260 letter for 2007/08 identified that the Council was working toward compliance with CIPFA/LASAAC guidance to establish where all of its heritable properties are, who holds title to them and what their values are. During 2008/09 the Council have commenced a project to conduct an examination of the title to the Council's heritable property within Inverclyde.



- **Group financial statements:** Within the group financial statements Strathclyde Police Joint Board and Strathclyde Fire and Rescue are consolidated as associates. Proper accounting practice requires a charge to be made to the income and expenditure account for pension costs based on FRS17 Retirement Benefits. The Local Government Pension Reserve Fund (Scotland) Regulations 2003 provides the statutory basis for removing the FRS17 charge from the general fund so that only the actual pension payments are charged. However, this legislation does not cover the new pension schemes established with effect from 6 April 2006, by the Police Pensions (Scotland) Regulations 2007 and the Fire-fighters Pension Scheme (Scotland) Order 2007. Strathclyde Fire and Rescue has amended their accounts to reflect this however Strathclyde Police Joint Board has opted not to make any adjustment and their auditors will qualify their audit opinions in relation to this issue. The Council have agreed to include a disclosure note within the group accounts concerning the qualification in the audit certificate of the Strathclyde Police Joint Board.
- **Removal of ring fenced funding:** The introduction of the Concordat with the Scottish Government resulted in the consolidation of some separate funding grants within the revenue support grant in 2008/09. When compared to the previous year, this has the effect of increasing the funding from revenue support grant and also increasing service net expenditure. This change in the basis/ nature of funding has a significant impact on the comparability of income and expenditure with the previous year.
- **Equal pay costs and single status costs:** actual and potential claims in relation to equal pay legislation have been reviewed and £1.028 million recognised as a provision. While there remain uncertainties over the actual costs that will be incurred to settle these cases, we are satisfied that this is a reasonable approach. The Council has sought to limit its exposure to the financial risk associated with equal pay claims by agreeing to offer equal pay compensation payments to specific groups of employees as part of a compensation package. Similarly, a specific earmarked balance of £0.809 million has been set aside to cover costs incurred for single status.

26. Matters arising from our audit of the 2008/09 financial statements were reported through a combination of the final audit report to members (issued in late October 2009) and also in the ISA 260 letter (issued to the Audit Committee on 23 September 2009). The 2008/09 ISA 260 letter should be reviewed as part of the financial statements preparation process for 2008/09 to ensure that all issues are addressed.

Audit committee arrangements

27. The audit committee's remit includes a requirement to oversee the performance of internal audit. The committee meets on a bi-monthly basis (although it also has special meetings for issues such as the issue of the ISA 260 letter). At each of the scheduled meetings a report is provided updating members on the progress made by internal audit (in terms of completion of reviews and the issue of reports). A summary of internal audit reports are included as part of the papers for these meetings however full reports are freely available to committee members on request. The 2009/10 internal audit plan is scheduled to be delivered by 31 March 2010 however there is a risk that this timescale will not be met.



28. All reports prepared by external audit are submitted to the committee. Internal Audit have developed a procedure to monitor action points from all external audit reports at the point of time when actions are due to be implemented.

Financial capacity

29. In November 2008 the Council appointed the Institute of Public Finance (IPF) to review the Council's financial management and capacity across the organisation. The Financial Capacity Development Plan (approved by the Policy and Resources Committee in September 2009) was produced as a response to the review and the Council face a challenge to deliver the plan within the timescales documented.
30. The planned restructure of the Finance department may impact on the capacity of the department to deliver services during the transition to the new structure.

Human resources / payroll system

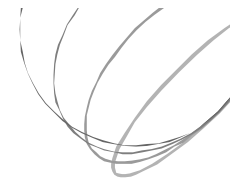
31. During the year, the Council migrated to a new integrated human resources / payroll system. A project team was formed to oversee the process, and the first payroll run (four weekly payroll) went live on 30 September 2009. Manual two weekly and weekly paid payrolls are scheduled for migration between October and December and the teacher's payroll is to be migrated between January and March 2010. Internal Audit has scheduled a review of the integration project as part of their 2009/10 audit plan.

Schools PPP

32. The Council entered into a PPP arrangement with e4i, for the delivery of two new build primary and two new build secondary schools. The primary schools are scheduled for completion in February 2010 and the secondary schools scheduled for May 2011.
33. There are a number of accounting issues in relation to PPP transactions, including the treatment of capital and revenue elements of the payment and consideration of residual values at the end of the contract period. The Council need to consider the relevant legislative framework and guidance in relation to these transactions, and ensure they are properly reflected in the financial statements.

Leisure Trust

34. In October 2001 the Council transferred the delivery of sport and recreational services to Inverclyde Leisure. Inverclyde Leisure is governed by a board of eleven representatives, five of which are elected Members of the Council. In 2008/09 the Council contributed £1.82 million of Inverclyde Leisure's turnover. We note that action to establish a service level agreement between the Council and Inverclyde Leisure is outstanding.



Summary assurance plan

35. Within these identified risk areas there is a range of more specific risks and these are summarised at Appendix A. In most cases, actions to manage these risks are either planned or already underway within the organisation. Details of the sources of assurance that we have received for each of these risks and any audit work we plan to undertake is also set out in Appendix A. In the period prior to the submission of the unaudited financial statements, we will liaise with senior officers on any new or emerging issues.

Materiality

36. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

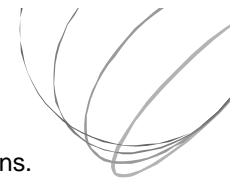
37. International Standard on Auditing 320 states that, *“information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of item or error judged in the particular circumstances of its omissions or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.”*

38. When considering, in the context of a possible qualification, whether the misstatement of an item, or a number of items taken together, is material in terms of its monetary value, we use professional judgement, experience and internal guidelines from peers as broad guidance in regard to considering whether the results of tests of detail are material.

39. An item may be judged material for reasons other than its monetary or quantitative value. An inaccuracy, which would not normally be regarded as material by amount, may be important for other reasons. When such an item affects a critical point in the accounts, its materiality has to be viewed in a narrower context (for example the failure to achieve a statutory requirement, an item contrary to law, or areas affected by central government control). Again we use professional judgement, experience and internal guidelines from peers to determine when such matters would fail to be covered in an explanatory paragraph, rather than as a qualification to the audit opinion.

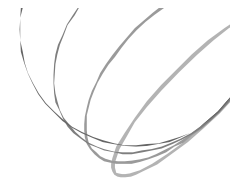
Reporting arrangements

40. Under the Local Government (Scotland) Act 1973, there is a requirement for unaudited financial statements to be presented to the council and the Controller of Audit within three months of the financial year end i.e. 30 June. The non-statutory target for audit completion is 30 September. To achieve this target, it is critical that a timetable for the audit of the accounts is agreed with us. An agreed timetable is included at Appendix B of this plan, which takes account of submission requirements, planned audit committee dates and audit resources.



41. Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft management reports will be issued to the Chief Executive/responsible director and relevant senior manager to confirm factual accuracy. Responses to draft reports are expected within two weeks of submission.
42. A copy of all final agreed reports will be sent to the Chief Executive/Director of Corporate Services Improvement and Performance, Chief Financial Officer, relevant senior manager, Internal Audit and Audit Scotland's Public Reporting Group.
43. We will provide an independent auditor's report to the Council and the Accounts Commission for Scotland that the audit of the financial statements has been completed in accordance with applicable statutory requirements, including an opinion on those financial statements. An annual report to members and the controller of audit will also be produced to summarise all significant matters arising from the audit and overall conclusions about insert client name management of key risks.
44. All annual reports produced by Audit Scotland are published on our website: (www.audit-scotland.gov.uk).
45. The full range of outputs to be delivered by the audit team are summarised below:

Planned outputs	Target delivery date
Governance	
Internal audit reliance	31 March 2010
Internal controls management letter	31 May 2010
Performance	
Assurance Improvement Plan	30 June 2010
Financial statements	
Report to Audit Committee in terms of ISA 260 (Communication of audit matters to those charged with governance)	TBC
Independent auditor's report on the financial statements	30 September 2010
Annual report to the Members and the Controller of Audit	31 October 2010
Audit opinion on Whole of Government Accounts	TBC
Grants	
Audit opinions on DWP/Scottish Government grant claims	As required

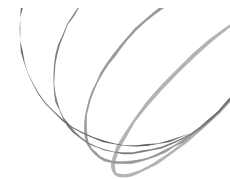


Quality control

46. We are committed to ensuring that our audit reflects best practice and demonstrates best value to the Council and the Accounts Commission. We operate a strong quality control framework that seeks to ensure that your organisation receives a high quality service. The framework is embedded in our organisational structures and processes and includes an engagement lead for every client; in your case this is, Peter Tait, who is responsible for ensuring that our work is carried out on time and to a high quality standard.
47. As part of our commitment to quality and continuous improvement, we may periodically seek your views. We would be grateful for any feedback on our services.

Fees and resources

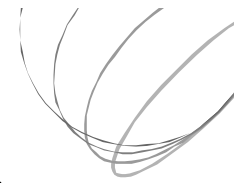
48. Our agreed fee for the 2009/10 audit of the Council is £299,500 comprising a local audit fee of £210,000 and a fixed charge of £89,500. Our fee covers:
- all of the work and outputs described in this plan
 - a contribution towards the costs of national performance studies and statutory reports by the Controller of Audit and the work of the Accounts Commission
 - attendance at the Audit Committee and key council/committee meetings
 - access to advice and information on relevant audit issues
 - access to workshops/seminars on topical issues
 - travel and subsistence costs.
49. In determining the agreed fee we have taken account of the risk exposure of the Council, the management assurances in place, and the level of reliance we plan to take from the work of internal audit. We have assumed receipt of the draft accounts and working papers by 30 June 2010. If the draft accounts and papers are late, agreed management assurances are unavailable, or planned internal audit reliance is not achieved, we reserve the right to charge an additional fee for further audit work.
50. An additional fee will be required in relation to any work or other significant exercises not within our planned audit activity. An additional fee will also be charged for work on any grant claims or returns not included in the planned outputs noted previously.



51. Lynn Bradley, Director, Audit Services (Local Government) is the appointed auditor for all local authorities audited by Audit Scotland. In practice, this operates by delegating management and certification responsibilities to Assistant Directors. For Inverclyde Council the Assistant Director is Peter Tait.
52. The local audit team will be led by Elaine Boyd who will be responsible for the day to day management of the audit and who will be your primary contact. Details of the experience/skills of our team are provided at Appendix C. The core audit team will call on other specialist and support staff, as necessary.

Independence and objectivity

53. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. We are not aware of any such relationships within the audit team.
54. We comply with ethical standards issued by the Auditing Practices Board and with Audit Scotland's requirements in respect of independence and objectivity, as summarised at Appendix E.



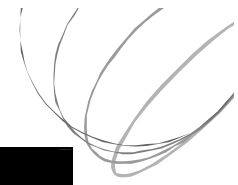
Appendix A - Summary assurance plan

In this section we identify a range of governance and other risks that may affect the financial statements of Inverclyde Council, the related source of assurance received and the audit work we propose to undertake to secure additional assurance. The management of risk is the responsibility of the Council and its officers, with the auditor's role being to review the arrangements put in place by management. Planned audit work, therefore, will not necessarily address all residual risks.

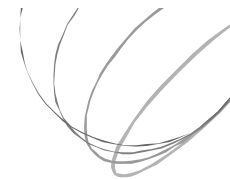
Risk	Source of assurance	Planned audit action
Financial management		
<p>The downturn in the country's economic performance, ongoing council tax freeze and uncertainty over future financial settlements has increased the financial pressure on the council. Investment income has decreased whilst the decline in property values has had a detrimental impact on the Council's ability to support the capital programme via income generated by capital receipts.</p> <p>These pressures mean it will be very challenging to sustain current levels of services and maintain appropriate levels of reserves. As at December 2009 the Council has estimated a revenue funding shortfall of £28m over the four year period 2011/14.</p>	<ul style="list-style-type: none"> ▪ The Council has a robust Financial Strategy in place which is reviewed and reported to Committee every 6 months. ▪ The 2010/11 budget will create a number of cross cutting saving workstreams which are intended to significantly address the £28million funding gap. Progress on specific workstreams will be reported to the appropriate Committee and the overall position will be reviewed regularly by the Policy and Resources Committee. 	<ul style="list-style-type: none"> ▪ Monitor the Council's financial position via the Policy & Resources committee reports and meetings with officers. ▪ Report in the Annual Report to Members.
<p>Although the Financial Strategy makes reference to other corporate plans (i.e. the SOA, Corporate Plan and Community Plan) there are no clear links between these strategic documents to ensure financial resources are clearly directed at achieving the Council's corporate objectives.</p>	<ul style="list-style-type: none"> ▪ Per 2008/09 Members Letter – Action point 4. ▪ The Financial Strategy will be reviewed and submitted to the Full Council in December 2009 and June 2010. ▪ The 2010/11 Budget will be recast to show resources allocated to Councils core priorities. ▪ The Council will improve linkages between Service Planning & Resources. Proposals will be reflected in revised directorate planning guidance. 	<ul style="list-style-type: none"> ▪ Monitor through review of the revised Financial Strategy, directorate planning guidance and key planning documents. ▪ Report in the Annual Report to Members.



Risk	Source of assurance	Planned audit action
<p>A Strategic Procurement Framework was presented to the September 2009 Policy and Resources Committee. The Council will need to increase momentum to significantly develop current procurement practices to achieve and embed the approach outlined in the new framework.</p>	<ul style="list-style-type: none"> ▪ Per 2008/09 Members letter – Action point 8. ▪ The Council will make progress against agreed workstreams within the Strategic Procurement Framework in line with timescales agreed by Committee, subject to available capacity. 	<ul style="list-style-type: none"> ▪ Monitor through review of the Corporate Performance Report submitted to the Policy and Resources Committee and through meetings with Council officers. ▪ Report in the Annual Report to Members.
<h3>Accounts presentation and disclosure</h3>		
<p>The financial closure planning process does not take account of the additional requirements of the SORP and, in particular, the introduction of International Financial Reporting Standards.</p>	<ul style="list-style-type: none"> ▪ Per 2008/09 Members Letter – Action point 2. ▪ The Internal Officer group will continue to take the necessary action to ensure the Council complies fully with IFRS requirements. 	<ul style="list-style-type: none"> ▪ Meet periodically with relevant Council officers to discuss progress. ▪ Compliance with standards will be assessed during the audit of the Council's 2009/10 financial statements.
<h3>Common good fund</h3>		
<p>The Council needs to prepare a common good asset register supported by title deeds to ensure the financial statements account for these assets appropriately.</p>	<ul style="list-style-type: none"> ▪ Per 2008/09 Members letter – Action point 1. ▪ As part of the 2009/10 budget process, a bid was made for additional funds to allow the exercise to be undertaken more speedily. An additional solicitor has now been recruited to progress this work. 	<ul style="list-style-type: none"> ▪ Monitor progress through meetings with Council officers. ▪ Report in the Annual Report to Members.
<h3>Financial capacity</h3>		
<p>The Financial Capacity Development Plan might not be delivered within the timescales documented and the financial capacity of the organisation as a whole may not be sufficient to manage the Council through a time of extreme financial pressure.</p>	<ul style="list-style-type: none"> ▪ Actions in the Plan have been prioritised to ensure the main areas are dealt with first. It is acknowledged that delivering all improvements may take longer than ideally planned. 	<ul style="list-style-type: none"> ▪ Monitor progress through review of committee minutes.
<p>The planned restructure of the Finance department may impact on the capacity of the department during transition to the new structure.</p>	<ul style="list-style-type: none"> ▪ Whilst any period of change will cause an element of disruption, the hub and spoke proposal is a key deliverable of the Finance capacity Development Plan and will be prioritised. 	<ul style="list-style-type: none"> ▪ Monitor through discussions with Council officers.

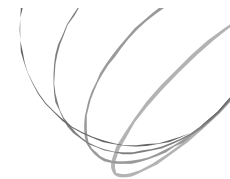


Risk	Source of assurance	Planned audit action
Human resources / payroll system		
Errors experienced during the migration of the manual and teacher's payrolls result in incorrect payments being made to employees.	<ul style="list-style-type: none">▪ Controls used in previous transfers will be retained and no material problems experienced to date.	<ul style="list-style-type: none">▪ Place reliance on the HR / Payroll Integration Project review being carried out by the Council's Internal Audit section as part of their 2009/10 annual plan.
Schools PPP		
Schools PPP is incorrectly accounted for in the financial statements.	<ul style="list-style-type: none">▪ Part of IFRS work plan and progress regularly reviewed by CFO and Finance Manager.	<ul style="list-style-type: none">▪ Disclosure will be assessed during the audit of the Council's 2009/10 financial statements.
Leisure trust		
If Inverclyde Leisure experience service performance issues the Council may not have appropriate mechanisms in place to address them.	<ul style="list-style-type: none">▪ A Service Level Agreement was approved by the Regeneration Committee on 14th January 2010. It is to be signed by Inverclyde Leisure and returned to the Council on 29th January 2010.	<ul style="list-style-type: none">▪ Verify that a signed agreement is in place.



Appendix B - Financial statements audit timetable

Key stage	Date
Testing and review of internal control systems and transactions	30 June 2010
Provision of closedown procedures to audit	31 March 2010
Meetings with officers to clarify expectations of detailed working papers and financial system reports	31 March 2010
Planned committee approval of unaudited financial statements	June 2010
Latest submission of unaudited financial statements with working papers package	30 June 2010
Progress meetings with lead officers on emerging issues	Weekly during audit process
Latest date for final clearance meeting with Chief Financial Officer and Corporate Director Improvement & Performance	17 September 2010 (TBC)
Agreement of unsigned financial statements for audit committee agenda, and issue of report to the audit committee on the audit of financial statements (ISA 260)	27 September 2010 (dependant on Audit Committee date)
Audit committee date	September 2010 (TBC)
Independent Auditors Report signed	By 30 September 2010
Latest date for submission of unaudited whole of government accounts return to external audit	TBC
Latest date for signing of WGA return	TBC
Annual report and certified accounts presented to Council	31 October 2010



Appendix C - Audit team

A summarised curriculum vitae for each core team member is set out below:

Lynn Bradley BSc CPFA CA

Director of Audit Services (appointed auditor)

Lynn took up post as Director of Audit in January 2005. Originally trained as an auditor with National Audit Office, Lynn has worked in various senior posts in the public and private sectors in Scotland and England. She spent several years working with local authorities on housing and regeneration projects. Before joining Audit Scotland, she was the Section 95 officer in a Scottish Council. Lynn was the co-author of CIPFA guidance on audit committee principles. She is currently the vice chair of LASAAC and a former CIPFA Council member and the past chair of CIPFA in Scotland.

Peter Tait CPFA

Assistant Director of Audit Services (certifying auditor)

Peter's career has given him an excellent breadth of experience covering public finance within Scotland, including Local Government, Agencies, Non-Departmental Public Bodies, the NHS and Central Government. With 32 years experience of public sector audit including 19 years at a senior management level, Peter has a strong understanding of the role of the finance function in large public sector organisations and a commitment to achieving best value.

He has assisted public sector bodies with a range of issues including governance, risk management, frameworks of control, financial systems, PFI/PPP schemes, staffing structures, financial reserves, arms length organisations, pension funds, financial planning, capital expenditure schemes, major IT developments and performance management.

Elaine Boyd FCCA

Senior Audit Manager

Elaine has eight years experience of public sector audit with Audit Scotland, covering local government, health and central government. Prior to this, Elaine spent seven years in a financial management and audit role within the public sector and seven years in private practice.

Laurence Slavin CPFA

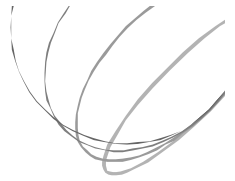
Senior Auditor

Laurence has six years experience of public sector audit with Audit Scotland, covering local government, health and education. Prior to this Laurence spent seven years in an IT audit role within the private practice and gained experience both in an audit capacity and as a consultant on large scale IT projects.

Stuart Nugent CPFA

Senior Auditor

Stuart has eight years experience of public sector audit experience with Audit Scotland, covering local government, and health.



Alan Mackenzie B. Acc

Auditor

Alan has over eight years experience of public sector audit working in the local government sector within Audit Scotland. Alan has significant experience of key audit areas including housing benefit, pension funds and procurement and is studying for the CIPFA accountancy qualification.

David Young

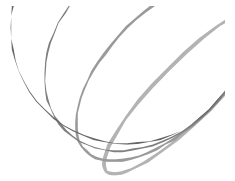
Auditor Trainee

David is a graduate of Glasgow University gaining a degree in economics. He has three years experience of public sector auditing covering local and central government, health and education and joined Audit Scotland as a CIPFA professional trainee in August 2008.

Jim Cumming

Senior Auditor (ICT)

Jim has nine years experience of public sector ICT audit with Audit Scotland, covering local government, health and the central government sectors. Prior to working for Audit Scotland, Jim spent 15 years in various IT development, quality, security, system administration and project management roles in engineering.



Appendix D - Reliance on internal audit

Auditing standards require internal and external auditors to work closely together to make optimal use of available audit resources. We seek to rely on the work of internal audit wherever possible and as part of our planning process we carry out an early assessment of the internal audit function. Our review of the internal audit service concluded that the internal audit service operates in accordance with the CIPFA code of practice for internal audit in local government. We therefore plan to place reliance on the work of internal audit in the following areas:

- implementation of the integrated HR / payroll system
- payroll
- treasury management
- cash and bank
- accounts payable
- statutory performance indicators
- statement on the system of internal financial control.



Appendix E - Independence and Objectivity

Auditors appointed by the Auditor General for Scotland are required to comply with the Code of Audit Practice and standing guidance for auditors, which defines the terms of appointment. When auditing the financial statements auditors are also required to comply with the auditing and ethical standards issued by the Auditing Practices Board (APB). The main requirements of the Code of Audit Practice, standing guidance for auditors and the standards are summarised below.

International Standards on Auditing (UK and Ireland) 260 (Communication of audit matters to those charged with governance) requires that the appointed auditor:

- discloses in writing all relationships that may bear on the auditor's objectivity and independence, the related safeguards put in place to protect against these threats and the total amount of the fee that the auditor has charged the client
- confirms in writing that the APB's ethical standards are complied with and that, in the auditor's professional judgement, they are independent and their objectivity is not compromised.

The standard defines 'those charged with governance' as 'those persons entrusted with the supervision, control and direction of an entity'. In your case, the appropriate addressee of communications from the auditor to those charged with governance is the Audit Committee. The auditor reserves the right to communicate directly with members on matters which are considered to be of sufficient importance.

Audit Scotland's Code of Audit Practice has an overriding general requirement that appointed auditors carry out their work independently and objectively, and ensure they do not act in any way that might give rise to, or could reasonably be perceived to give rise to, a conflict of interest. Appointed auditors and their staff should avoid entering in to any official, professional or personal relationships which may impair their independence, or might lead to a reasonable perception that their independence could be impaired.

The standing guidance for auditors includes a number of specific requirements. The key requirements relevant to this audit appointment are as follows:

- during the currency of an appointment, auditors should not perform non-audit work for an audited body, consultancy or otherwise, without the prior approval of Audit Scotland
- the appointed auditor and key staff should, in all but exceptional circumstances, be changed at least once every five years in line with Audit Scotland's rotation policy
- the appointed auditor and audit team are required to carry out their duties in a politically neutral way, and should not engage in high profile public party political activity
- the appointed auditor and audit team must abide by Audit Scotland's policy on gifts and hospitality, as set out in the Audit Scotland Staff Code of Conduct.