



Forward planning, reporting back:

A financial guide for non-executive directors
of Scottish Government executive NDPBs

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A financial guide for non-executive directors of Scottish Government executive NDPBs

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Foreword

By Ian J Robbie MA CA CPFA
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Public bodies across Scotland are currently engaged in a detailed review of the finances and the services they provide in anticipation of significant cuts in public spending following the UK-wide Comprehensive Spending Review. While ultimately it is the politicians who will decide on spending priorities, the delivery of public services depends on public bodies themselves and their partners in the voluntary and private sectors.

Scottish Government executive Non-Departmental Public Bodies (NDPBs) operate within a financial, legal and regulatory framework which is different from other central government bodies. Understanding this framework is essential for non-executive directors of NDPBs, even more so given the extent of current challenges.

Forward planning, reporting back is designed to support non-executive directors of executive NDPBs gain a better understanding of the financial aspects of their role focusing primarily on the annual financial cycle from funding arrangements, budget setting and monitoring through to financial reporting. However, the material in the Guide places financial matters in the context of the wider strategic role of non-executive directors and boards in the delivery by executive NDPBs of their objectives.

On behalf of the Public Sector Committee of The Institute of Chartered Accountants of Scotland, I am pleased to present this Guide. It reinforces the Institute's commitment to delivering its Royal Charter obligation to act in the public interest.

October 2010

Introduction

1. Good financial management and effective stewardship are cornerstones of any successful organisation whether it is a public, private or voluntary sector organisation. While this may no longer be news, we are all accustomed to hearing on a regular basis about underperforming or failing organisations. Prevention is better than cure and board members have a pivotal role in improving organisational performance, improving financial scrutiny and governance, and providing accountability to stakeholders.
2. Non-executive directors of Scottish Government executive Non-Departmental Public Bodies (NDPBs) face many challenges in common with other public sector bodies although the financial, legal and regulatory framework in which executive NDPBs operate require non-executive directors to apply their knowledge, experience and judgement within this separate context.
3. This Guide has been developed for non-executive directors and non-executive boards of executive NDPBs by The Institute of Chartered Accountants of Scotland to complement the publication *On Board: A Guide for Board Members of Public Bodies in Scotland*, which is available on the Scottish Government's website (www.scotland.gov.uk).
4. *On Board* provides board members with comprehensive material on a wide range of generic issues, such as the principles of corporate governance, roles and responsibilities, financial management and conduct, which are relevant to board members of Scottish public bodies in general. Our Guide is specifically tailored to the executive NDPB sector in Scotland. It is a practical guide for non-executive directors, individually and collectively, on understanding key aspects of financial management and financial reporting by executive NDPBs. Through assisting non-executive directors to gain a better understanding of these issues, the Guide aims to strengthen the capacity of boards to improve organisational performance, financial scrutiny and governance, and accountability to stakeholders.
5. The Guide uses and explains terms and concepts which are familiar to professional accountants and seeks to make these accessible for the non-accountant. It is designed to be read alongside the NDPB's corporate documents, such as its Management Statement and corporate plan. A copy of the NDPB's latest annual report and accounts should assist with understanding the material in the Guide on: stewardship and the annual report and accounts (chapter 3); and audit arrangements (chapter 4).
6. The executive NDPB sector is a diverse sector with individual NDPBs carrying out administrative, commercial, executive or regulatory functions on behalf of the Scottish Government. However, executive NDPBs have a variety of key features in common. They:
 - are normally established by statute such as an Act of Parliament or Royal Charter;
 - provide specialist advice to Ministers and others;
 - have a national, Scotland-wide, remit;
 - have a board whose members are normally appointed by Ministers or The Queen;
 - employ their own staff, who are not civil servants;
 - manage their budgets; and
 - prepare an annual report and accounts for laying before the Scottish Parliament.

7. The diversity of the sector was one of the key challenges in the preparation of the Guide, and by identifying those issues NDPBs have in common in relation to financial management and financial reporting, we hope that non-executive directors of all executive NDPBs in Scotland find the Guide of value. While the Guide focuses on issues relevant to executive NDPBs generally, it recognises that NDPBs which are companies or charities, or both, described in the Guide as ‘NDPBs with a difference’ operate within a more complex legal and regulatory framework. Chapter 3 highlights a number of additional matters relevant to the preparation and filing of the annual report and accounts by executive NDPBs with a difference. Chapter 4 highlights the whistleblowing duty placed on the auditors of charitable NDPBs.

Executive NDPBs with a difference

Company and charitable status place additional legal and regulatory responsibilities on executive NDPBs meaning that they have to comply with company law or Scottish charity law, or both.

Non-executive directors of company NDPBs will also be directors of the company under company law and non-executive directors of charitable NDPBs will be trustees of the charity under charity law. Therefore, the implications of these different roles should be explored with the NDPB by new non-executives during the induction process.

8. The Guide is organised into five chapters:

Chapter 1: Funding arrangements

This chapter provides information on how Scottish Government executive NDPBs are funded and how funding flows between the Scottish Government and its executive NDPBs. It also places the funding of executive NDPBs within the overall context of Scottish Government spending plans and overall UK spending plans.

Chapter 2: Planning, monitoring and decision-making

This chapter examines the role of the NDPB board in translating strategy into plans and actions in the context of available funding. It includes information about setting and monitoring the annual budget and the relationship between budget monitoring and the wider performance monitoring arrangements.

Chapter 3: Stewardship and the annual report and accounts

This chapter provides information about the preparation and content of the annual report and accounts to enable the board to provide scrutiny and challenge surrounding the year-end reporting process.

Chapter 4: Audit arrangements

This chapter provides information about the purpose of financial audit, the standards external auditors must comply with, auditor responsibilities and the auditor’s report requirements, to give the board an overview of external audit arrangements.

Chapter 5: Role of the Chief Financial Officer in an executive NDPB

This chapter examines the role of the Chief Financial Officer (CFO) in both accounting for the financial transactions of the executive NDPB and in providing a strategic, leadership role as a member of the executive NDPB’s management team.

9. If you have any comments on the Guide please contact: accountingandauditing@icas.org.uk.

Chapter 1: Funding arrangements

Chapter overview

- 1.1 This chapter provides information on how Scottish Government executive NDPBs are funded and how funding flows between the Scottish Government and its executive NDPBs. It also places the funding of executive NDPBs within the overall context of Scottish Government spending plans and overall UK spending plans. Chapter 2 goes on to provide information on board involvement in approving plans and budgets and in monitoring plans and budgets during the financial year.
- 1.2 The sections in this chapter are:
- Spending review process
 - Setting the Scottish budget
 - Scottish Government funding of its executive NDPBs
 - Grant-in-aid
 - End year flexibility
 - Scottish Public Finance Manual

Spending review process

- 1.3 Spending reviews are detailed examinations of portfolio budgets, which are normally undertaken every two years by Scottish Ministers. At each spending review, expenditure plans for each Scottish ministerial portfolio are set for the following three years. Once expenditure plans are set there is a strong expectation that any new initiatives and additional cost pressures will be absorbed within existing plans. However, funding mechanisms contain a degree of flexibility which enables the Scottish Government to review its priorities on an ongoing basis, within the constraints of its overall expenditure plans, and to carry forward funding to future financial years, although the carry forward of funds can only be undertaken with the approval of the UK Parliament.
- 1.4 In Scotland, the spending review process is scheduled around the timeframe of UK spending reviews as the overall Scottish budget is set during this process. At present, the Scottish budget allocation from the UK is largely derived by applying the population-based Barnett formula to changes in planned spending by comparable UK Government departments. Budgets are allocated to each Scottish portfolio once deductions have been made for the costs of the Scotland Office (which is a UK Government department), the Scottish Parliament Corporate Body and Audit Scotland. Although the overall Scottish budget is determined with reference to comparable spending by the UK Government departments, it is for Scottish Ministers to determine spending priorities within each Scottish ministerial portfolio, which are further cascaded to directorates and through directorates to public sector bodies, including executive NDPBs.
- 1.5 Further information on how the Scottish Government is funded is set out in a *Statement of Funding Policy* published by HM Treasury in October 2007.
- 1.6 The last year of one spending review period becomes the first year of the next spending review period. For example, the 2007 spending review set revised spending plans for 2008-09 and new plans for 2009-10 and 2010-11.

Setting the Scottish budget

- 1.7 The annual budgeting process in Scotland is connected to, but is separate from, the spending review process. Detailed expenditure plans are developed each year by the Scottish Government within the constraints on the overall Scottish budget set during the spending review process.

- 1.8 Each year a Budget Bill is presented to the Scottish Parliament for approval. The Budget Bill includes the Scottish Government's expenditure proposals plus expenditure proposals from the Scottish Parliament Corporate Body and Audit Scotland. Following Scottish parliamentary approval, the Budget Act becomes the legal basis for expenditure to take place. Normally the Scottish Government publishes its draft budget in September each year setting out its expenditure plans for the following financial year. The Budget Bill must be introduced to the Scottish Parliament by 20 January, with the Budget Act for the next financial year passed in February. Further information on setting the Scottish budget is available on the Scottish Government's website.
- 1.9 The Scottish Government's annual budget and the budgets of public bodies, including executive NDPBs, are prepared on a resource basis, which is known in the public sector as a resource budget. This means that budgets reflect the financial resources which are expected to be used during the financial year and are not purely based on cash expected to be paid out during the financial year. Budgets are prepared on the same basis as annual accounts. This enables like-for-like comparisons to be made between planned and actual expenditure and income and also reflects practice in the private sector which uses accrual accounting.
- 1.10 Collectively this regime is known as resource accounting and budgeting (RAB). Where executive NDPBs and other public bodies have external sources of income, such as income from fees and charges and donations, their budgets are set on a net expenditure basis. For executive NDPBs, which have unpredictable demand led income streams from external sources, remaining within budget is especially challenging, particularly at a time when economic conditions are unfavourable.
- 1.11 The budget sets out an executive NDPB's financial plans for the year, and reflects its corporate plan, while the annual accounts report what actually happened. Therefore, it is essential for the exercise of good financial control and financial management that budgets and annual accounts are prepared on the same basis. Financial management information produced during the year for budget monitoring and control purposes should also include information prepared on this same basis.

Scottish Government funding of executive NDPBs

- 1.12 An executive NDPB's budget is set on a resource basis but expenditure is largely funded on a cash basis during the financial year. The purpose of funding on a cash basis is to ensure that public borrowing as a whole is undertaken efficiently i.e. to ensure the UK government is not borrowing more cash than is required for the public sector to pay its bills. This means that any outstanding creditors at the end of the financial year may be funded by the following year's cash, and long-term liabilities only require cash funding when they are due to be paid. Depreciation charges on fixed assets (both tangible and intangible) and the charge for the cost of capital are planned within the resource budget but don't require any cash funding.
- 1.13 Cash funding received from an executive NDPB's sponsor directorate is known as grant-in-aid (or GIA). Following a spending review, sponsor directorates are in a position to advise executive NDPBs of the amount of grant-in-aid they are likely to receive over the following three year period. However, the amount is not fixed following completion of the spending review process and formal notification of grant-in-aid is given each year in a letter from the sponsor directorate. Official notification must be given annually as funding is dependent on Scottish parliamentary approval of the overall Scottish budget via the Budget Act. The overall Scottish budget itself is dependent on the UK parliament passing the Annual Appropriation Act which provides authority for UK spending.

- 1.14 Funding arrangements, along with resource accounting and budgeting requirements, essentially set executive NDPBs two key financial targets:
- An overall resource budget, limiting the actual net expenditure incurred during the financial year, which should not be exceeded; and
 - An overall cash allocation which means that cash drawn down from the sponsor directorate should not exceed the amount notified by the sponsor department.
- 1.15 These targets must be managed together as cash is required to fund salaries and most other items of expenditure. However, bills are not always paid in the same financial year as the related expenditure is incurred.

Grant-in-aid

- 1.16 Executive NDPBs operate at arm's length – meaning that the Scottish Government does not seek to impose detailed controls over their day-to-day spending. However, spending must be undertaken within a framework of agreed controls which are set out in an executive NDPB's Management Statement and associated Financial Memorandum.

What are the Management Statement and Financial Memorandum?

The Management Statement sets out the broad framework within which the executive NDPB will operate and the Financial Memorandum sets out aspects of the financial framework in greater detail. These are drawn up by the sponsor directorate in consultation with the NDPB. It is important to note that these documents do not convey any legal powers or responsibilities.

An executive NDPB's Management Statement and Financial Memorandum are reviewed and updated periodically, normally every two to three years.

Non-executive directors should ensure that they are aware of the content of their NDPB's Management Statement and Financial Memorandum.

- 1.17 There are a number of important aspects of funding arrangements relevant to the role of the board which are discussed in more detail below:
- Notification of grant-in-aid
 - Drawdown arrangements for grant-in-aid
 - Accounting for grant-in-aid

Notification of grant-in-aid

- 1.18 The sponsor directorate notifies the executive NDPB of its cash allocations and also specific resource allocations for the forthcoming financial year for depreciation and the cost of capital. Allocations are elements of either the overall cash allocation or the NDPB's resource budget and must be monitored separately during the financial year.

- 1.19 In addition, the sponsor directorate will notify the executive NDPB of ministerial priorities and key performance indicators with prescribed targets. Key performance indicators can be specific to the activities of the executive NDPB or can relate to broader initiatives being pursued by the Scottish Government, such as reducing energy costs and carbon footprint. Some executive NDPBs will have statutory targets which must also be met.
- 1.20 An executive NDPB should expect to receive a final notification of its grant-in-aid, the grant-in-aid letter, before the start of each financial year the grant-in-aid relates to i.e. before 1 April each year. The final notification, as opposed to earlier provisional notifications, provides the NDPB with certainty about its funding for the year and enables budgets for the year to be finalised. It also confirms the key performance indicators which should prompt NDPBs to ensure that systems and processes to gather and monitor the financial, or other information which is required to demonstrate performance, are in place. Ideally, systems and processes should be in place from the beginning of the financial year.

What cash allocations are included in the grant-in-aid letter?

Cash allocations fall into three categories:

- **Grant-in-aid to fund operational costs**
Operational costs are the day to day running costs of the executive NDPB such as staff costs and premises costs. All executive NDPBs will have operational costs.
- **Grant-in-aid to fund programme costs**
Programme costs are the costs of delivering particular initiatives, normally associated with the delivery of frontline services. Not all NDPBs will have programme costs.
- **Grant-in-aid to fund capital projects**
Capital projects involve expenditure on the construction, development or purchase of fixed assets. Capital projects are one off projects which are undertaken so that NDPBs can improve the delivery of their functions over the longer-term. Grant-in-aid to fund capital projects must be used exclusively on capital projects. Grant-in-aid to fund operational costs may only be used to fund capital projects with the agreement of the sponsor directorate.

- 1.21 It is important that the board is aware of any difficulties or delays encountered in negotiations with the sponsor directorate about next year's funding and seeks any explanations as to why. The Chairman and the Chief Executive have a lead role in any dialogue between the executive NDPB and the sponsor directorate surrounding the agreement and notification of grant-in-aid. If notification is not received by 1 April, the executive NDPB has no authority to spend and a letter of comfort must be obtained from the sponsor directorate to enable spending to continue.
- 1.22 Prior to the final grant-in-aid letter being received, there will be discussions between the executive NDPB and its sponsor directorate surrounding cash and resource allocations for the year. Resource allocations comprise depreciation and the cost of capital. Correspondence from sponsor directorates may provide an indication of cash and specific resource allocations in writing prior to the final notification. Discussions with the sponsor directorate about funding will coincide with the executive NDPB's annual planning and budgeting processes which are covered in Chapter 2 of the Guide.

Why do NDPBs have separate allocations for depreciation and the cost of capital?

- **Depreciation**

Having a separate allocation for depreciation acts as a control over the fixed assets that an executive NDPB can carry on its balance sheet thereby encouraging the executive NDPB to actively manage its fixed asset base including identifying surplus assets for disposal. If the actual depreciation charge incurred by the NDPB exceeds the allocation for depreciation in the grant-in-aid letter, the NDPB will have to constrain its operational expenditure in order to remain within its combined allocation for operational costs plus depreciation.

Accounting rules require fixed assets, other than land which is owned, to be depreciated over their useful lives. Depreciation charges are non-cash charges and therefore do not impact on the amount of grant-in-aid available to drawdown, unless actual depreciation exceeds the resource allocation for depreciation in the grant-in-aid letter.

- **Cost of capital**

The cost of capital is effectively an interest charge on an executive NDPB's average net assets held during the year. Like depreciation it is a non-cash charge. The cost of capital represents a return to taxpayers on their funding of the executive NDPB and through having an allocation which should not be exceeded the executive NDPB must ensure that taxpayers' funding of its net assets is kept within an agreed level.

The rate of interest is set by HM Treasury and is currently set at 3.5%. However, from 2011-12 the cost of capital is expected to be abolished which will further align government accounting with generally accepted accounting practice.

The cost of capital is recorded as expenditure in the NDPB's accounts but an amount equal to the cost of capital is recorded as income. This means that the cost of capital has no impact on the overall net expenditure of the NDPB.

Draw down arrangements for grant-in-aid

- 1.23 Arrangements for drawing down grant-in-aid from the sponsor directorate are set out in an executive NDPB's Management Statement. Although arrangements may vary, grant-in-aid is normally paid in monthly instalments.
- 1.24 A written application must be made to the sponsor directorate to support each request for funds i.e. the NDPB must provide evidence of need. Evidence of need is the minimum information the sponsor department requires to enable it to monitor:
- How the NDPB is managing its cash flow.
 - Actual expenditure to date and estimated expenditure of grant-in-aid for the year.
 - Actual expenditure to date and estimated expenditure for the year compared to the NDPB's resource budget.
- 1.25 Grant-in-aid should not be paid out in advance of need which means that cash in the NDPB's bank accounts from draw downs of grant-in-aid must be kept at a level consistent with efficient operation of the NDPB but no higher.

Accounting for grant-in-aid

- 1.26 Grant-in-aid is accounted for differently from other income in the annual accounts of executive NDPBs.
- 1.27 NDPBs were once required to treat grant-in-aid, except grant-in-aid for capital purposes, as income within the annual accounts until a change to the accounting framework was introduced in 2007-08. At present, grant-in-aid is treated as part of the financing of the executive NDPB and is recorded directly within the NDPB's reserves.
- 1.28 As a consequence of treating grant-in-aid as financing, executive NDPBs report their net expenditure within their annual accounts, not whether they have achieved a surplus or deficit. This change has not been extended to NDPBs which are companies or charities, or both, to ensure that these forms of executive NDPB continue to comply with company and charity accounting requirements as appropriate. Chapter 3 contains further information on the accounting framework for NDPBs.

End year flexibility

- 1.29 If an executive NDPB assesses that it will have unspent resources at the end of the financial year (i.e. it will not have spent its overall cash allocation and specific resource allocations) there is a mechanism called end year flexibility, or EYF, which can be used to carry forward resources from one financial year to another. This means that if an executive NDPB has a capital project or a programme where the timetable has slipped, it can notify the Scottish Government to request that unspent resources are transferred to the following year. End year flexibility is therefore designed to avoid unnecessary spending towards the end of the financial year. It also means that an executive NDPB's activities are not constrained by an arbitrary cut off date i.e. 31 March each year.
- 1.30 Good quality financial management information is vital for executive NDPBs to identify potential under spends at an early stage as requests for end year flexibility must be submitted to the sponsor directorate at the earliest opportunity and in accordance with any deadline agreed with the sponsor directorate. If deadlines for requests for end year flexibility are not met then there is a risk that the executive NDPB will not receive permission to carry forward resources. It is also important to note that access to end year flexibility is not automatic.
- 1.31 At Scottish Government level, unspent resources in one area of the Scottish public sector can be reallocated to another area if notified sufficiently early. Early notification also gives the Scottish Government the opportunity to request that the UK Parliament authorises the carry forward of any unspent resources across the Scottish budget to the following year. End year flexibility arrangements are set out in Chapter 11 of the *Statement of Funding Policy* published by HM Treasury.
- 1.32 Executive NDPBs should also report potential overspends to their sponsor directorate as soon as these are identified. Early notification to the sponsor directorate gives the Scottish Government the opportunity to intervene to support the NDPB and to ensure that the Scottish budget as a whole remains in balance i.e. is met. However, executive NDPBs remain responsible for managing their financial resources and should take all reasonable steps to address any projected overspends.

Scottish Public Finance Manual

"It is essential that the board has processes and systems in place to ensure compliance with the Scottish Public Finance Manual (SPFM). Board members should look to the staff of the public body for advice and assurance that the SPFM is being complied with but should also be aware of the areas covered by the SPFM and have access to a copy for reference purposes." (On Board, paragraph 4.1)

- 1.33 The *SPFM* is issued by Scottish Ministers and governs all matters relating to public finance and reporting in public bodies and is designed to facilitate compliance with the Public Finance and Accountability (Scotland) Act 2000. It provides guidance for executive NDPBs and their sponsor departments:
- on the relevant statutory, Scottish parliamentary and administrative requirements;
 - emphasises the need for economy, efficiency and effectiveness; and
 - aims to promote good practice and high standards of propriety and financial management.
- 1.34 The *SPFM* covers a number of matters dealt with throughout this Guide, not least how executive NDPBs are funded.

References for this chapter:

See glossary for the meaning of accrual accounting, capital project, creditors, deficit, depreciation, financial year, generally accepted accounting practice (GAAP), intangible fixed assets, liabilities, net assets, net expenditure, non-cash charges, reserves, surplus, tangible fixed assets and useful life.

The *Statement of Funding Policy* (October 2007):
www.hm-treasury.gov.uk/d/pbr_csr07_funding591.pdf

Chapter 11 of the *Statement of Funding Policy* covers end year flexibility arrangements for the devolved administrations.

Scottish Government website:
www.scotland.gov.uk

Scottish Government information on setting the Scottish budget:
www.scotland.gov.uk/Topics/Government/Finance/18127/11754

The *Scottish Public Finance Manual*:
www.scotland.gov.uk/Topics/Government/Finance/spfm/Intro

Information in the *SPFM* on accountability, including a model Management Statement and Financial Memorandum:
www.scotland.gov.uk/topics/government/finance/spfm/accountability

On Board: A Guide for Board Members of Public Bodies (2006):
www.scotland.gov.uk/Publications/2006/07/11153800/0

The Public Finance and Accountability (Scotland) Act 2000:
www.opsi.gov.uk/legislation/scotland/acts2000/asp_20000001_en_1

The above links are live links in the electronic version of the Guide, which can be downloaded at:
www.icas.org.uk/ndpbguide

Chapter 2: Planning, monitoring and decision-making

Chapter overview

- 2.1 This chapter examines the role of the board in translating strategy into plans and actions in the context of available funding. Through including information about setting and monitoring the annual budget and the relationship between budget monitoring and the wider performance monitoring arrangements, chapter 2 aims to help boards provide effective scrutiny and challenge in the context of the tighter constraints on public spending which the UK now faces. Audit Scotland's 2010-11 work programme included an assessment of the effectiveness of boards across different types of public body, its report the *Role of boards* was published in September 2010. In addition to reporting on board effectiveness, the report clarifies the role and responsibilities of boards across a broad spectrum of issues.
- 2.2 The sections in this chapter are:
- Annual planning and budgeting process: an overview
 - Translation of strategy into plans and budgets
 - Monitoring and decision-making

Annual planning and budgeting process: an overview

- 2.3 Each year an executive NDPB must prepare plans and budgets for the next financial year prior to its commencement. This means the board should be looking ahead at the same time as monitoring performance against the current year's objectives, including the achievement of financial targets.
- 2.4 The board of an executive NDPB is normally responsible for the approval of its updated corporate plan, and the more detailed annual business (or operational) plan, before these are submitted to the sponsor directorate for final approval by Scottish Ministers. The corporate plan and business plan should demonstrate alignment between the corporate objectives of the NDPB and the Scottish Government's national outcomes contained within the National Performance Framework. Further information on the National Performance Framework and guidance on the outcome based approach is available on the Scottish Government website. This message was reinforced by John Swinney MSP, Cabinet Secretary for Finance and Sustainable Growth, in a letter to Scottish public bodies in May 2009. Mr Swinney's letter is available on the Institute for Government website.
- 2.5 Board involvement in the planning process is likely to increase as public sector spending is reduced across the UK and greater challenge and scrutiny is required to ensure that planning assumptions are robust and that plans remain on track.
- 2.6 Corporate plans, business plans and budgets must contain spending plans which are in line with:
- the funding allocated by Scottish Ministers as part of the spending review process, including any end year flexibility; and
 - any funding which has been approved by Scottish Ministers on an ad hoc basis.
- 2.7 An executive NDPB's corporate plan is the starting point for its annual business planning and budget setting process. The board should scrutinise, in particular, high value, novel or contentious expenditure proposals included in corporate and business plans. Annual budgets are normally approved by the board prior to final approval by the Scottish Ministers via the sponsor directorate.

- 2.8 Cash and non-cash resources to fund the executive NDPB are approved by the Scottish Parliament in the annual Budget Act, with formal notification given to executive NDPBs by the sponsor directorate in the annual grant-in-aid letter. Budgets should be developed which demonstrate how the executive NDPB plans to use both its cash allocation and resource budget for the year.

Translation of strategy into plans and budgets

‘One of the key tasks of the board is to establish the mission, aims and objectives of the public body.’ (On Board, section 3.6)

- 2.9 An executive NDPB’s corporate plan sets out how it will address long-term strategic objectives over a period of about three years, normally coinciding with the Scottish Government’s spending review period. The final year of a corporate plan usually forms year one of the next three year corporate plan. If the spending review does not take place as normal, executive NDPBs should still update their corporate plans annually with a three year time horizon. However, corporate plans prepared in this way will only receive ministerial approval for the year ahead.
- 2.10 The corporate plan should include an analysis of the environment in which an executive NDPB operates. This aspect of the corporate plan is brought into sharper focus by current and predicted future economic conditions and the impact these are expected to have on public sector spending.

What are the key responsibilities of the board in managing the planning process?

The board should:

- Ensure that effective long term and medium term planning takes place
- Ensure that plans reflect the body’s statutory duties and the policies and priorities of the Scottish Government
- Consider, challenge and if necessary change plans
- Review the plans and performance against them on a regular basis

On Board, section 3.6

- 2.11 With the prospect of spending reviews for the foreseeable future bringing reductions in public expenditure, the board should be taking steps to ensure that its executive NDPB is well prepared to meet these challenges by considering how the NDPB should manage the corporate planning process and how the board can provide the vision required to meet today’s and tomorrow’s financial and operational challenges. The board also needs to ensure that as a body they have a sufficient understanding of executive NDPB funding and financial reporting arrangements in order to provide effective scrutiny in more difficult times. Audit Scotland’s publication *Improving public sector efficiency* contains recommendations relevant to the financial management of executive NDPBs, which reflect the current economic climate.

Improving public sector efficiency

“Without examining options, such as more flexible deployment of staff and reduced staffing levels, rationalising the assets used and seeking alternative ways of delivering services, public bodies may not be able to reduce their costs while maintaining the levels and quality of front-line services. To meet the challenges presented by the current economic climate a more fundamental approach is needed.” (Improving public sector efficiency, paragraph 12)

In February 2010, Audit Scotland published *Improving public sector efficiency*, a report on savings achieved in the first year (2008-09) of the Scottish Government’s Efficient Government Programme, which aims to deliver £1.6 billion efficiency savings across the Scottish public sector over the three years to 2010-11. The report contains fourteen recommendations, with eleven addressed to both the Scottish Government and Scottish public bodies.

Recommendations relevant to executive NDPBs include:

- Applying a priority based approach to budgeting and spending
- Improving collaboration and joint working, overcoming traditional service boundaries
- Improving information on costs, activity, productivity and outcomes, including setting baselines to measure performance against
- Maintaining the momentum of activities and initiatives to improve purchasing and asset management and extending shared services
- Strengthening the involvement of front-line staff, service providers and users in redesigning public services

The full report is available on the Audit Scotland website.

- 2.12 There is greater pressure than at any time in recent years on executive NDPBs to identify and deliver efficiency savings through the planning process, which will mean delivering “more for less”, and providing evidence that this has been achieved. The annual business plan and budget will be the key means by which an executive NDPB demonstrates how it intends to deliver its objectives and achieve efficiency savings. Executive NDPBs which are extending core services to meet new statutory obligations or additional objectives within the corporate plan may see an increase in the funding they receive for the financial year: however the increase may be less than originally anticipated. The board should examine, challenge and if necessary change proposals for the achievement of efficiency savings.
- 2.13 Across the UK, it is likely that efficiency savings will not be sufficient in future to fill the funding gap between the resources needed to fund public services at their current or intended future level and the resources available. Decisions about cuts in public services will be made in the political arena and future spending reviews will be particularly challenging for the public sector. Any cuts could impact on the overall aims, objectives and responsibilities of the executive NDPB and it is vital that the board keeps up to date with changes in income and expenditure patterns which could impact at a later date on their NDPB’s finances. The board should be considering how to address any current and anticipated future pressure on funding as part of the executive NDPB’s risk management processes.
- 2.14 The executive NDPB will need to develop robust business cases for capital and other projects it wishes to include in the corporate plan in support of its objectives. The existence of tighter financial constraints will tend to encourage more innovative solutions to delivering services and

to delivering value for money. Innovation brings risks therefore the board should ensure that the financial implications of any new risks attached to new proposals are addressed within the executive NDPB's risk management framework. Budgets include more detailed information on financial plans than do corporate plans. However, it is important that the board discusses and forms a view on robustness of cost and income estimates and the concomitant risks at the corporate planning stage by examining and challenging the key underlying assumptions.

- 2.15 Stress testing (or scenario planning) can be used when looking at the robustness of underlying assumptions. This involves looking at the extent to which costs estimates may change if major underlying assumptions are adjusted for different scenarios. This approach will enable the board to consider the likelihood (risk) that the underlying assumptions may vary and to determine in advance what steps could be taken, if they do vary, to ensure that the executive NDPB's finances remain on track. Executive NDPBs which depend in part on non-government sources of income, such as fees, charges and licences, need to pay particular attention to how changes in planned income may impact on financial performance and the achievement of a balanced budget.
- 2.16 Non-executive directors are appointed by the Scottish Ministers to represent ministerial interests and to ensure the delivery of government policy. They are also required to act as advisors to Ministers. It is vital that non-executive directors bear this in mind during the planning process.

Monitoring and decision-making

"Plans and budgets should be continually monitored. Regular monitoring reports should be produced both for internal purposes and to meet the information needs of the board and the sponsor directorate."
(On Board, section 4.2)

- 2.17 Plans and performance measures must be continually monitored throughout the year and the board should receive information on performance from the management team of the NDPB at least quarterly. The focus of budgetary and management information systems should be progress towards meeting the NDPB's financial and non-financial targets and broader objectives. Therefore, these information systems should demonstrate a clear link between inputs (i.e. resources) and outputs (i.e. results) and outcomes. Outcomes indicate a level of performance in relation to objectives.
- 2.18 The board should review its management information needs periodically to ensure that its financial and other information needs continue to be met. These needs may be more likely to change in times of financial pressure. It is particularly important that financial reporting systems which will deliver the information needs of both the senior staff of the executive NDPB and of the board are established prior to the commencement of the next financial year. By establishing information needs and reporting systems, with the appropriate controls, the executive NDPB and the board will have the means to evaluate the information needed to monitor performance and to make decisions during the year: this will also provide the executive NDPB with the means to report on overall performance within the annual report and accounts. Having robust systems and controls in place ensures the accuracy of the information produced and enables the executive NDPB and the board to place reliance on the information as a basis for decision-making. Most importantly the board will be able to provide scrutiny and challenge based on a realistic picture of the executive NDPB's performance.
- 2.19 Boards often use committees to examine issues in detail and this can strengthen the role of the board. However, the board should ensure that it does not become overly reliant on committees by providing sufficient board level challenge to the conclusions of those committees. The board needs to be comfortable that what each committee is doing is actually what the board needs. Committees should have written remits and terms of reference which should be kept under review, possibly annually.

- 2.20 As a board matures it could move towards exception reporting for some issues i.e. only receiving reports on issues where the results are not as expected, for example, if a target is not going to be met. This reduces the amount of routine information provided to the board and focuses attention on key issues where the NDPB is being challenged.
- 2.21 The following issues are covered in this section with the aim of linking processes to some of the practical issues involved:
- Risk management arrangements
 - Internal audit
 - Statement on internal control
 - Performance measurement
 - Financial management information

Risk management arrangements

“The board should ensure that there is a system in place for continuous risk management in the public body which extends from the front line services through to the board. This involves having a framework of prudent effective controls in place to enable risks to be assessed and managed. The board itself should regularly review the key business risks affecting the organisation.” (On Board, section 4.6)

- 2.22 The delivery of the executive NDPB’s objectives is the responsibility of its management. Having robust arrangements to identify, evaluate and record the risks faced by the NDPB supports the achievement of its objectives. NDPBs operate in a dynamic environment therefore an executive NDPB should review its risks on a regular basis both during the annual planning process and during the financial year.
- 2.23 As part of the board’s responsibility to ensure risk management arrangements are in place and to review the key business risks on a regular basis, the board should ensure that the risk management process itself remains focused and manageable. This could mean challenging management to reduce or remove risks in addition to identifying any new risks which may need to be added to the risk register. Providing this degree of challenge will ensure that risk management is dynamic and embedded within the NDPB’s overall control environment at all levels of involvement. Internal audit is a key resource in assessing the robustness of controls established to manage risk.

Internal audit

“Internal audit is a type of management control. It is an internal appraisal service, established by the management of an organisation which reviews the internal control system. It should effectively examine, evaluate and report on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources.” (On Board, section 4.7)

- 2.24 The service provided by internal audit is a key source of assurance to the board on whether the executive NDPB has established adequate systems and internal controls. The head of internal audit should have direct access to the board and the Chairman of the board. Scottish Government guidance on internal audit arrangements and procedures is included in the *Scottish Public Finance Manual (SPFM)*.
- 2.25 The role of internal audit has evolved over the years with the service now providing objective assurance not just on financial controls but providing advice on risk management arrangements and assurance on controls generally.

- 2.26 Boards should also consider how the NDPB's internal audit service could:
- provide assurance on systems and controls established to monitor the achievement of efficiency savings;
 - identify opportunities which would create savings without compromising the effectiveness of controls in place; and
 - carry out ad hoc enquiries and investigations (e.g. travel and subsistence expense claims).
- 2.27 The work of internal audit will also contribute to the Accountable Officer's annual review of the executive NDPB's system of internal control and his or her signing of the statement on internal control.

Statement on internal control (SIC)

- 2.28 The statement on internal control is a signed statement by the Accountable Officer which describes the executive NDPB's risk and control framework and sets out the results of the Accountable Officer's review of its effectiveness. This is a requirement of the *SPFM*, which includes detailed guidance on the preparation of the statement by Scottish public bodies.
- 2.29 Each year a statement on internal control must be published as a component part of the executive NDPB's annual report and accounts. Further information about the statement is set out in chapter 3.

Performance measurement

"Efficiency indicators and performance measurement and business targets are an essential tool to help focus on what is required and review how resources have been managed and objectives met." (On board, section 4.5)

- 2.30 Executive NDPBs are likely to have a number of performance measures with targets which must be monitored during the year and reported in the annual report. Performance measures and targets may arise from a number of sources, for example:
- Statutory measures and targets

These are measures and targets which are specified in legislation which can only be amended with the approval of the Scottish Parliament. Therefore statutory measures and targets are unlikely to change from year to year.

Statutory measures and targets are normally non-financial targets and tend to focus on the effectiveness of an executive NDPB's service, for example, specifying the maximum time the NDPB has to process and issue a licence following receipt of an application.

- Measures and targets agreed with the sponsor directorate

Measures and targets agreed annually with the sponsor directorate are likely to be a mixture of financial and non-financial. For example, an executive NDPB with external sources of income may be expected to generate a specified amount of income or a NDPB which opens its doors to the public may have a target to increase visitor numbers. It is also possible that measures and targets may be linked to policy matters which are not specific to the NDPB, for example, environmental measures such as carbon and waste reduction targets.

Unlike statutory measures and targets these are more likely to vary between financial years.

- Internally set measures and targets

An executive NDPB can set its own measures and targets, providing where appropriate trend information over a period of years. *On Board* suggests that trend information reported in the annual report should cover a five year period. This coincides with the strategic planning horizon which is normally five years, two years longer than the period covered by the corporate plan.

2.31 As performance measures can emanate from a number of sources there is a risk that the executive NDPB finds itself working towards the achievement of too many or irrelevant measures. The board has the ability to take an overview of the measures and targets being prepared by the executive NDPB and is well placed to advise the NDPB's senior management and the sponsor directorate whether individual targets are 'SMART':

- Specific
- Measurable
- Attainable
- Relevant/ Realistic
- Time-based

... and whether as a whole these will improve service performance, increase efficiency, transparency and accountability.

2.32 Developing systems to collect information for the production of performance measures will use valuable resources, and time spent on monitoring could be excessive. Accountability does not increase in direct proportion to the number of measures produced. It is important to keep these under review and the executive NDPB should be prepared to drop targets, where it has the authority, which are no longer relevant or where the reason for having a target, such as to improve performance in a particular area, has been addressed. This will avoid staff having an inappropriate focus on achieving targets rather than improving performance.

2.33 Having too many performance measures and targets is inefficient and can distract attention from the achievement of improvements in key areas. It is better to focus on a smaller number of key performance measures and targets which are linked to the corporate plan.

Financial management information

"Any variations between actual spending/use of resources and performance, and planned spending/use of resources and performance must be investigated, and action taken to bring the plan back under control or to change the planning assumptions, if appropriate." (On board, section 4.2)

2.34 Once plans and budgets are set, the board is responsible for monitoring the NDPB's performance and for ensuring that corrective action is taken if plans and budgets are off course. In order to do this effectively the board requires timely financial management information which is tailored to meet its needs. The design of the information and its frequency should be driven by the particular circumstances of the NDPB: there is no one size fits all approach and what may be suitable for one NDPB may not be suitable for another. It is also vitally important that the board understands the information which is being provided and this will influence its design and content and the amount of detail which is appropriate, including the accompanying narrative commentary.

- 2.35 The board should ensure that the information is sufficient for the purposes of monitoring its key financial targets, which are:
- its overall resource budget; and
 - its overall cash allocation.
- 2.36 The information should also enable the board to monitor other financial targets as required by the grant-in-aid letter, which are discussed in chapter 1 of the guide.
- 2.37 An essential feature of financial management information is that it must include a forecast of income and expenditure for the year in comparison to the budget, only then can the board assess whether the correct action has been identified by management and is appropriate to rectify any projected over spends, or indeed under spends.
- 2.38 Forecast cash flow information will be required by management to assess the cash needs of the NDPB. In addition, forecast cash flow information will be helpful to the board in assessing whether the NDPB will remain within its overall cash allocation.
- 2.39 Financial management information produced during the year for monitoring and control purposes should be prepared on the same basis as the annual budget and the annual accounts. This does not mean that financial management information should be prepared in the same format as the annual accounts. The format of financial management information is a presentational issue which should not affect the basis on which it is prepared.
- 2.40 The narrative commentary accompanying the figures is an essential part of the management information produced. The management commentary should include an overview of the executive NDPB's current and forecast performance against budget and key financial targets, explanations for key variances and planned corrective action. It could also include an explanation of any technical terms used to assist the board's understanding of the information provided.

Some tips for boards on financial information

- Regularly review the content and presentation of financial information, including the level of detail provided, perhaps annually, to ensure that it remains fit for purpose
- Ensure that financial information clearly demonstrates how the NDPB is performing in relation to its financial targets, supplemented by information on performance against wider corporate objectives
- Ensure that financial information is provided in a timely manner and sufficiently frequently to enable the board to provide effective scrutiny and challenge
- Be prepared to ask for less information if the volume provided is clouding the issues
- Always be prepared to ask management to explain any difficult technical terms
- If plan A does not deliver as anticipated, ensure that there is a plan B
- Apply the triangulation of information concept as a means of testing the validity of underlying assumptions

Triangulation means corroborating one source of information with another source. If the two sources of information suggest different outcomes, the board should then seek an independent third source of information, for example, from a professional advisor, to further test the underlying assumptions.

References for this chapter

See glossary for the definition of Accountable Officer, inputs, outcomes and outputs.

Audit Scotland, the *Role of Boards* (2010):

www.audit-scotland.gov.uk/work/central_national.php?year=2010

Scottish Government website:

www.scotland.gov.uk

Information on the national performance framework:

www.scotland.gov.uk/About/scotPerforms

Information on the outcome based approach:

www.scotland.gov.uk/Topics/Government/public-bodies/effective-pb-programme/Approach

Institute for Government:

www.instituteforgovernment.org.uk

Letter from the Cabinet Secretary for Finance and Sustainable Growth (7 May 2009):

www.instituteforgovernment.org.uk/pdfs/john-swinney.pdf

On Board: A Guide for Board Members of Public Bodies (2006):

www.scotland.gov.uk/Publications/2006/07/11153800/0

Audit Scotland, *Improving public sector efficiency* (February 2010)

www.audit-scotland.gov.uk/work/all_national.php?year=2009

Scottish Public Finance Manual guidance on internal audit arrangements:

www.scotland.gov.uk/Topics/Government/Finance/spfm/internaud

The above links are live links in the electronic version of the Guide, which can be downloaded at:

www.icas.org.uk/ndpbguide

Chapter 3: Stewardship and the annual report and accounts

Chapter overview

- 3.1 This chapter provides information about the preparation and content of the annual report and accounts to enable the board to provide meaningful scrutiny and challenge surrounding the year-end reporting process.
- 3.2 The preparation and approval of the annual report and accounts is the final stage of the annual financial cycle. The annual report and accounts report what has happened in the past year and as historic documents in a dynamic and fast moving world they are perceived by some as being of limited value. However, for the NDPB and the board the annual report and accounts are important in demonstrating to the sponsor directorate, to the Scottish Parliament, and to the public how they have met their stewardship responsibilities during the financial year.
- 3.3 The sections in this chapter are:
- Board responsibility for approving the annual report and accounts
 - Overview of annual report and accounts requirements
 - Elements of the annual report: narrative and other information accompanying the accounts
 - Financial reporting framework
 - Format of the accounts
- 3.4 The annual accounts are frequently referred to in publications and guidance as the financial statements. The guide refers throughout to “the annual accounts” or “the accounts”.

Board responsibility for approving the annual report and accounts

“The board is responsible for approving the annual accounts and ensuring that the Minister is provided with the annual report and accounts to be laid before the Scottish Parliament.” (On Board section 4.4)

- 3.5 An executive NDPB must prepare an annual report and accounts for each financial year, which are sent to the Minister, via the sponsor directorate, for laying before the Scottish Parliament. The annual report and accounts must be laid no later than nine months after the end of the financial year. A combined annual report and accounts must be prepared, unless specific dispensation is given by Scottish Ministers. For an executive NDPB the requirement to prepare accounts arises from the Finance and Accountability (Scotland) Act 2000 (the 2000 Act) or its founding legislation. For NDPBs which are companies or charities, or both, company law and charity law, as appropriate, also include a statutory requirement to prepare accounts.
- 3.6 The annual accounts are subject to scrutiny by an external auditor who issues a report on the accounts following board approval and sign off by the Accountable Officer (normally the Chief Executive). Further information on external audit is set out in chapter 4.

Overview of annual report and accounts requirements

- 3.7 The annual report and accounts must be prepared in accordance with the *Government Financial Reporting Manual (FReM)*, which applies to most central government bodies. The *FReM* is prepared by HM Treasury following consultation with the Financial Reporting Advisory Board (FRAB) and is issued by the relevant authorities in Scotland, in England and Wales, and in Northern Ireland. In Scotland, the relevant authority is the Scottish Government i.e. Scottish Ministers. FRAB is a board of independent experts which oversees the development of financial reporting guidance across

the UK public sector. Both the Scottish Government and Audit Scotland are represented on FRAB. The *FReM* is updated for each financial year.

- 3.8 Scottish Ministers, in agreement with the Public Audit Committee of the Scottish Parliament, are responsible for approving the form and content of the annual report and accounts. In practice, the form and content of the annual report and accounts is set out in the *FReM* and should be applied by the executive NDPB. The executive NDPB is notified of this requirement in the form of a direction from Scottish Ministers – known as an accounts direction.
- 3.9 The board should enquire how the executive NDPB ensures that all the necessary requirements for the annual report and accounts are complied with.

Executive NDPBs with a difference – NDPBs which are companies or charities

Executive NDPBs which are companies are also required to comply with the reporting and accounting requirements in the Companies Act 2006 and to file their directors' report and accounts with Companies House.

Executive NDPBs which are charities are also required to comply with the reporting and accounting requirements in the Charities and Trustee Investment (Scotland) Act 2005 and to file their annual report and accounts with the Office of the Scottish Charities Regulator (OSCR).

Executive NDPBs which are charitable companies are required to comply with both company and charity law.

Executive NDPBs which have charitable status, including charitable companies, are not permitted to apply International Financial Reporting Standards. Instead they are required to follow the accounting guidance in *Accounting and Reporting by Charities: Statement of Recommended Practice (Charities SORP)*. Accounting guidance within the *Charities SORP* is an interpretation of UK accounting standards for the charity sector.

The *FReM* requires executive NDPBs which are charities to follow the principles set out therein and to provide any additional disclosures it requires where these go beyond the *Charities SORP* or the Companies Act 2006.

Trustees' annual report guidance within the *Charities SORP* should be followed. For charitable NDPBs which are companies this is in addition to the directors' report requirements within the *FReM* and the Companies Act 2006. Conversely, charitable NDPBs which are not companies should follow the trustees' annual report guidance within the *Charities SORP* rather than the directors' report guidance within the *FReM*.

Elements of the annual report: narrative and other information accompanying the accounts

- 3.10 Narrative reporting by the UK public sector draws substantially on private sector practice, particularly requirements placed on medium-sized and large companies, including listed companies, by company law, and on listed companies, by the *UK Corporate Governance Code*. The *UK Corporate Governance Code* replaces the *Combined Code on Corporate Governance* for accounting periods commencing on, or after, 29 June 2010.
- 3.11 The *FReM* requires an annual report to be prepared to accompany the annual accounts, even if an executive NDPB is not required by statute to prepare an annual report.
- 3.12 The narrative elements of the annual report which the NDPB must prepare are:
- Directors' report
 - Remuneration report
 - Statement of Accountable Officer's responsibilities
 - Statement on internal control
- 3.13 This Guide does not cover any other narrative information which an executive NDPB may be required to prepare on an annual basis or may choose to prepare.

Directors' report

- 3.14 The content of the directors' report is based on the company law requirements for medium-sized and large companies. In seeking to adopt private sector practice, company law requirements are subject to a degree of interpretation by the public sector.
- 3.15 The key elements of the directors' report are:
- names of all persons, who at any time during the year, were non-executive directors or executive directors or persons who held the post of Chairman or Chief Executive; and
 - management commentary, including information on environmental, social and community matters and performance against statutory targets, targets agreed with the sponsor directorate and internally set targets.
- 3.16 Narrative reporting in the private sector has taken a step forward with the introduction of the business review for medium-sized and large companies. The *FReM* requirements for a management commentary draw on the business review.
- 3.17 The Companies Act 2006 sums up the objectives of the business review in relation to a company, which is to "inform members of the company and help them assess how directors have performed their duty to promote the success of the company". For an executive NDPB, the management commentary provides it with an opportunity to communicate to stakeholders how it is meeting its strategic objectives and performing financially, and the principal risks and uncertainties facing the NDPB.
- 3.18 The *FReM* specifies a number of additional matters which the executive NDPB must report. This includes details of company directorships and other significant interests held by board members which may conflict (or may be perceived to conflict) with their responsibilities towards the NDPB. However, where an up-to-date register of interests is open to the public, such as on the NDPB's website, disclosure in the directors' report may be limited to how to access the information.

Remuneration report

3.19 The remuneration report requirements are based on the Companies Act 2006 requirements for listed companies. The following key information must be included in the remuneration report:

- the names of members of the remuneration committee;
- details of the NDPB's remuneration policy for non-executive and executive directors;
- non-executive board members' remuneration analysed into bandings of £5,000;
- the Chairman's, Chief Executive's and executive directors' remuneration including salaries, bonuses and benefits in kind, also analysed into bandings of £5,000;
- the pension entitlements of the Chief Executive and executive directors; and
- payments for compensation on early retirement and for loss of office.

Information about the remuneration of any individual who ceased to hold office during the year should also be disclosed.

3.20 Employers' responsibilities under the Data Protection Act 1998 regarding the disclosure of personal data, including data on salaries and pensions is included in the *Scottish Public Finance Manual (SPFM)*.

Statement of Accountable Officer's responsibilities

3.21 This is a statement signed by the Accountable Officer which explains his or her personal responsibility to Scottish Ministers for preparing the annual accounts. It must appear within the document containing the annual report and accounts before the statement on internal control.

Statement on internal control

3.22 The statement on internal control is a signed statement by the Accountable Officer which describes the executive NDPB's risk and control framework and sets out the results of the Accountable Officer's review of its effectiveness. It is a requirement of the *SPFM*, which includes detailed guidance on the preparation of the statement by Scottish public bodies. The following three key points are highlighted in the *SPFM*:

- the statement should be the end result of a risk management process which is embedded in the planning, operational, monitoring and review activities of the body, these activities being the critical elements of the statement;
- the completion of a statement should be informed and supported by an assurance framework; and
- if significant internal control developments have been, or are, necessary to correct weaknesses, an outline of the actions taken, or proposed, should be included in the statement.

3.23 The statement on internal control was introduced to the UK public sector in 2001, drawing on private sector practice for listed companies set out in the publication *Internal Control: Revised Guidance for Directors on the Combined Code*.

Financial reporting framework

3.24 From 2009-10, guidance within the *FReM* on the preparation of accounts is based on international accounting standards, known collectively as IFRSs (International Financial Reporting Standards), which are issued by the International Accounting Standards Board (IASB). In previous financial years the *FReM* was based on accounting standards issued by the UK Accounting Standards Board (ASB). IFRSs are developed primarily for private sector organisations; therefore the *FReM* adapts or interprets aspects of these standards for use in the public sector context.

- 3.25 The financial reporting framework for the accounts of an executive NDPB normally consists of statutory requirements, plus underlying guidance and standards which must be followed, in this instance the *FReM* and IFRSs. Other legislation may also form part of the financial reporting framework of a NDPB, for example, the Companies Act 2006 for company NDPBs.
- 3.26 The annual accounts of an executive NDPB are required to give a “true and fair view” in accordance with the financial reporting framework which applies to the NDPB and comply with the accounts direction issued by Scottish Ministers. The accounts direction is a statutory direction to each executive NDPB on the form and content of its accounts. Normally, the accounts direction will refer to the *FReM* but it could include additional reporting requirements. The accounts direction is updated from time to time.

What is a true and fair view?

In layman’s terms the meaning of the true and fair view could be summed up as “the accounts are about right.”

There is no statutory definition of the true and fair view, although it is a concept which is central to accounting practice in the UK. Normally accounts will be considered to give a true and fair view if they comply with accounting standards. However, the preparation of accounts is not merely a compliance exercise and requires a degree of judgement. Moreover, there can be exceptional circumstances where departure from accounting standards is necessary for accounts to give a true and fair view.

This following quotation from a legal opinion provides an interpretation of the meaning of true and fair, although the meaning is expressed in negative terms.

“Accounts will not be true and fair unless the information they contain is sufficient in quantity and quality to satisfy the reasonable expectations of the readers to whom they are addressed”

*Leonard Hoffmann QC and Mary H Arden
13 September 1983*

- 3.27 The standard setting process is dynamic and the board can expect to see changes in accounting standards coming through regularly which may impact on the accounts of their NDPB. The IASB has a programme for reviewing and updating its standards to ensure that these remain relevant to the information needs of users of accounts.

Format of the accounts

- 3.28 Accounts consist of a number of primary statements and supporting notes. It is common in the public and wider not-for-profit sector for accounts formats to be tailored to meet the needs of specific types of entity. However, the primary statements of all entities have broadly similar objectives, the key objectives being to report on an entity’s:

- financial performance for the year;
- financial position at the end of the year (i.e. its assets, liabilities, reserves); and
- cash flows during the year.

For the 2009-10 financial year, the board can expect to see the format of the NDPB's accounts change due to the implementation of IFRS. Further changes to the format of the accounts are planned for 2010-11 to further align the format with IFRS, although not all the primary statements are affected.

- 3.29 The key elements of the accounts, including primary statements, are described below, including planned changes for 2010-11. The terminology used to describe the primary statements reflects the illustrative NDPB accounts produced to accompany the *FReM*, which are available on the HM Treasury website. The NDPB referred to in these illustrative accounts, published by HM Treasury, is 'NDPB Green'. A hyperlink to NDPB Green's accounts is given at the end of this chapter. The illustrative accounts do not cover all the items which NDPBs need to account for. Therefore, each NDPB should ensure that it applies the guidance within the *FReM* relevant to its activities.

Net expenditure account or statement of comprehensive net expenditure

- 3.30 The objective of the net expenditure account is to present the NDPB's financial performance. It is the equivalent of the operating cost statement which was required prior to the implementation of IFRS. Normally an executive NDPB's expenditure will exceed its income (before taking account of grant-in-aid), hence the title 'net expenditure account'. As set out in paragraph 1.27, grant-in-aid funding from the Scottish Government is not treated as income for the purpose of these statements.
- 3.31 From the 2010-11 financial year, the net expenditure account will be replaced by the statement of comprehensive net expenditure. This statement effectively extends the net expenditure account to include unrealised gains and losses on the revaluation of assets, such as property and intangible fixed assets.
- 3.32 Gains or losses arising from asset revaluations are unrealised. An unrealised gain means that the value of an asset has increased but that the increase has not been converted into a cash surplus by selling the asset.

Statement of financial position

- 3.33 The statement of financial position was previously known as the balance sheet. The statement of financial position reports the NDPB's net assets and liabilities and its total reserves.

Statement of changes in reserves or statement of changes in equity

- 3.34 The objective of the statement of changes in reserves is to report movements in reserves during the year which are not reflected in the net expenditure account. This statement replaces the previous statement of recognised gains and losses.
- 3.35 From 2010-11 the statement of changes in reserves will be replaced by a statement of changes in equity. The statement has been revised to exclude unrealised gains and losses on the revaluation of certain types of asset which are now to be shown in the statement of comprehensive net expenditure.

Statement of cash flows

- 3.36 The statement of cash flows records the actual movements in cash in the financial year. All cash received (inflows) by the NDPB, and spent (outflows) by the NDPB are shown in aggregate in this statement.

Notes to the accounts

- 3.37 The first note following the primary statements is always the accounting policies note. The other notes to the accounts provide additional information to support the figures in the primary statements. This includes further analysis of the figures and narrative disclosures prescribed by the financial reporting framework.

References for this chapter

See glossary for definitions for Accountable Officer, accounting policies, accounting standards, assets, intangible fixed assets, liabilities, reserves, statement of recognised gains and losses, *UK Corporate Governance Code*, unrealised gains and unrealised losses.

On Board: A Guide for Board Members of Public Bodies (2006):

www.scotland.gov.uk/Publications/2006/07/11153800/0

The Public Finance and Accountability (Scotland) Act 2000:

www.opsi.gov.uk/legislation/scotland/acts2000/asp_20000001_en_1

Government Financial Reporting Manual (FReM):

www.hm-treasury.gov.uk/FReM_index.htm

Financial Reporting Advisory Board:

www.hm-treasury.gov.uk/psr_frab_index.htm

Office of the Scottish Charity Regulator (OSCR):

www.oscr.org.uk

Accounting and Reporting by Charities: Statement of Recommended Practice (The Charities SORP):

www.charity-commission.gov.uk/Charity_requirements_guidance/Accounting_and_reporting/Preparing_charity_accounts/sorpfront.aspx

The *UK Corporate Governance Code* (2010) and

The *Combined Code on Corporate Governance* (2008):

www.frc.org.uk/corporate/ukcgcode.cfm

Scottish Public Finance Manual:

www.scotland.gov.uk/Topics/Government/Finance/spfm/Intro

Information on employers responsibilities under the Data Protection Act 1998. See paragraphs 32 and 33 at:

www.scotland.gov.uk/Topics/Government/Finance/spfm/annualaccounts#10

International Accounting Standards Board:

www.ifrs.org

Illustrative accounts for NDPB Green:

www.hm-treasury.gov.uk/FReM_proformas.htm

The above links are live links in the electronic version of the Guide, which can be downloaded at:

www.icas.org.uk/ndpbguide

Chapter 4: Audit arrangements

Chapter overview

- 4.1 This chapter provides information about the purpose of external financial audit; the standards external auditors must comply with; auditor responsibilities; and auditor's report requirements, to give the board an overview of external audit arrangements.
- 4.2 The sections in this chapter are:
- What is a financial audit?
 - Legal framework and standards for audit and auditors
 - Auditor's report on the annual accounts
 - Other auditor responsibilities

What is a financial audit?

- 4.3 Simply put, a financial audit is an independent assessment of an organisation's annual accounts as presented by its management.
- 4.4 This independent assessment is undertaken by an external auditor in accordance with professional auditing standards. Compliance with these standards enables the external auditor to issue a report on an organisation's annual accounts, including an opinion on whether they are true and fair.

Legal framework and standards for audits and auditors

- 4.5 All executive NDPBs are required to have their annual accounts audited by an external auditor appointed by the Auditor General for Scotland (the Auditor General). The auditor will be either Audit Scotland, which is a public sector organisation, or a private firm of accountants which is registered with a recognised supervisory body, such as The Institute of Chartered Accountants of Scotland, to undertake audit work. The requirement for any public sector body to have an audit is set out in primary legislation. For executive NDPBs this is normally the Public Finance and Accountability (Scotland) Act (the 2000 Act) or their founding legislation. For NDPBs which are companies or charities, or both, company law and charity law, as appropriate, also include statutory requirements for the audit of accounts.
- 4.6 External auditors are required to conduct their work in accordance with the 2000 Act and with Audit Scotland's *Code of Audit Practice*, which requires compliance with standards prescribed by the UK Auditing Practices Board (the APB).
- 4.7 Standards prescribed by the APB are:
- International Standards on Auditing (UK and Ireland) known as ISAs (UK and Ireland)

These standards contain objectives, requirements and application guidance which apply to audits of UK organisations in both the private and not-for-profit sectors. The standards apply to the life-cycle of audits from the planning stage through to issuing the auditor's report and communicating audit findings to the board.

- International Standard on Quality Control (UK and Ireland) 1 known as ISQC1

The requirements of this standard are designed to enable the external audit firm to establish and maintain a system of quality control to provide it with reasonable assurance that: the firm and its

personnel comply with professional standards and applicable legal and regulatory requirements, and reports issued by the firm are appropriate in the circumstances.

- APB's Ethical Standards for Auditors

Ethical Standards contain basic principles and essential procedures covering the integrity, objectivity and independence of external auditors in their auditing of annual accounts.

Auditor's report on the annual accounts

- 4.8 The structure of the auditor's report, which includes the auditor's opinion, is prescribed within auditing standard ISA 700 (UK and Ireland). This standard applies to the auditor's report issued on the annual accounts of a UK organisation. Legislative and regulatory requirements overlay the auditing standard and impact on various aspects of the auditor's report, therefore the external auditor should tailor the auditor's report and opinion to the specific circumstances of the executive NDPB.
- 4.9 Auditor's reports are modified in certain circumstances either to highlight a significant uncertainty to the reader of the accounts or to modify the opinion, for example, if an organisation is unable to provide audit evidence to support a figure or if the auditor disagrees with management about how an item has been accounted for.
- 4.10 The auditor's report is addressed to the person or persons on whose behalf the audit is undertaken. In Scotland, this is normally the executive NDPB, the Auditor General for Scotland and the Scottish Parliament.
- 4.11 Included in the auditor's report is information on:
- The financial information within the scope of the audit
 - The responsibilities of the board, the Accountable Officer and the auditor
 - Whether the Statement on Internal Control is compliant with Scottish Government guidance
 - The basis of the auditor's opinion describing the work undertaken by the auditor with reference to the 2000 Act, Audit Scotland's *Code of Audit Practice* and ISAs (UK and Ireland)

What financial information is included within the scope of the audit?

Normally included within the scope of the audit are:

- the annual accounts, which comprise the net expenditure account, statement of financial position, statement of cash flows, statement of changes in reserves and the accompanying notes, including the accounting policies; and
- the part of the remuneration report which contains numerical information on the remuneration of the Chairman, other board members, the Chief Executive and other executive staff.

- 4.12 Most importantly, the auditor's report will include an expression of opinion on the annual accounts with reference to the financial reporting framework applied by the organisation. The next section of this chapter explains the content of the auditor's opinion on the annual accounts of an executive NDPB.

Auditor's opinion

4.13 The auditor's opinion is split into two main parts:

- The auditor's opinion on the annual accounts and the audited part of the remuneration report.
- The auditor's opinion on regularity, which is unique in the UK to the public sector.

Auditor's opinion on the annual accounts and the audited part of the remuneration report

4.14 This part of the opinion is normally divided into three sections:

- The annual accounts

The auditor is required to state in his or her opinion, whether the accounts give a true and fair view in accordance with the applicable financial reporting framework. The applicable financial reporting framework is described with reference to all legislation which determines how the accounts are prepared. These references effectively encompass the financial reporting framework described in chapter 3.

- The numerical information in the remuneration report

The auditor is required to state in his or her opinion whether the numerical information in the remuneration report is properly prepared in accordance with the relevant legislation, and directions made by Scottish Ministers. The numerical information is normally described as 'the part of the remuneration report to be audited'; the remuneration report should highlight which part is audited and which part is not. As the remuneration report does not form part of the annual accounts, a separate section in the auditor's report is required.

- Other information published with the annual accounts, excluding the numerical information in the remuneration report

Other information includes, for example, statements prepared by the Chairman, statements prepared by the Chief Executive, the directors' report (essentially the main narrative included in the Annual Report) and the unaudited part of the remuneration report. The auditor is required to read the other information published with the annual accounts and to report on whether or not the other information is consistent with the annual accounts. There is no requirement to audit the other information.

Auditor's opinion on regularity

4.15 In the UK the auditor of a public sector organisation (except for local authorities where there is no such requirement) has a duty to report in the opinion on whether an organisation has applied its income and expenditure in accordance with the purposes intended by Parliament and on whether financial transactions have been undertaken in accordance with applicable legislation and other authorities. This opinion is known as the regularity opinion and is unique in the UK to the public sector.

4.16 In Scotland, the duty of the auditor to report on regularity is set out in the Public Finance and Accountability (Scotland) Act 2000. This Act requires the auditor to give an opinion on whether the expenditure and receipts shown in the accounts were incurred or applied in accordance with any applicable enactments and guidance issued by Scottish Ministers.

Reports by the Auditor General under section 22 of the 2000 Act

- 4.17 In addition to the auditor's report on the annual accounts, the Auditor General may prepare an additional report under section 22(3) of the 2000 Act. A report under section 22(3) will be prepared if there are any issues which the Auditor General wishes to bring to the attention of the Scottish Parliament.

Both the auditor's report on the annual accounts and the Auditor General's section 22 report, if one is prepared, must be attached to the accounts before they are laid before the Scottish Parliament.

Other auditor responsibilities

Performance audit

- 4.18 Section 23 of the 2000 Act gives the Auditor General the right to initiate examinations into economy, efficiency and effectiveness with which executive NDPBs have used their resources to discharge their functions. Examinations into economy, efficiency and effectiveness by the auditor of an executive NDPB are procured through Audit Scotland and may involve participation in:
- A performance audit covering issues which are broadly relevant to public bodies or the executive NDPB sector resulting in a national report
 - A review of the executive NDPB's response to recommendations in a national report
 - A performance audit or examination of an issue specifically relevant to the executive NDPB

Best Value: an evolving issue for the NDPB sector

- 4.19 The duty of Best Value is incorporated within the responsibilities placed on Accountable Officers. Further information on the duty of Best Value is set out in the *Scottish Public Finance Manual*.
- 4.20 In its publication *Auditing Best Value in central government bodies*, Audit Scotland sets out how it will build on current reporting arrangements to develop its approach to the audit of Best Value in central government bodies.

Auditing Best Value in central government bodies

“We are committed to ensuring that Best Value auditing across the public sector adds value to existing arrangements. It will be risk-based, build on our knowledge of individual bodies and recognise the increasing focus on partnership working.” (Auditing Best Value in central government bodies, page 2)

Current reporting arrangements include:

- An annual audit which is based on key priorities and risks in the central government sector
- National performance audit reports on specific services presented to the Scottish Parliament’s Public Audit Committee
- Thematic reports on cross-government issues
- Short reports on accounts where the Auditor General wants to bring issues arising from accounts to the attention of the Scottish Parliament

Planned developments to ensure that all the principles of Best Value are covered and reported over time:

- The development of ‘use of resources’ audit tools covering areas such as financial management, information management and procurement, which can be used by both auditors and for self-assessment
- The annual auditor’s report on the accounts will make reference over the five-year period of the audit appointment to specific work on Best Value
- National performance audits and performance information will form part of the evidence on the extent to which central government bodies are improving

Short reports on accounts and in-depth performance reports on individual bodies to the Scottish Parliament will continue as options which can be used for examining bodies where a number of risks have been identified.

The full publication is available on the Audit Scotland website.

Whistleblowing responsibilities for auditors of charitable NDPBs

- 4.21 Under Section 46 of the Charities and Trustee Investment (Scotland) Act 2005, the auditor of a charitable NDPB has both a duty and a right to report to the Office of the Scottish Regulator in certain circumstances. The auditor’s duty and right to report extends to the activities or affairs of any institution or body corporate connected to the charity, for example a subsidiary company. The auditor of a charitable NDPB continues to have a duty and right to report even when the audit appointment has ceased.
- 4.22 A right to report exists when the auditor becomes aware of a matter which the auditor has reasonable cause to believe is likely to be relevant for the purposes of the exercise by OSCR of any of its functions (other than its function to identify and investigate apparent misconduct).

- 4.23 The auditor must report to OSCR any matter the auditor has reasonable cause to believe is likely to be of material significance for the purposes of the exercise by OSCR of its function to identify and investigate apparent misconduct in the charitable NDPB's administration.
- 4.24 OSCR has issued guidance on Section 46 of the Act entitled *the Duty of Auditors to Report Matters of Material Significance to OSCR and the Charity Commission* which is available on its website.

References for this chapter

See glossary for the definition of Accountable Officer and Best Value.

The Public Finance and Accountability (Scotland) Act 2000:
www.opsi.gov.uk/legislation/scotland/acts2000/asp_20000001_en_1

Audit Scotland's *Code of Audit Practice* (2007)
www.audit-scotland.gov.uk/utilities/search_report.php?id=1

The APB's standards:
www.frc.org.uk/apb/publications

Scottish Public Finance Manual chapter on Best Value:
www.scotland.gov.uk/Topics/Government/Finance/spfm/BestValue

Audit Scotland's *Auditing Best Value in central government bodies* (2009):
www.audit-scotland.gov.uk/work/central_national.php?year=2009

OSCR guidance *the Duty of Auditors to Report Matters of Material Significance to OSCR and the Charity Commission*:
www.oscr.org.uk/whistleblowingguidance.stm

The above links are live links in the electronic version of the Guide, which can be downloaded at:
www.icas.org.uk/ndpbguide

Chapter 5: Role of the Chief Financial Officer in an executive NDPB

Chapter overview

- 5.1 This chapter examines the role of the Chief Financial Officer (CFO) in both accounting for the financial transactions of the executive NDPB and in providing a strategic leadership role as a member of the executive NDPB's management team. It is vitally important that the CFO has, of right, a full place in the leadership team (comprising the board and management team) in any organisation.
- 5.2 The title CFO should not be confused with the Accountable Officer. All executive NDPBs must have an Accountable Officer who will normally be the Chief Executive. The Accountable Officer is personally answerable to the Scottish Parliament for the propriety and regularity of the public finances for the executive NDPB and for ensuring that resources are used economically, efficiently and effectively. The responsibilities of the Accountable Officer are set out in the *Memorandum of Accountable Officers* for public bodies which is issued by the Principal Accountable Officer for the Scottish Government and reproduced in the Accountability Section of the *Scottish Public Finance Manual (SPFM)*.
- 5.3 The sections in this chapter are:
- Definition of Chief Financial Officer
 - Principles defining the role of the Chief Financial Officer in a public service organisation
 - Practical issues for the Chief Financial Officer
 - Qualifications for the Chief Financial Officer

Definition of Chief Financial Officer

- 5.4 The CFO is the organisation's most senior executive role charged with responsibility for leading and directing financial strategy and operations. The CFO is often called the Finance Director, Director of Finance or Director of Corporate Services.

Principles defining the role of the Chief Financial Officer in a public service organisation

- 5.5 A statement published by the Chartered Institute of Public Finance and Accountancy (CIPFA) in June 2009 entitled *The Role of the Chief Financial Officer in Public Service Organisations*, outlines current good practice. The statement sets out five principles for the role of the CFO in public service organisations.

What are these five principles?

The Chief Financial Officer in a public service organisation:

1. is a key member of the leadership team, helping it to develop and implement strategy and to resource and deliver the organisation's strategic objectives sustainably and in the public interest;
2. must be actively involved in, and able to bring influence to bear on, all material business decisions to ensure immediate and longer term implications, opportunities and risks are fully considered, and alignment with the organisation's financial strategy; and
3. must lead the promotion and delivery by the whole organisation of good financial management so that public money is safeguarded at all times and used appropriately, economically, efficiently, and effectively.

To deliver these responsibilities, the Chief Financial Officer:

4. must lead and direct a finance function that is resourced to be fit for purpose; and
5. must be professionally qualified and suitably experienced.

The full Statement on the *Role of the CFO* is available on the CIPFA website.

Practical issues for the Chief Financial Officer

5.6 The CFO has a wide range of financial responsibilities and these responsibilities fall into two broad categories:

- the strategic corporate management role; and
- the accounting role.

The strategic corporate management role of the Chief Financial Officer

5.7 The strategic corporate management role of the CFO includes the following:

- membership of the management team

Membership of the management team ensures that the CFO is able to contribute to and support strategic and operational decision-making in an effective manner. Aspects of this strategic role relate directly to the CFO's financial management responsibilities and financial expertise.

- delivering best value and driving efficiency

NDPBs require robust financial information for forward planning and to evaluate the financial consequences of different options and scenarios. The CFO has responsibility for ensuring that the management team has the good quality financial information it requires for planning and making decisions about how best to deliver the NDPB's corporate plan objectives and to deal appropriately with ad hoc developments.

At an operational level the CFO has a key role to play in streamlining, simplifying and standardising processes to make efficiency improvements and savings in the delivery of services (for example, implementing and managing shared services or outsourcing functions).

- providing leadership to members of the accountancy profession within the NDPB

The CFO has a responsibility to provide professional leadership, to manage training in accountancy and to lead a balanced team of appropriately qualified and experienced staff. The 'head of accountancy profession role' should apply across all departments of the NDPB, not merely the finance department, to ensure uniform and robust financial practices, throughout the organisation.

The accounting role of the Chief Financial Officer

5.8 The CFO's responsibilities in this category relate to:

- recording all financial transactions undertaken by the NDPB;
- maintaining robust financial systems; and
- reporting the financial results of the NDPB during and at the end of the financial year.

5.9 The *SPFM* issued by the Scottish Ministers governs all matters relating to public finance and financial reporting in public bodies. The CFO has a key role making sure that the executive NDPB meets all relevant requirements in the *SPFM*.

5.10 A number of important aspects of the CFO's accounting role are described below, although this list is not exhaustive and may vary between organisations.

- to prepare and control budgets and prepare management information

It is good practice to prepare a rolling programme of budgets for the next three or more years in order to identify trends and to prepare the NDPB for anticipated changes. The CFO is also responsible for preparing forecasts against budget so that corrective action can be considered in the first instance by the NDPB's management team and later scrutinised by the board. NDPBs may have a Finance and Resources Committee (or equivalent) which scrutinises the NDPB's budgets, forecasts, charging schemes and other financial issues in some depth prior to scrutiny by the board as a whole.

- to control the financial ledger

The CFO is responsible for controlling the financial ledger, which records all the expenditure and income of the NDPB, and also for controlling all subsidiary financial records (for example, costing systems, payroll records).

The accounting records of executive NDPBs are tightly prescribed by the *SPFM*.

- to prepare the annual accounts

The CFO is responsible for preparing the statutory annual accounts at the end of each financial year and for ensuring that the NDPB is fully prepared for external audit visits.

- to pay salaries and wages

The CFO is responsible for ensuring that salaries and wages are correctly calculated, paid on time to the correct individuals, and recorded correctly in the financial ledger. Taxes and National Insurance contributions must also be accounted for and paid over to the UK Government.

- to collect income and draw down grant-in-aid

The CFO should ensure that all income due to the executive NDPB is collected and recorded and that a written application is made to the sponsor department to support each request for grant-in-aid to be drawn down from the Scottish Government.

- to arrange insurance cover

NDPBs are not normally permitted to purchase commercial insurance and self-insurance will normally be appropriate. In exceptional cases, the CFO may negotiate commercial insurance cover with the approval of the sponsor directorate.

The *SPFM* has a separate section on insurance which specifies special factors which may justify commercial insurance being taken out.

Qualifications for the Chief Financial Officer

- 5.11 It is UK Government policy that all government departments should have a CFO who has full membership of one of the professional accountancy bodies listed below or have an equivalent qualification. The HM Treasury publication *Managing Public Money* notes that “It is good practice for all other public sector organisations, including Scottish public bodies, to do the same, and to operate to the same standards”. ICAS supports this policy. In addition, the CFO should have considerable practical experience in a relevant field.
- 5.12 In the UK and Ireland there are six professional accountancy bodies, each incorporated under Royal Charter, which together comprise the Consultative Committee of Accountancy Bodies (CCAB).

Which accountancy bodies comprise the CCAB?

- The Institute of Chartered Accountants of Scotland (ICAS)
- The Association of Chartered Certified Accountants (ACCA)
- Chartered Accountants Ireland (CAI)
- The Chartered Institute of Management Accountants (CIMA)
- The Chartered Institute of Public Finance and Accountancy (CIPFA)
- The Institute of Chartered Accountants in England and Wales (ICAEW)

- 5.13 Full membership of one of the six CCAB accountancy bodies can only be achieved following the successful completion of a number of years of practical training and rigorous professional examinations. CCAB-qualified accountants are also under a professional duty to keep up-to-date through participating in continuing professional development (CPD), which is a mandatory professional requirement.
- 5.14 A person may have other qualifications, such as a degree in business studies or a Master of Business Administration (MBA). However, unless that person also holds a full CCAB qualification, other qualifications do not represent the same rigorous accountancy training, knowledge and adherence to professional standards; nor are they subject to ongoing professional regulation.

References for this chapter

See glossary for the meaning of Accountable Officer.

Scottish Public Finance Manual:

www.scotland.gov.uk/Topics/Government/Finance/spfm

The CIPFA statement on *The Role of the Chief Financial Officer in Public Service Organisations* (June 2009):

www.cipfa.org.uk/panels/finance_director

Managing Public Money:

www.hm-treasury.gov.uk/psr_mpm_index.htm

Annex 4.1 of Managing Public Money Sets out UK Government policy on finance directors, described in the Guide as CFOs.

The above links are live links in the electronic version of the Guide, which can be downloaded at:

www.icas.org.uk/ndpbguide

Glossary

The terms defined in the glossary are highlighted at the end of each chapter. Many of the terms used are defined within the chapters of the Guide and where this is the case definitions are not necessarily repeated in the glossary.

A

Accountable Officer

- The person who is personally responsible for propriety, regularity and value for money issues in relation to the public funds under their stewardship.

The Chief Executive will normally be designated as the NDPB's Accountable Officer. Chapter 3 of *On Board* sets out the role of the Chief Executive, and separately from this, the role of the Chief Executive as Accountable Officer. Further information on the role of Accountable Officers is also included in the "Accountability" section of the *Scottish Public Finance Manual*.

Accounting policies

- Accounting policies are the specific principles, bases, conventions, rules and practices applied by the NDPB in preparing and presenting its accounts.

Accounting standards

- Accounting standards are pronouncements on how transactions and other events should be reflected in the accounts. Compliance with accounting standards is normally required for accounts to give "a true and fair view".

Accrual accounting

- Accrual accounting is a method of accountancy which records revenues and expenses when they are incurred, regardless of when cash is exchanged.

Assets

- Assets are resources which are:
 - (a) controlled by the NDPB as a result of past events; and
 - (b) from which future economic benefits are expected to flow to the NDPB.

There are a number of different asset classifications which board members are likely to be familiar with such as property (land and buildings), investments, debtors and cash.

B

Best Value

- Best Value provides a common framework for continuous improvements in public services in Scotland and is complemented by other aspects of Public Service Reform such as Efficient Government, the National Performance Framework and Community Planning.

Best Value is a duty which applies to all public bodies in Scotland. It is a statutory duty in local government, and in the rest of the public sector it is a formal duty on Accountable Officers. Compliance with the duty of Best Value is an auditable requirement under the terms of the Public Finance and Accountability (Scotland) Act 2000.

C

Capital project

- An investment project requiring relatively large sums of money to acquire, to develop or to improve a tangible fixed asset or intangible fixed asset.

Creditors

- Creditors are third parties to whom money is owed. Creditors which exist at the end of the financial year are recognised as liabilities in the statement of financial position.

D

Deficit

- A deficit occurs if there is an excess of expenditure over income in a reporting period.

Depreciation

- A measure of wearing out, consumption or other reduction in the useful life of a fixed asset. Depreciation is charged to the net expenditure account each year. From the 2010-11 financial year, depreciation charges will be recorded in the statement of comprehensive net expenditure.

F

Financial year

- This is the period to be covered by the annual accounts. In the public sector the financial year is 1 April to 31 March.

G

Generally accepted accounting practice (GAAP)

- The accounting and disclosure requirements required by law and pronouncements by accounting standard setters supplemented by accumulated professional judgement. For NDPBs, the pronouncements of the standard setter are contained in the *FReM* issued by HM Treasury, which is based on international accounting standards, known collectively as IFRSs (International Financial Reporting Standards).

I

Inputs

- Inputs are resources needed to formulate and implement projects, programmes or policies.

Intangible fixed assets

- Identifiable non-monetary assets without physical substance controlled by the NDPB which have a useful life of more than one year.

L

Liabilities

- Liabilities are obligations to transfer future economic benefits to another entity as a result of past transactions or events. A liability can be straightforward like a trade creditor where a supplier is owed money, or more complex like a provision where there is uncertainty over the timing of or the amount of the liability.

N

Net assets

- These comprise a NDPB's assets less its liabilities, where its total assets exceed its total liabilities.

Non-cash charges

- These comprise charges recorded in the net expenditure account (or from 2010-2011, the statement of comprehensive net expenditure) which do not result in a cash out flow for the NDPB. For NDPBs non-cash charges are depreciation and cost of capital.

Net expenditure

- This comprises a NDPB's expenditure less its income before interest, where its total expenditure exceeds its income. Most NDPBs will incur net expenditure in each financial year; this figure will be disclosed in the net expenditure account. From the 2010-11 financial year, net expenditure will be disclosed in the statement of comprehensive net expenditure.

Net liabilities

- These comprise a NDPB's liabilities less its assets, where its total liabilities exceed its total assets. Where an NDPB has net liabilities at the end of the financial year, its net liabilities figure appears as a total in the statement of financial position.

O

Outcomes

- Outcomes are benefits resulting from outputs. Outcomes should correspond to the NDPB's objectives.

Outputs

- Outputs are products which result from inputs and should facilitate the meeting of outcomes.

R

Reserves

- The reserves of a NDPB in total represent its net worth and normally comprise a general reserve, which records its core funding from the sponsor department, and a revaluation reserve. A figure for total reserves appears in the statement of financial position.

Revaluation reserve

- An amount within reserves, which shows the accumulated and unrealised amount of revaluations of fixed assets (non-current assets).

S

Statement of recognised gains and losses

- This is a primary statement which was prepared by NDPBs (other than companies or charities) under UK GAAP. The statement records unrealised gains and losses incurred during the financial year which are not recorded in the operating cost statement. The most common example of an unrealised gain is an increase in the value of property; a loss would be recorded in the event of a decrease in the value of property.

Surplus

- A surplus occurs if there is an excess of income over expenditure in a reporting period.

T

Tangible fixed assets

- Assets which have physical substance and are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes on a continuing basis in the NDPB's activities. These are assets such as property (land and buildings), motor vehicles and equipment, including IT.

The term "tangible fixed assets" is a familiar term within UK accounting standards but is not a term which features in IFRSs. Under IFRSs the collective term for assets, including tangible fixed assets, which have a useful life of more than one year is "non-current assets".

U

UK Corporate Governance Code

- The *Corporate Governance Code* sets out standards of good practice for listed companies in relation to issues such as board composition and development, remuneration, accountability and audit and relations with shareholders. All companies incorporated in the UK and listed on the Main Market of the London Stock Exchange are required under the Listing Rules to report on how they have applied the Code in their annual report and accounts.

The *UK Corporate Governance Code* replaces the *Combined Code on Corporate Governance* for periods commencing on, or after, 29 June 2010.

Unrealised gains

- An increase in economic benefits where the increase has not been converted into a cash surplus. The most common example of an unrealised gain is an increase in the value of property.

For the financial year 2009-10, unrealised gains are recorded in a NDPB's statement of changes in reserves. From the financial year 2010-11, these will be recorded in the comprehensive statement of net expenditure.

Unrealised losses

- A decrease in economic benefits where the decrease has not been converted into a cash deficit. The most common example of an unrealised loss is a decrease in the value of property.

For the financial year 2009-10, unrealised losses are recorded in a NDPB's statement of changes in reserves. From the financial year 2010-11, these will be recorded in the comprehensive statement of net expenditure.

Useful life

- The useful life is the period over which the NDPB expects to derive economic benefits from an asset. The term is normally associated with assets which have a useful life of over one year, i.e. fixed assets, including intangible fixed assets; an asset's useful life is used in the calculation to determine the annual depreciation charge.

Useful sources of information

The links below are live links in the electronic version of the Guide, which can be downloaded at: www.icas.org.uk/ndpbguide

A

Audit Scotland: www.audit-scotland.gov.uk

- *Auditing Best Value in central government bodies* (2009)
www.audit-scotland.gov.uk/work/central_national.php?year=2009
- *Code of Audit Practice* (March 2007)
www.audit-scotland.gov.uk/utilities/search_report.php?id=1

This publication is being updated in 2010
- *Improving public sector efficiency* (February 2010)
www.audit-scotland.gov.uk/work/all_national.php?year=2009
- *Role of boards* (September 2010)
www.audit-scotland.gov.uk/work/central_national.php?year=2010
- *Scotland's public finances: preparing for the future* (November 2010)
www.audit-scotland.gov.uk/work/all_national.php?year=2009

Auditing Practices Board: www.frc.org.uk/apb

- APB standards and other guidance:
www.frc.org.uk/apb/publications

C

Charity Commission: www.charitycommission.gov.uk

- *Accounting and Reporting by Charities: Statement of Recommended Practice (The Charities SORP)*:
www.charity-commission.gov.uk/Charity_requirements_guidance/Accounting_and_reporting/Preparing_charity_accounts/sorpfront.aspx

Chartered Institute of Public Finance and Accountancy (CIPFA): www.cipfa.org.uk

- CIPFA planned statement on *The Role of the Head of Internal Audit in Public Services Organisations* (May 2010):
www.cipfa.org.uk/panels/audit
- CIPFA statement on *The Role of the Chief Financial Officer in Public Service Organisations* (June 2009):
www.cipfa.org.uk/panels/finance_director

Companies House: www.companieshouse.gov.uk

- Guidance on Annual requirements, including filing:
www.companieshouse.gov.uk/about/gbhtml/gp2.shtml#ch1

D

Deloitte: www.deloitte.com

- *In the hot seat. Reducing costs in public sector organisations in an age of austerity* (March 2010)
www.deloitte.com/view/en_gb/uk/industries/government-public-sector/index.htm

E

Ernst & Young: www.ey.com

- *Lessons from Change: the government and the public sector* (2010)
www.ey.com/GL/en/Industries/Government---Public-Sector/Lessons-from-change---Rebuilding-for-the-future-in-the-government-and-public-sector

F

Financial Reporting Advisory Board: www.hm-treasury.gov.uk/psr_frab_index.htm

Financial Reporting Council: www.frc.org.uk

- *Combined Code on Corporate Governance* (2008)
www.frc.org.uk/corporate/ukcgcode.cfm
- *UK Corporate Governance Code* (2010):
www.frc.org.uk/corporate/ukcgcode.cfm

H

HM Treasury: www.hm-treasury.gov.uk

- *Government Financial Reporting Manual (FReM)*
www.hm-treasury.gov.uk/FReM_index.htm
- Illustrative accounts for NDPB Green:
www.hm-treasury.gov.uk/FReM_proformas.htm
- *Managing Public Money*:
www.hm-treasury.gov.uk/psr_mpm_index.htm
- *Spending Review 2010*
www.hm-treasury.gov.uk/spend_index.htm
- *Statement of Funding Policy* (October 2007):
www.hm-treasury.gov.uk/d/pbr_csr07_funding591.pdf

I

International Accounting Standards Board: www.ifrs.org

Institute of Chartered Accountants of Scotland (ICAS): www.icas.org.uk

- *A financial guide for non-executive directors of Scottish Government executive NDPBs:*
www.icas.org.uk/ndpbguide

Institute for Government: www.instituteforgovernment.org.uk

- John Swinney's letter to all Scottish public bodies on the relationship between the Scottish Government and public bodies (7 May 2009)
www.instituteforgovernment.org.uk/pdfs/john-swinney.pdf

K

KPMG: www.kpmg.com

- *Tough choices ahead: The future of the Public Sector* (2009)
www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Pages/Tough-Choices-Ahead.aspx

N

National School of Government: www.nationalschool.gov.uk

O

Office of Public Sector Information: www.opsi.gov.uk.

- The Public Finance and Accountability (Scotland) Act 2000:
www.opsi.gov.uk/legislation/scotland/acts2000/asp_20000001_en_1

Office of the Scottish Charity Regulator (OSCR): www.oscr.org.uk

- *The Duty of Auditors to Report Matters of Material Significance to OSCR and the Charity Commission:*
www.oscr.org.uk/whistleblowingguidance.stm

P

PricewaterhouseCoopers (PWC): www.pwc.co.uk

- *Finance at the Crossroads: The changing role of Finance in Government and the Public Sector* (May 2009):
www.pwc.co.uk/eng/publications/finance_at_the_crossroads_0509.html

S

Scottish Government: www.scotland.gov.uk

- *Audit Committee Handbook*:
<http://www.scotland.gov.uk/Publications/2008/08/08140346/0>
- Information on the outcome based approach:
www.scotland.gov.uk/Topics/Government/public-bodies/effective-pb-programme/Approach
- Information on the national performance framework
www.scotland.gov.uk/About/scotPerforms
- Information on Setting the Scottish budget:
www.scotland.gov.uk/Topics/Government/Finance/18127/11754
- *On Board: A Guide for Board Members of Public Bodies* (2006):
www.scotland.gov.uk/Publications/2006/07/11153800/0
- *The Scottish Public Finance Manual*
www.scotland.gov.uk/Topics/Government/Finance/spfm/Intro

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