



AUDIT COMMITTEE

AGENDA

7th Meeting, 2001 (Session 1)

Tuesday 1st May 2001

The Committee will meet at 2.00 pm in Committee Room 3 to consider the following agenda items:

1. **Committee Business:** The Committee will decide whether to take agenda item 5 in private.
2. **Scottish Parliament European Familiarisation Scheme:** The Convener will report back to the Committee.
3. **Scottish Environment Protection Agency:** The Committee will consider a letter from Patricia Hinton, Chief Executive of SEPA.
4. **Financial Reporting Advisory Board:** The Committee will consider a letter from the Minister for Finance and Local Government.
5. **National Health Service Bodies in Tayside:** The Committee will consider the evidence taken on the report by the Auditor General for Scotland entitled 'National Health Service Bodies in Tayside' (AGS/2001/3).

Callum Thomson
Clerk to the Audit Committee
Room 1.6, Committee Chambers
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The papers for this meeting are:

Agenda Item 3

Letter and Memorandum from Patricia Henton, Chief Executive, Scottish Environment Protection Agency	AU/01/7/1
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Agenda Item 4

Letter from Angus Mackay , Minister for Finance and Local Government, enclosing draft arrangements	AU/01/7/2
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Paper by the Clerk on the Financial Reporting Advisory Board	AU/01/7/3
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Agenda Item 5

Letter from the Convener and response dated 26 April 2001 from Mr Trevor Jones and Mr Peter Bates	PRIVATE PAPER
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Letter from the Convener and response dated 24 April 2001 from Mr Frank Brown	PRIVATE PAPER
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Letter from the Convener and response dated 24 April 2001 from Mr John Mathieson	PRIVATE PAPER
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Letter from the Convener and response dated 24 April 2001 from Mr Howard Waldner	PRIVATE PAPER
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Letter from the Convener and response dated 24 April 2001 from Mr Phillip Colville	PRIVATE PAPER
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Letter from the Convener and acknowledgement dated 24 April 2001 from Mr Geoff Scaife	PRIVATE PAPER
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Letter from the Convener to Sir William Stewart	PRIVATE PAPER
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Letter from the Convener to Mrs Frances Havenga	PRIVATE PAPER
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Our Ref: MPH/HLC
ORG04-A29
From M Patricia Henton
Chief Executive

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26 March 2001

Andrew Welsh MSP
Convener
Audit Committee
Scottish Parliament
EDINBURGH
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Dear Mr Welsh

SEPA'S RESPONSE TO THE AUDITOR GENERAL'S REPORT "A MEASURE OF PROTECTION: A BASELINE REPORT ON PERFORMANCE MEASUREMENT IN THE SCOTTISH ENVIRONMENT PROTECTION AGENCY"

I am writing further to my letter to Mr Thomson of 19th January 2001 and to a subsequent telephone enquiry from him. The delay in my response is due to the fact that I wanted to ensure you received a detailed update on our progress.

Since the publication of the report, SEPA has met with the Auditor General and his staff and has agreed an overall programme which will take forward the issues raised in the Auditor General's report. We have commented on each of the points in the report and have now clarified with Audit Scotland the meaning of certain points which were unclear. We have also submitted these to our Audit Committee and will be providing them with a timetable against which they will monitor management actions.

SEPA will provide a report on progress in December 2001 to Audit Scotland which will be an important milestone for assessing our progress. In Summer 2002, a formal report giving our opinion of what we have accomplished will be provided. It is expected that this report will form the basis of Audit Scotland's report to the Committee on how much SEPA has achieved.

A copy of our specific responses to each recommendation is appended to this letter.

SEPA welcomes Audit Scotland's commitment to working with us on taking forward the findings of the report and view their work as helpful and constructive. We are mindful, nevertheless, of the considerable challenges which some aspects of their recommendations pose us but look forward to addressing those as part of our ongoing commitment to protecting and enhancing Scotland's environment.

Yours sincerely

M PATRICIA HENTON

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cc Callum Thomson, Clerk to the Audit Committee, Scottish Parliament
Robert Leishman, Office of the Auditor General for Scotland
David Hughes-Hallet, Chairman, Audit Committee
W Halcrow, Director of Operations
J Ford, Director of Finance and Corporate Support

Audit Scotland's Recommendations

i) The Scottish Executive and SEPA should review strategic and management objectives. These should have clear goals and measurable targets which can provide a complete picture of SEPA's objectives.

ii) Development of SEPA's performance framework should introduce greater focus on environmental improvement and on the environmental outcomes of SEPA's regulatory activity.

iii) SEPA should use management information already at hand (such as water improvement action plans) to monitor whether its planned contribution to improvements has been achieved.

iv) SEPA should extend its quality control procedures to ensure regulatory functions are undertaken consistently and that required standards are met.

v) Targets used by SEPA should reflect guidance and provide a complete picture of performance against expectations.

SEPA Response

It is recognised by both SEPA and the Scottish Executive that SEPA's statutory objectives are currently focused on process, not outcomes. This is the subject of discussion with the Executive and the review should move in the direction indicated by Audit Scotland, in line with the principles of Modernising Government and general trends in the public sector. It must be recognised that this will take time.

This is already being addressed. SEPA welcomes Audit Scotland's commitment to working with it and will value its input.

SEPA intends to use action planning to achieve environmental improvement, recognising that improvement and protection of the environment as a result of its regulatory duties should also be measured. It is agreed that where SEPA is not in total and immediate charge of the outcome, then intermediate outputs to measure SEPA's effort and success are essential.

This is agreed and work is currently in hand. Quality assurance is already provided through ISO 9000 accreditation for most business processes. Quality control already covers virtually all of SEPA's test functions and is intended to be extended to its regulatory and other functions in the near future. The setting of standards for measuring against is already in hand.

It is intended to address the matter of guidance in the issue referred to, namely that on waste management inspections. This guidance was published over a decade ago when conditions in respect of landfills and other waste management facilities were substantially different to nowadays and also prior to devolution. In the context of a devolved Scotland, the guidance needs revision and the matter will be taken up with the Scottish Executive.

Audit Scotland's Recommendations

vi) Where the planned frequency of inspection and sampling differs from expected levels, the reasons for the differences and the associated risks should be assessed and documented.

vii) SEPA should ensure that enforcement policies are consistently applied across all similar types of licence. Where compliance is based on operator assessments, these assessments should be undertaken consistently.

viii) The new performance measurement framework should include more meaningful measures of overall efficiency.

ix) SEPA should ensure that its Information Systems Strategy delivers the additional information required in the timescales identified.

x) The additional information available should be used to provide managers at all levels within SEPA with a clearer view of operational efficiency.

xi) SEPA should investigate whether the level of income raised from providing ad hoc advice is an accurate reflection of the resources devoted to such activities.

SEPA Response

This is agreed entirely. There was a comprehensive exercise carried out on this in 1997, but the momentum has not been maintained to the extent that management expects. This is being addressed.

This is agreed. The current reorganisation is designed to assist in achieving this. Proper day to day guidance through uniform advice will be put in place.

This is agreed. It should be recognised that Audit Scotland's view is focused on unit costs which is appropriate in many areas of SEPA's work, but not all.

This is agreed.

This is agreed. Management information is essential to the efficient and effective operation of the organisation.

This is agreed. The activity time recording system being developed should provide this information.



SCOTTISH EXECUTIVE

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March 2001

DETERMINATION OF ACCOUNTING POLICIES

1. On 8 March last year you indicated that your Committee was content to support the recommendation that officials proceed to negotiate a suitable extension to the remit of the Financial Reporting Advisory Board (FRAB) together with appropriate Scottish representation to address the above.
2. Jack McConnell gave an undertaking that the proposed form of any arrangements would be brought back to the Committees before any agreement is formalised.
3. While it has taken longer than hoped to make progress on this officials have now agreed final draft revised terms of reference for the FRAB, membership arrangements and working arrangements. I see this as a very successful outcome.
4. Under the proposed arrangements Scottish Ministers will look to the FRAB for independent advice on the technical rules of accounting (i.e. application of all financial reporting standards and principles) and to minimum disclosure requirements. The FRAB will have no role in the format of the accounts or to disclosures beyond the minimum requirements. The format of the accounts is for discussion with the Committee.
5. I attach copies of the final drafts of the documents and would welcome your Committee's agreement to the proposals.

ANGUS MacKAY

THE TERMS OF REFERENCE OF THE FINANCIAL REPORTING ADVISORY BOARD [1.3.01]

1. Context

1.1 The primary aims of financial reporting by central government bodies are to demonstrate to the public and their representatives in the UK and Scottish Parliaments:

- the financial performance of the bodies;
- their stewardship of public funds and assets; and
- that, where appropriate, public monies and other resources have been used for the purposes intended by the Parliaments;

and to provide the Parliaments with information which is reliable and sufficient as a basis for

- their consideration and approval of the levels of resources and cash voted to services; and
- their examination of performance in carrying out policies, functions, programmes and projects.

1.2 Financial reporting is also intended to underpin the UK Government's planning, monitoring and management of public expenditure.

1.3 The authority to develop financial reporting requirements rests with HM Treasury and the Scottish Ministers in respect of accounts meeting the criteria set out in paragraph 2.1.b. below.

1.4 Financial reporting by central government bodies should be based on Generally Accepted Accounting Practice (GAAP) adapted where appropriate to take account of the public sector context. For Resource Accounts in England and Wales

and for Whole of Government Accounts this requirement is set out in sections 5 and 9 of the Government Resources and Accounts Act 2000.

1.5 Under section 24 of the Government Resources and Accounts Act 2000 the Treasury is required to consult an advisory group on financial reporting principles and standards for resource accounts and Whole of Government Accounts. The Scottish Ministers, with the agreement of the Audit Committee of the Scottish Parliament, have determined that they should be similarly advised on such matters. The FRAB will be the advisory group, and thus will provide an independent element into the process of setting financial reporting standards for the UK Government and the Scottish Ministers.

2. Terms of Reference

2.1 Responsibilities of the Board:

- a. The Board will provide independent advice to HM Treasury and the Scottish Ministers.
- b. The Board will advise HM Treasury and the Scottish Ministers on the application of financial reporting standards and principles:
 - i. Where HM Treasury is responsible for issuing reporting requirements, in respect of:
 - Departmental resource accounts
 - Non-departmental public bodies
 - Trading funds
 - Whole of Government Accounts
 - ii. Where the Scottish Ministers are responsible for issuing reporting requirements, in respect of:
 - Accounts falling under sections 19 and 20 of the Public Finance and Accountability (Scotland) Act 2000.
 - accounts of executive non departmental public bodies where the Scottish Ministers have the power of direction

- c. The Board will decide how it reaches its conclusions.
- d. The Board's advice to the Scottish Ministers will be restricted to the technical rules of accounting and to minimum disclosure requirements. It will not extend to the format of accounts or to disclosures beyond the minimum requirements.
- e. The Board will examine all amendments to the guidance issued by HM Treasury and the Scottish Ministers in respect of the bodies listed in b. above, with the aim of ensuring the guidance complies with GAAP, and that departures or modifications from it, due to public sector and spending control contexts, are fully explained and justified.
- f. The Board will prepare an annual report of its activities, including its views on the changes made during the period to the accounting guidance issued by HM Treasury and the Scottish Ministers in respect of bodies listed in b. above, and will send a copy of its report direct to the PAC and Treasury Select Committee of the UK Parliament.

2.2 HM Treasury and the Scottish Ministers:

- a. Will ensure that all relevant matters, including proposed changes to the guidance in respect of accounts meeting the criteria in 2.1.b. above are brought to the Board's attention within a reasonable time. In particular, changes to Financial Reporting Standards and other elements of GAAP that affect such guidance will, as far as possible, be brought to attention in sufficient time to enable their implementation, as appropriate, within the same timescale as changes are to be made generally.
- b. Will examine all issues raised by the Board within its terms of reference.

- c. Will consider all advice received from the Board.
 - d. Will formally lay the Board's report before the House of Commons and the Scottish Parliament respectively.
2. 3 HM Treasury will provide the secretariat to the Board.

3. Membership

3.1 The Board will comprise:

- 1 member nominated by the Treasury
- 1 member nominated by the Scottish Ministers
- 1 member nominated by the Comptroller and Auditor General
- 1 member nominated by the Auditor General for Scotland
- 1 member nominated by the Audit Commission
- 3 members nominated by the Principal Finance Officers of UK government departments to represent respectively departments, trading funds, and non departmental public bodies.
- 1 member nominated by the Head of the Government Statistical Service
- 1 member nominated by the Accounting Standards Board
- 1 member, an independent economist, nominated by the Head of the Government Economic Service.

3.2 In addition, an independent Chairman of the Board will be nominated by the Chief Accountancy Adviser to the Treasury, and in respect of future appointments, in agreement with the Scottish Ministers.

3.3 The periods of appointment will be determined by the nominating bodies.

3.4 The Board will meet as required in each year to discuss matters relating to financial reporting as they arise.

1. FRAB: UK/SCOTLAND WORKING ARRANGEMENTS [1.3.01 VERSION]

1. HM Treasury will continue to provide the FRAB Secretariat. The role of secretariat will be distinct from the Treasury's input to preparing papers and discussing accounting issues with the Board. The Secretariat role, although, for administrative convenience and continuity, provided by the Treasury, will be carried out independently of the Treasury and the Scottish Ministers. If any of the parties concerned (ie the Treasury, the Scottish Ministers, the Board, or the Secretariat) consider that the Secretariat has either failed to act impartially or that there is an impediment to acting impartially, it should be brought to the attention of the other parties for resolution.

2. The Board's forward work programme and individual meeting agendas will be agreed between the Secretariat, HM Treasury, and Scottish Executive Finance

3. Responsibility for preparing papers and taking forward the necessary consultations will be agreed between the Secretariat, HM Treasury, and Scottish Executive Finance. Those consultations will include:

a. with those responsible in HM Treasury and Scottish Executive Finance for spending control and Parliamentary control.

b. with relevant bodies in respect of accounting guidance, the responsibility for which rests with HM Treasury or the Scottish Ministers.

4. Any dispute with The FRAB's view will be taken forward as follows. The Board is advisory. Therefore, it is open to HM Treasury and the Scottish Ministers, jointly or individually, not to follow the Board's advice. The Board can, of course, refer to such an action in its report, which is laid before the UK and Scottish Parliaments.

Determination of Accounting Policies Financial Reporting Advisory Board (FRAB)

Purpose

The Audit and Finance Committees have been asked to consider the final drafts of the terms of reference and working arrangements for FRAB.

Background

The Public Finance and Accountability (Scotland) Act 2000 and the written agreement between the Audit Committee and the Scottish Ministers on the form of accounts and powers of direction make provision for the Parliament to have a role in the determination of accounting policies. The role of FRAB is to advise the Treasury and the Scottish Ministers on the technical rules of accounting and minimum disclosure requirements.

Members may recall that the determination of accounting policies was first raised by the then Minister for Finance in his letter of 12 December 1999 to the Audit and Finance Committees, at which time, the Committees' views on extending the remit of and having Scottish representation on FRAB were sought. The Committees considered the matter and on 7 February, the Conveners wrote jointly seeking further clarification of several points.

The joint letter expressed concern at that time about the nature of the proposed relationship between the FRAB, the Treasury, the Scottish Ministers and the Scottish Parliament - particularly whether Scottish Ministers would be able to exercise the same discretion as the Treasury in applying any FRAB advice and procedures for dispute resolution.

Memoranda from the Minister for Finance and the National Audit Office addressing those concerns were considered by the Committees (Audit at the meeting on 7 March 2000). On this basis, the Committees agreed that they were content to support the Minister's request to negotiate a suitable extension to the remit of the FRAB and secure appropriate Scottish representation but that the proposed arrangements should be brought before the Committees again before being finalised.

Points of Note

The Minister's letter of 17 April encloses the latest drafts for comments by the Committees; the Finance Committee will be considering them on 8 May. The points raised previously by both Committees appear to be addressed.

The first document is the *Terms of Reference of the Financial Reporting Advisory Board*. Membership of the Board will include members nominated by Scottish Ministers, the Auditor General for Scotland and the Audit Commission - this was one of the issues raised previously. Members may note that paragraph 2.1(f) states that the FRAB annual report is to be sent to the Public Accounts Committee and the

Treasury Committee of the UK Parliament. No mention is made of this report being sent to either the Audit Committee or Finance Committee of the Scottish Parliament.

The second document is the *FRAB: UK/Scotland Working Arrangements*. This would appear to be uncontroversial.

Action

The Committee is asked to consider whether it wishes to make any comments on the final drafts of the documents, with a view to the Conveners of the Audit and Finance Committees responding jointly to the Minister for Finance and Local Government.

Format of Accounts

Paragraph 4 of the Minister's letter makes reference to discussions on the format of the accounts. Members may recall that the Committee considered this matter last July and it was agreed, in respect of the 1999/2000 accounts, that when presenting the accounts, shadow accounts should be submitted to the Audit Committee which would show percentage changes on the face of the accounts.

The consolidated accounts for 1999/2000 are presently being audited. It is hoped that the Committee will have these and the shadow accounts for consideration prior to summer recess and be able to take a view on the format of the 2000/01 accounts (which will relate to the first budget which was passed by the Scottish Parliament).

Anne Peat
April 2001