Financial Auditing and Reporting: 2004 - 2005

General Report by the Comptroller and Auditor General for Northern Ireland

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The Comptroller and Auditor General is the head of the Northern Ireland Audit Office employing some 145 staff. He and the Northern Ireland Audit Office are totally independent of Government. He certifies the accounts of all Government Departments and a wide range of other public sector bodies; and he has statutory authority to report to Parliament on the economy, efficiency and effectiveness with which departments and other bodies have used their resources.

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Report by the Comptroller and Auditor General for Northern Ireland

Introduction

1. This Report brings together the results of financial audit work undertaken by the Northern Ireland Audit Office over the last twelve months and highlights issues arising from it. The aim of this work is to provide the Northern Ireland Assembly and Parliament with independent assurance that accounts are properly prepared,and that income and expenditure has been applied for the purposes intended. The report contains the following sections:

- RESOURCE ACCOUNTS
- EXECUTIVE AGENCY AND NON-DEPARTMENTAL PUBLIC BODY ACCOUNTS
- NORTHERN IRELAND CONSOLIDATED FUND

Part 1

Resource Accounts 2004 - 2005

Strengthening Corporate Governance in Central Government Bodies

1. Important lessons have been drawn from a number of high profile governance failures in the private sector. In particular there has been a realisation that the way organisations are directed and controlled from the top are key to their success. Corporate Governance is equally important in the public sector where departments, agencies and non-departmental public bodies (NDPBs) are responsible for large amounts of expenditure to achieve government policy objectives.

2. Corporate governance in central government bodies in Northern Ireland is generally good as many of the processes and structures were in place long before the current focus on governance developed. However, I have had to report on a number of worrying failures of governance in Northern Ireland public bodies in recent years and it is generally recognised that there are many opportunities to strengthen governance in the public sector. I welcome the recent guidance which has been issued on the subject. In particular I endorse the HM Treasury Code of Good Practice; 'Corporate Governance in Central Government Departments' and the publication from the Independent Commission on Good Governance in Public Services; 'The Good Governance Standard for Public Services', both of which outline the principles of good governance and suggest ways for strengthening governance across the public sector. I would emphasise the following key elements of Corporate Governance which departments and their sponsored bodies should seek to develop:

- Strengthening the Board – To ensure the Board is effective the members should have the appropriate skills and expertise and be fully aware of their role. In addition the Board should include independent non-executive members to provide a challenge function and bring relevant skills and experience to achieve its effective operation. I therefore welcome the recent recruitment of non-executive members to departmental boards;
- Risk Management – The public sector has used risk management in a number of guises for quite a considerable time. This process of risk management has been reinforced in recent years by the development of risk registers which every public sector body has now developed. However, the risk management process can be further strengthened by ensuring key staff always consider risk when making decisions and understand the impact of their decision on the overall corporate risks which contribute to the success or failure of the organisation. In essence, this embodies a risk management culture throughout the organisation; and
- Sponsored Bodies – It is important to ensure the correct governance arrangements are established between sponsoring departments and its sponsored bodies so that objectives are achieved in the most efficient, effective and economic manner. In Northern Ireland this aspect is particularly important because of the heavy reliance on agencies and NDPBs to deliver important elements of the department's responsibilities. I endorse the principle included in the HM Treasury Code of Good Practice 'Corporate Governance in

Central Government Departments' which recommends that the department's relationship with its sponsored bodies should reflect the department's assessment of how well the sponsored body can manage its risks. Therefore, I would urge sponsor departments to re-examine its current arrangements to ensure the balance of monitoring is sufficient for the risks involved.

3. My office intends to be more proactive in encouraging good governance practice in the bodies we audit and I will report further on this next year.

Variances in Departmental Estimates

1. Background

1.1 The power to incur expenditure is granted by Parliament annually through the Budget Order. Departments are required under government accounting rules to produce supply estimates to cover predicted expenditure for the year ahead. Supply estimates are defined as detailed spending plans which form the basis on which Parliament votes the spending limits, and associated cash requirements, for departments. Supply estimates for Northern Ireland departments contain two key elements:

- Net resource requirement – this is the total amount of resources required by the department to carry out its functions and to fund the spending of relevant sponsored bodies (primarily NDPBs). It contains both cash and non cash elements.
- Net cash requirement – this is the amount of cash the department requires from the Northern Ireland Consolidated Fund to carry out its functions and again to support sponsored bodies.

Departments should therefore plan their resource and cash requirements so that these do not exceed the limits of those amounts that have been voted by Parliament. Where the voted net resource requirement or net cash requirement is breached, an Excess Vote arises, and the approval of Parliament must be sought.

1.2 Net resource and net cash requirement estimates for Northern Ireland departments, as voted by Parliament, are compared in the departmental resource accounts with outturns realised for the year and significant variances are explained. Departments are required, under government accounting, to include explanations for variances of £500,000 or 10 per cent, whichever is greater, for both expenditure and receipts. Tables 1 and 2 below identify the reported estimate against outturn for both net resources and net cash for all Northern Ireland departments in 2004-05.

2. Commentary on Estimates against Outturn

Net Resources Estimate against Outturn

2.1 Parliament voted Northern Ireland departments an upper limit as regards their net resource requirement of almost £12 billion for the 2004-05 year. In 2004-05, the departments' actual resource needs were £0.4 billion, or 4 per cent, less than the upper limit, compared with £1.4 billion or 11 per cent in 2003-04. This represents a significant improvement over the previous year.

2.2 The Department of Health, Social Services and Public Safety – Health and Personal Social Services Superannuation Account was the only account that had an overspend (£32 million). The reasons for this excess are further explained within this volume at page 20. All other departments had resource needs which were lower than the amounts voted, ranging from 1 to 13 per cent of the relevant limits set.

2.3 The most significant variations in percentage terms, where actual resource needs were less than forecast, occurred within the Department of Agriculture and Rural Development (13 per cent /£40 million) and the Department of Finance and Personnel (10 per cent/ £18 million). In the Department of Agriculture and Rural Development this was mainly due to lower levels of animal disease which reduced compensation expenditure, delays in the start up of Agri-Environment Programmes and delays in the Executive Programme Funds. The variance in the Department of Finance and Personnel was largely due to a tail off in activity on the EU Programme for Peace and Reconciliation and EU Community Initiatives and the non cash costs being less than forecast as a result of the reversal of a permanent diminution in the value of the NI Government Office Estate.

2.4 There were three other Departments whose resource outturns in actual terms indicate significant actual resource needs less than forecast. The Department of Education had a variance of £100 million, which was mainly due to slippage on a number of schools infrastructure projects, amounts carried forward on schools' delegated budgets under Local Management of Schools arrangements and lower than expected grant requirements. The variance in the Department for Regional Development was £110 million. This was largely due to a greater improvement in the condition of the roads network than estimated. The variance in the Department for Social Development of £123 million was partly due to delays in the uptake of grant aid in respect of Urban Regeneration and lower Jobseekers allowance payments stemming from lower unemployment in the year.

Net cash requirement estimate against outturn

2.5 Parliament voted a limit of £10.3 billion cash to ensure Northern Ireland departments were able to fulfill their functions during 2004-05. The departments' actual cash needs were £518 million, or 5 per cent, less than the limit set compared with £629 million or 7 per cent in 2003-04.

2.6 One resource account, the Department of Finance and Personnel Superannuation and Other Allowances Account, had an excess net cash requirement of £7 million. The reasons for this are further explained within this volume at page 16.

2.7 All other departments had actual net cash requirements which were lower than the limits set - ranging from 1 to 46 per cent. The Department of Agriculture and Rural Development's actual net cash requirement was 20 per cent (£62 million) lower than estimated and the Department of Finance and Personnel's was 17 per cent (£34 million) lower than estimated. The reasons for the cash variances in the Department of Agriculture and Rural Development mirrored the explanations for variances in resource outturn noted in paragraph 2.3 above. These were further exacerbated by capital underspends in respect of Science Services, which encountered a slow start, and the Service Delivery Group which experienced delays in capital spending caused by a review of the College of Agriculture, Food and Rural Enterprise. The cash variance in the Department of Finance and Personnel was largely due to slippage in major capital projects within the Department, as well as the tail off in EU funded activity noted in paragraph 2.3 above. The Department of Enterprise, Trade and Investment (DETI) and the Office of the First Minister and Deputy First Minister (OFMDFM) both had actual net cash requirements which were 15 per cent lower than estimated. In DETI this was mainly due to unforeseen increases in EU grant creditors and a reduction in the use of provisions, while in OFMDFM this was mainly due to lower than anticipated costs in a number of areas including staffing and project support expenditure. The Northern Ireland Authority for Energy Regulation had an actual net cash requirement which was 46 per cent lower than that estimated, due to an increase in deferred income as a result of the commencement of the All Ireland Project in the year.

2.8 The largest variances in actual terms were at the Department for Social Development, which had a net cash requirement of £110 million less than that voted by Parliament, and at the Department of Education, where the actual net cash requirement for the year was £108 million less than the Estimate. Again the reasons for these large variations mirrored the explanations for variances in resource outturn noted in paragraph 2.4 above.

3. Conclusion

3.1 The importance of robust estimates has been highlighted further in the 2004-05 year, with one of the two excess votes in the year stemming from errors made in the estimates procedures. Effective estimating and monitoring procedures are essential to ensuring good financial management and accountability in departments.

3.2 Whilst I recognise that an effective system of in year monitoring exists so that savings can be used in another part of the public sector when identified, the scale of variation from estimates for both resource and cash outturn for some of the departments suggests the need for further improvement in the estimates process. However, I also recognise that in some specific circumstances, mainly demand led areas, it can be difficult to produce reliable estimates of spend. In my view it is essential that departments continue to examine and refine their systems and processes for producing estimates to ensure that Parliament are only asked to approve Estimates based on robust forecasts of likely spend.

3.3 Departments must continue to closely monitor their resource and cash outturn during the financial year so that any variations from Estimates are minimized at the year end. Departments are now starting to produce more regularly in year, accrual-based accounts which should assist in reducing the level of variances and ensure that the level of under and over spending is further reduced. It is essential that reliable financial information is produced more regularly during the year to monitor resource and cash outturns.

Figure 1: Net Resources Comparison Estimate To Outturn 2004-05

	ESTIMATE Net Total £000s	OUTTURN Net Total £000s	Over/ (Under) £000s	Percentage difference from estimate %
Department of Agriculture and Rural Development	305,385	265,074	(40,311)	13
Department of Culture, Arts and Leisure	96,771	91,161	(5,610)	6
Department of Education	1,711,373	1,611,721	(99,652)	6
Department of Education - Teachers' Superannuation	355,358	355,021	(337)	0
Department of Employment and Learning	704,755	681,198	(23,557)	3
Department of Enterprise, Trade and Investment	262,166	251,834	(10,332)	4
Department of Finance and Personnel	182,772	164,308	(18,464)	10
Department of Finance and Personnel – Superannuation and Other Allowances	258,689	255,216	(3,473)	1
Department of Health, Social Services and Public Safety	2,844,801	2,819,327	(25,474)	1
Department of Health, Social Services and Public Safety Health and Personnel Social Services Superannuation	346,160	378,325	32,165	9
Department of the Environment	150,457	144,480	(5,977)	4
Department for Regional Development	1,421,699	1,311,488	(110,211)	8
Department for Social Development	3,009,368	2,885,888	(123,480)	4
Office of the First Minister and the Deputy First Minister	67,932	63,218	(4,714)	7
Northern Ireland Assembly	33,982	31,361	(2,621)	8
Assembly Ombudsman for Northern Ireland and Northern Ireland Commissioner for Complaints	1,211	1,131	(80)	7
Food Standards Agency	2,820	2,789	(31)	1
Northern Ireland Audit Office	7,416	7,099	(317)	4
Northern Ireland Authority for Energy Regulation	853	825	(28)	3
TOTAL:	**11,763,968**	**11,321,464**	**(442,504)**	**4**
		Over	**32,165**	
		(Under)	**(474,669)**	
		Total	**(442,504)**	

Figure 2: Net Cash Requirement Comparison Estimate to Outturn 2004-05

	Estimate Net Total £000s	Outturn Net Total £000s	Over/ (Under) £000s	Percentage difference from estimate %
Department of Agriculture and Rural Development	304,341	242,312	(62,029)	20
Department of Culture, Arts and Leisure	94,327	88,206	(6,121)	6
Department of Education	1,709,898	1,602,324	(107,574)	6
Department of Education - Teachers' Superannuation	107,931	102,301	(5,630)	5
Department of Employment and Learning	740,887	715,369	(25,518)	3
Department of Enterprise, Trade and Investment	276,326	234,600	(41,726)	15
Department of Finance and Personnel	196,079	161,972	(34,107)	17
Department of Finance and Personnel - Superannuation and Other Allowances	28,189	35,167	6,978	25
Department of Health, Social Services and Public Safety	2,867,212	2,791,402	(75,810)	3
Department of Health, Social Services and Public Safety - Health and Personnel Social Services Superannuation	7,375	6,902	(473)	6
Department of the Environment	139,295	132,721	(6,574)	5
Department for Regional Development	733,130	696,385	(36,745)	5
Department for Social Development	2,967,978	2,858,263	(109,715)	4
Office of the First Minister and the Deputy First Minister	66,893	56,848	(10,045)	15
Northern Ireland Assembly	26,124	24,137	(1,987)	8
Assembly Ombudsman for Northern Ireland and Northern Ireland Commissioner for Complaints	1,241	1,188	(53)	4
Food Standards Agency	2,928	2,896	(32)	1
Northern Ireland Audit Office	7,254	6,755	(499)	7
Northern Ireland Authority for Energy Regulation	844	456	(388)	46
TOTAL:	**10,278,252**	**9,760,204**	**(518,048)**	5
		Over	**6,978**	
		(Under)	**(525,026)**	
		Total	**(518,048)**	

Department of Agriculture and Rural Development - Resource Accounts 2004-05

Failure of Processing and Marketing grant applicants to follow procurement rules

Purpose of the Report

1. The Department of Agriculture and Rural Development (the Department) administers Processing and Marketing grants which are partially funded by the European Union (EU). One of the conditions for the award of these grants is that procurement procedures such as obtaining quotations or tendering are carried out by applicants for all eligible expenditure. I noted that in a substantial number of cases there was insufficient evidence available to prove that the required procurement procedures had been adhered to in relation to these grants. I estimate that up to £3.3million of grant funding was given in which there was insufficient evidence of compliance with the required procurement procedures. The Department has re-examined these grants and is generally content that adequate procurement procedures were followed although they would concede that these procedures were not properly documented.

Background

2. Processing and Marketing grants aim to improve the economic performance and international competitiveness of the food processing sector through the application of appropriate technology together with sound manufacturing and environment management practice. The Department's 2004-05 resource accounts include a charge of £4.7 million for such grants.

Examples of non-compliance

3. My testing of the grants made under the Processing and Marketing scheme identified numerous instances in which there was insufficient evidence of proper procurement procedures having been carried out. By way of illustration I outline two examples of apparent poor procurement practice below:

- I noted that a grant claim was submitted to the Department for a generator costing £10,000 and a forklift costing £14,500. In each of these cases, at the time of my audit, the Department held no evidence that quotations had been obtained despite the fact that the terms of the letter of offer required that 4 written quotations should be obtained. Grants totalling £3,500 for the generator and £5,075 for the forklift were paid; and
- In another case internal wiring costing £23,058 was claimed for and £7,423 in grants paid, and again, at the time of my audit, there was no evidence that the required procurement procedures had been followed. In this case no quotations were available for my review nor had the work been tendered for, despite the

fact that the terms of the letter of offer stated that open tendering by public advertisement should have been carried out given the value of the work.

4. In a number of other cases, grant applicants justified the fact that they had not carried out procurement procedures on the basis that the work being done was of a 'specialist' nature and could only be carried out by one supplier. However in each of the cases I looked at there was no evidence available to me to prove that this was in fact the case. Furthermore, my audit indicated that for many of the 'specialist' items being claimed for, such as the provision of chill room facilities, storage bins and building works, there would appear to be several suppliers available who could have been approached for quotes/tenders. The letters of offer under which the grants were made do not make any provision for the possibility of not obtaining quotes/tendering where work is of a specialist nature.

5. As a result of my findings, the Department re-examined the circumstances of the grant payments and is generally content that adequate procurement procedures were followed although they would concede that these procedures were not properly documented. Also in a number of these cases the Department would point out that where quotes/tenders were not obtained there were good commercial reasons why this was the case although again these were not documented at the time the grant was approved.

Lessons to be learned

6. Procurement procedures such as quotations and tendering are an important control in the prevention of fraud and ensuring value for money and are a clearly stated condition for the payment of grant. There is a lack of evidence available to prove that the procurement procedures set out by the Department in their letter of offer to grant applicants have been followed in a significant number of cases.

7. Key lessons arising from my examination of these grant payments are:

- The importance of proper procurement procedures should be stressed to grant applicants at the time a letter of offer is made. It should be made clear that where these procedures have not been followed grants may be withheld or reclaimed by the Department;
- Provision should be made in the letter of offer to grant applicants for the unusual situation where normal procurement procedures cannot be carried out, for example where there is only one possible supplier. Where this is the case the letter of offer should require the applicant to provide full justification before any purchase is made; and
- The Department should perform a challenge function and apply appropriate checks in its reviews of grant claims, particularly where the required procurement procedures have not been carried out. Written evidence should be retained to record the results of this challenge. Where there is no satisfactory explanation for a lack of quotations or tendering then the grant should be withheld or, if already paid, reclaimed by the Department.

8. I asked the Department what it intended to do in future to ensure expenditure claimed is properly incurred. The Department told me that it accepted that the scheme should have been clearer in its requirements regarding tendering and any exceptions to tendering. It also fully accepted that the documentation retained to support its decisions was in some cases inadequate to demonstrate that the conditions in the letter of offer had been fully met. This also gave the impression that the Department was not rigorously pursuing its challenge function. It stressed, however, that it had re-examined many of the cases involved and satisfied itself that sufficient evidence existed and the payment of grant was justified.

9. In terms of future actions, the Department said that it was revising the scheme to explicitly recognise the exceptional circumstances in which tenders may not be required, and setting out the evidence which must be retained on file to support the approval of such cases. It would also be requiring all beneficiaries to produce tender documentation for a selected sample of 5% of expenditure items included in each claim. Importantly in future, immediately after issuing a letter of offer to applicants, a visit will take place to underscore the need to adhere to the scheme conditions (including those for tendering) and emphasising the penalties for non-compliance in terms of non-payment or procedures for recovery. Finally, all staff involved in grants payments are being reminded of the need for effective challenge and for the maintenance of proper records to support decisions made.

Conclusion

10. I am concerned by the lack of evidence which was available to prove that proper procurement procedures were followed for a substantial amount of grants paid in the year. It is important that the Department follow up on its commitment to ensure that it performs an effective challenge function to grant applicants together with appropriate checks of grant claims. In addition adequate evidence must be retained to prove that sufficient challenge has taken place and that procurement rules have been followed.

Department of Finance and Personnel Superannuation and Other Allowances Resource Account 2004-05

Excess Vote

Purpose of Report

1. In 2004-05, the Department of Finance and Personnel Superannuation and Other Allowances resource account reflects that it expended more cash than Parliament had authorised. By so doing, the Department breached Parliament's control of expenditure and incurred what is termed an "excess" for which further parliamentary authority is required. I have qualified my opinion on the Department of Finance and Personnel Superannuation and Other Allowances 2004-05 resource account in this regard. The purpose of this report is to explain the reasons for this qualification and to provide information on the extent and nature of the breach to inform Parliament's further consideration.

My responsibilities with regard to the breach of regularity

2. As part of my audit of the Department of Finance and Personnel Superannuation and Other Allowances' financial statements, I am required to satisfy myself that, in all material respects, the expenditure and income shown in the Resource Accounts have been applied to the purposes intended by Parliament and conform to the authorities that govern them; that is, they are "regular". In doing so, I have had regard to Parliamentary authority and in particular the Supply limits Parliament has set on expenditure.

3. By incurring expenditure that is unauthorised and is thus not regular, the Department has breached Parliament's controls.

Background to the Excess

4. Parliament authorises and sets limits on departmental expenditure on two bases – 'resources' and 'cash'. Such amounts are set out in Supply Estimates for which Parliament's approval and authority is given in annual Budget Orders.

5. By this means, Parliament has authorised a single 'Net Cash Requirement' for the Department of Finance and Personnel Superannuation Scheme. This is the limit on the amount of cash that can be used. The Department of Finance and Personnel Superannuation Scheme's Net Cash Requirement, for the Superannuation account covers all of its Requests for Resources plus working capital requirements.

6. The Net Cash Requirement also represents the maximum amount of cash that may be provided to the Department of Finance and Personnel Superannuation Scheme from the Consolidated Fund. It is net of the amount of cash that the Department receives relating to income that Parliament has authorised as Accruing Resources. Parliament sets separate limits on the amount of Accruing Resources that can be applied towards meeting current expenditure.

Limits

7. The limits described above for the Department of Finance and Personnel Superannuation Scheme were set out in the Northern Ireland Main Supply Estimate for 2004-05, as amended by the Northern Ireland Spring Supplementary Estimates. The limit on the Net Cash Requirement was set at £28,189,000. This limit was authorised in the Budget (Northern Ireland) Order 2004, the Budget (Northern Ireland) (No.2) Order 2004 and the Budget (Northern Ireland) Order 2005. The breach reported below is against this limit.

Breach of limit on Net Cash Requirement

8. Schedule 1 to the Department of Finance and Personnel Superannuation and Other Allowances 2004-05 resource accounts shows that the Net Cash Requirement was £35,167,347.96 which is £6,978,347.96 (24.76%) in excess of the amount authorised. This was funded by the Department's shared Bank Account. It is proposed to ask Parliament to authorise an additional grant of Supply from the Consolidated Fund of £6,978,347.96 by an Excess Vote.

Details and Causes

9. As explained by the Department in the footnote to Schedule 1 (page 20) of the resource accounts, the Excess arose due to a miscalculation of the amount of increase in working capital included in the Estimate (£8.516 million). This is partially offset by under-expenditure in the pension scheme (£2.158 million) and insignificant other variances (£0.6million).

I asked the Department how the miscalculation in the Estimate had arisen. The Department told me that in preparing the estimates, it failed to exclude monies due to the Consolidated Fund on collection and Consolidated Fund Supply debtors from the calculation of the movement in debtors.

The Committee of Public Accounts reported on 7 February 2005 in the report entitled 'Excess Votes (Northern Ireland) 2003-04' (HC 311) that it expected "all Pension Schemes in Northern Ireland which are subject to resource budgeting to review their estimates procedures to make sure they are not vulnerable to the deficiencies which gave rise to [the excess arising in the Teachers' Pension Scheme 2003-04 resource account]." As a result, the Committee expressed its expectation that all Northern Ireland departments have robust procedures in place to estimate and monitor their use of cash and resources.

I asked the Department to explain what it has done to meet the Committee's expectation that Northern Ireland pension schemes should review their estimates procedures to avoid excesses. The Department has informed me that it has reviewed its pension scheme estimates' procedures in light of the requirement to produce a Superannuation and Other Allowances resource account which complies with Financial Reporting Standard 17. This has included the development of processes and procedures, incorporating the use of Government Actuaries Department to provide specialist and professional advice in forecasting pension scheme running costs and liabilities, to help inform the estimates process. In addition steps have been taken to improve knowledge and understanding of the technical budgetary and accounting issues in respect of preparing estimates and accounts for the Principal Civil Service Pension Scheme (Northern Ireland). The Department is continuing to review and strengthen internal systems to support the estimates and accounts production process and in particular finance staff have updated their technical knowledge and now have a greater understanding of the issues unique to the calculation of movements in working capital.

Actions taken by the Department to help prevent a recurrence

10. The Department told me that, it has taken steps to minimise the risk of such an excess recurring. Steps taken include:

- improved knowledge and understanding within Finance staff of the technical budgetary and accounting issues in respect of the Superannuation and Other Allowances Resource Account including greater interaction between staff working in these areas;
- a review of procedures for monitoring Pension Scheme cash receipts and cash expenditure;
- a review to take place of the existing policy to use a shared bank account for the Pension Scheme transactions.

Summary and conclusions

11. In forming my opinion on the Department of Finance and Personnel Superannuation and Other Allowances 2004-05 financial statements, I am required to confirm whether, in all material respects, the expenditure and income of the Department of Finance and Personnel Superannuation and Other allowances have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. On the basis of my findings at paragraphs 1 to 10 above, I concluded that cash net expenditure of £35,167,347.96 was in excess of the amount authorised by Parliament and that it was therefore irregular. My audit opinion has been qualified in this respect.

Department of Health, Social Services and Public Safety - Resource account 2004-05

Incorrect claims for exemption from Health Service charges

1. The Department's resource accounts include the accounts of the four Health Boards which I have audited.

2. I have qualified my opinion on each Board's accounts for 2004/05 on the grounds that income due to each Board in respect of Family Practitioner Services was not received due to patients incorrectly claiming exemption from charges

3. The total loss of income for 2004/05 was estimated by the Central Services Agency to fall between £8.2 million and £10.3 million. The Central Services Agency processes claims and makes payment to contractors providing Family Practitioner Services on behalf of the Boards.

4. I have qualified my opinion on the Department's Resource Accounts as this income due, but not received, has not been applied to the purposes intended by Parliament and is not in conformity with the appropriate authorities.

5. The Department told me that substantial progress has been made in reducing the levels of incorrectness of claims for exemption from prescription charges. By the end of March 2005, the estimated level of income not received due to patients incorrectly claiming exemptions from charges had fallen by some 46.5% from 1999/00 levels. Also during the period the estimated level of incorrect exemptions rate reduced from 8.14% to 4.99%, with cumulative reductions in income not received in excess of £25 million.

6. A Fixed Penalty Charge Scheme has been implemented whereby patients who evade charges from prescriptions, dental or ophthalmic treatments are fined. During the 2004/05 financial year Counter Fraud Unit imposed some 2,100 Penalty Charges and 760 Surcharges on individuals who did not pay for their original health charges. In addition, approximately 280 cases were taken through the Small Claims Court for recovery of charge, penalties and other associated costs.

Department of Health, Social Services and Public Safety

Health and Personal Social Services Superannuation Scheme Resource Account 2004-05

Excess Vote

Purpose of Report

1. In 2004-05, the Department's Superannuation Scheme expended more resources than Parliament had authorised. By so doing, the Scheme breached Parliament's control of expenditure and incurred what is termed an "excess" for which further parliamentary authority is required. I have qualified my opinion on the Department of Health, Social Services and Public Safety Health and Personal Social Services Scheme's 2004-05 resource account in this regard. The purpose of this report is to explain the reasons for this qualification and to provide information on the extent and nature of the breach to inform Parliament's further consideration.

My responsibilities with regard to the breach of regularity

2. As part of my audit of the Department of Health, Social Services and Public Safety Health and Personal Social Services Superannuation Scheme's financial statements, I am required to satisfy myself that, in all material respects, the expenditure and income shown in the Resource Accounts have been applied to the purposes intended by Parliament and conform to the authorities which govern them; that is, they are "regular". In doing so, I have had regard to Parliamentary authority and in particular the Supply limits Parliament has set on expenditure.

3. By incurring expenditure that is unauthorised and is thus not regular, the Scheme has breached Parliament's controls.

Background to the Excess

4. Parliament authorises and sets limits on departmental expenditure on two bases – 'resources' and 'cash'. Such amounts are set out in the Supply Estimates for which Parliament's approval and authority is given in annual Budget Orders.

5. By this means, Parliament has authorised a Request for Resources for the Scheme. It thereby authorises amounts for current expenditure which are net of forecast income, known as operating accruing resources. Parliament sets limits on the amount of income that can be applied towards meeting expenditure. The amounts authorised for Requests for Resources and Accruing Resources together represent a limit on the gross current expenditure that may be incurred under the Request for Resources.

Limits

6. The limits described above for the Department of Health and Social Services Health and Personal Social Services Superannuation Scheme were set out in the Northern Ireland Main Supply Estimate for 2004-05, as amended by the Northern Ireland Spring Supplementary Estimates. The limit for Request for Resources A was set at net expenditure of £346,160,000 together with a limit on Accruing Resources of £143,840,000. This limit was authorised in the Budget (Northern Ireland) Order 2004, the Budget (Northern Ireland) (No.2) Order 2004 and the Budget (Northern Ireland) Order 2005. The breach reported below is against this limit.

Breach of limit on Request for Resources

7. Schedule 1 to the Department of Health, Social Services and Public Safety Health and Personal Social Services 2004-05 resource accounts shows net expenditure on Request for Resources A of £378,324,692.48 which is £32,164,692.48 (9.29 per cent) in excess of the amount authorised. Operating income authorised to be appropriated in aid of expenditure on this Request for Resources was limited to £143,840,000. This amount was wholly earned and applied. The Scheme also earned during the year from these income sources an additional £12,148,511.50. This is shown as excess Accruing Resources in Note 11 on page 26. It is proposed to ask Parliament to increase the limit on Accruing Resources by this amount to allow it to be applied towards meeting the excess on this Request for Resources, and to authorise the balance of £20,016,180.98 as additional use of resources by an Excess Vote.

Details and Causes

8. As explained by the Department in the footnote to Schedule 1 (page 17) of the resource accounts, the Excess arose because the Estimate of net expenditure was derived from an actuarial valuation as at March 1999. An up-to-date valuation (as at March 2003) was completed by the Government Actuary in September 2005 and this was used to calculate the 2004-05 outturn. The Estimate was therefore too low because accurate actuarial information factoring in changes to the membership profile, demographic trends and interest rate was not available when the Supplementary Estimates were being prepared in January 2005. The absence of a sufficiently up-to-date actuarial valuation also resulted in my inability to form an opinion on the 2003-04 Scheme Accounts.The Department told me that obtaining up to date actuarial valuations is a lengthy process, requiring careful analysis of membership changes: from commissioning until completion, the 1999 valuation took almost 3 years, whilst the 2003 valuation took almost 18 months to complete. The Department did receive a revised scheme valuation to assist with the 2004/05 Departmental Resource Account in September 2005, but, this was not available for the 2004/05 Spring Supplementary Estimate.

9. The Committee of Public Accounts reported on 7 February 2005 in the report entitled 'Excess Votes (Northern Ireland)' (HC311) that it expected "all pension schemes in Northern Ireland which are subject to resource budgeting to review their estimates procedures to make sure they are not vulnerable to the deficiencies which gave rise to the excess arising in the Teachers' Pension Scheme 2003-04 Resource Account". As a result, the Committee expressed its expectation that all Northern Ireland departments have robust procedures in place to estimate and monitor their use of cash and resources.

I asked the Department to explain what it had done to meet the Committee's expectations that Northern Ireland pension schemes should review their estimates procedures to avoid excesses. The Department told me that this report was issued after the final deadline for submission of the 2004/05 Spring Supplementary Estimates, which were due with DFP on 3rd February 2005. The Department was therefore unable to take account of the PAC findings in respect of the 2004/05 position.

Since the PAC report the Department has subsequently reviewed its systems taking account of the findings and recommendations therein.

Actions taken by the Department to help prevent a recurrence

10. The department told me that it has taken steps to minimise the risk of such an excess recurring. Steps taken include:

- More regular liaison with the Government Actuary's Department (GAD);
- An agreement from GAD for the submission of updated assumptions in respect of the annual accounts;
- Agreement from GAD to apply sensitivity analysis on actuarial assumptions in time for Main and Supplementary Estimates;
- Developing detailed procedure documentation for preparation of the Main and Supplementary Estimates incorporating a checklist for estimating expenditure and accruing resources.

Summary and conclusions

11. In forming my opinion on the Department of Health, Social Services and Public Safety Health and Personal Social Services Superannuation Scheme 2004-05, I am required to confirm whether, in all material respects, the expenditure and income of the Department of Health, Social Services and Public Safety Health and Personal Social Services Superannuation Scheme have been applied for the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. On the basis of my findings at paragraphs 1 to 10 above, I concluded that the net expenditure on Request for Resources A of £32,164,692.48 was in excess of the amount authorised by Parliament and that it was therefore irregular. My audit opinion has been qualified in this respect.

Department for Social Development: Resource Account 2004-05

Part 1 : Introduction and Executive Summary

Summary

Introduction

1.1 The Department for Social Development is responsible for administering a wide range of expenditure aimed at helping those in need, promoting measurable improvements to housing in Northern Ireland and tackling disadvantage amongst individuals and communities. Through the Social Security Agency and the Northern Ireland Child Support Agency, the Department is responsible for the administration of social security benefits and child support. The Northern Ireland Housing Executive is responsible for administering Housing Benefit. The Department's financial assistance to the housing and urban regeneration sectors is administered through its Resources, Housing and Social Security Group and the Urban Regeneration and Community Development Group respectively. In 2004-05, the Department accounted for expenditure of £4.4 billion on these areas, including associated administration costs, in its consolidated Resource Account.

1.2 This report:

- summarises the results of my audit and sets out the reasons for my qualified audit opinion (Part 1);
- reviews the results of my audit of expenditure on social security benefits and examines the reasons for the uncertainties over certain debtor balances in the Balance Sheet (Part 2);
- reviews the results of my audit of grants paid by the Department to Registered Housing Associations (Part 3); and
- reviews the results of my audit of expenditure by the Department on urban regeneration and community development grants (Part 4).

Executive Summary

On the reasons for my qualified audit opinion

1.3 I have qualified my opinion on the account because of:

- significant levels of estimated fraud and error in certain social security benefits;
- weaknesses in the Department's audit trails arising from deficiencies in the interaction between the Department's Programme Accounting Computer System (PACS) and its various benefit systems which resulted in limitations in

the evidence available to support significant social security programme debtor balances; and

- weaknesses in financial control and monitoring of expenditure in relation to urban regeneration and community development grants to voluntary and community bodies.

Fraud and Error in Social Security Benefits

1.4 The estimated level of losses through fraud and error in social security benefits in 2004-05 is £120.4 million which is 3.3 per cent of expenditure on benefits.

1.5 I have qualified my audit opinion on the financial statements due to the significant level of estimated fraud and error in social security benefits.

Weaknesses in Audit Trail for Certain Debtor Balances

1.6 As a result of weaknesses in the Department's audit trails mainly arising from deficiencies in the interaction between the Department's Programme Accounting Computer System and its various benefit systems, there were limitations in the evidence to support my audit of certain significant social security programme debtor balances. There is significant uncertainty over the accuracy and completeness of these amounts, which total around £46.3 million gross. I have therefore qualified my audit opinion on the financial statements because of the limitations in evidence.

Encashment Control Creditor – removal of previous qualification

1.7 In previous years, the Department was unable to obtain sufficient information to confirm the actual encashment of individual order book foils and the majority of girocheques. In 2004-05 the Agency was able to obtain sufficient information to allow the encashment control balance to be individually identified at customer level, hence providing my staff with sufficient detail to perform audit work on the year end balance. I acknowledge the Agency's efforts in this area and, as a result of my testing, can conclude that it is appropriate to remove this element of my previous qualification.

Grants to Registered Housing Associations – removal of previous qualification

1.8 On the basis of my audit findings, I have concluded that the Department's financial controls and monitoring of grants to Housing Associations is satisfactory and I have decided not to qualify my audit opinion on this area of expenditure this year. Part 3 of this report explains further the basis of this conclusion.

Financial Control Weaknesses over Urban Regeneration and Community Development Grants to Voluntary and Community Bodies

1.9 On the basis of my audit findings, I have concluded that, although progress has been made, the Department's financial controls and monitoring of expenditure in relation to grants to voluntary and community bodies is still not adequate. The basis for this conclusion is detailed in Part 4 of this report.

1.10 The Department has or is currently actioning some new initiatives to improve financial control and monitoring of expenditure. These are detailed at paragraphs 4.28 and 4.33 of this report.

1.11 As a result of the inadequacy of the Department's financial controls and monitoring of this expenditure I am unable to determine whether the expenditure was applied to the purposes intended and was regular. I have therefore qualified my audit opinion on the financial statements.

Part 2: Schedule 2 - Qualified Audit Opinion Arising from the Level of Estimated Fraud and Error in Social Security Benefits and Schedule 3 - Uncertainties over Certain Debtor Balances

Introduction

2.1 The Departmental Resource Account (Request for Resources A) provides for expenditure by the Department for Social Development (DSD) on "a fair system of financial help to those in need and to ensure that parents who live apart maintain their children; encouraging personal responsibility and improving incentives to work and save."

2.2 During 2004-05, the Department accounted for expenditure of £1.75 billion on non – contributory social security benefits, £1.51 billion on contributory social security benefits and £70 million on social fund benefit expenditure, administered by the Social Security Agency. This included Income Support £489 million, Jobseeker's Allowance £85 million, Disability Living Allowance £550 million, Attendance Allowance £187 million, Carer's Allowance £85 million, Pension Credit £278 million, Retirement Pension & Bereavement Benefits £1,172 million and Incapacity Benefit £321 million. Additionally, the Department accounted for expenditure of £377 million on Housing Benefit, which is administered by the Northern Ireland Housing Executive (NIHE).

2.3 This part of my report sets out:

- the background and the accounting arrangements for this expenditure; (paragraphs 2.4 to 2.6)
- NIAO audit approach (paragraphs 2.7 to 2.10); and
- summary of audit findings and conclusion (paragraphs 2.11 to 2.34).

Background and the accounting arrangements for this expenditure

2.4 Part 1 of this report explains the structure of the Department. The Social Security Agency (the Agency) is an Executive Agency within the Department. As the Agency is part of the DSD, benefits expenditure accounted for within the Agency Account is also included within 2004-05 DSD Resource Account programme expenditure.

2.5 My audit of the 2004-05 Social Security Agency Account has recently been completed. The Agency Account was qualified because of:

- significant levels of estimated fraud and error in certain social security benefits; and
- limitations in the evidence available to support significant social security programme debtor balances.

This qualification of the Agency Account also impacts upon the Department's Resource

Account.

2.6 As well as the Social Security Agency's benefits expenditure, the Department's Resource Account also includes Housing Benefit which is administered by NIHE and accounted for by the Department. I reported the results of my audit of the 2004-05 NIHE Accounts on 1st July 2005. The NIHE Accounts were qualified because of a limitation of audit scope as a result of the estimated losses due to fraud and error within Housing Benefit. This qualification also impacts upon the Department's Resource Account.

NIAO Audit Approach

2.7 The Agency's Standards Assurance Unit (the Unit) examines statistical samples of all benefit awards on a continuous basis. From these samples they are able to monitor the accuracy of payments made, the quality of decision making and estimate the gross monetary value of error. The Unit also completes a programme of benefit reviews which are designed to produce a reasonable estimate of the level of fraud and error in benefit awards.

2.8 As part of our audit work in this area my staff examined and reperformed a sample of the Unit's non–contributory and social fund benefits case work during the year for both the payment accuracy and decision making and the benefit review exercises. I can report that I am content that the work undertaken continues to be of good standard and the results produced by the Unit are accurate and complete. The Agency also administers contributory benefit expenditure on behalf of the Inland Revenue. The accounts of the Northern Ireland National Insurance Fund are audited by the National Audit Office (NAO). As part of their work on the Northern Ireland National Insurance Fund NAO also examine and reperform a sample of contributory benefit cases and have indicated that they also consider the work of the Unit to be of a good standard.

2.9 The benefit review reports give an estimate, on a rolling basis, of the levels of fraud and error including both customer fraud and error and internal error. The information included within benefit review reports enables the Department to consider how effective their processes have been at addressing the levels over time. The Agency also carries out financial accuracy exercises which estimate levels of internal Agency error. No new benefit review reports were completed for 2004-05 in time for my audit and therefore it is difficult for me to assess recent changes in the level of overall fraud. The Agency has told me that the completion of the current programme of benefit review reports has been delayed due to a need to fundamentally review the overall approach to the measurement of fraud and error and to allow concerns around the duplication of the calculation of internal error and financial accuracy information to be addressed. I am disappointed that I have not had an opportunity to consider the 2003-04 Disability Living Allowance Benefit Review which the Agency previously told me would be available in 2004. In this case, the Agency is seeking to amend the methodology used in estimating the level of fraud and error. I understand these benefit reviews will be available before the end of 2005 and I may decide to report separately depending on the significance of the results.

2.10 The Agency uses the Programme Accounting Computer System (PACS) in the preparation of their accounts. This system is operated and managed by the Department for Work and Pensions (DWP) in Great Britain. However there are currently deficiencies in the interaction between PACS and its various benefit information systems which have led to limitations in the evidence available to support significant social security programme debtor balances. My staff reviewed progress made by the Agency in addressing this issue.

Findings

2.11 This section:

- reviews the results of my audit of expenditure on contributory, non–contributory and means tested social security benefits administered by the Social Security Agency and NIHE (paragraphs 2.12 to 2.21); and
- examines the reasons for the uncertainties over certain debtor balances in the Balance Sheet (paragraphs 2.23 to 2.27).

Figure 1: Estimated level of fraud and error 2004-05

	Benefit	2004-05 £ million	2003-04 £ million
Non–contributory	Income Support	30.8*	30.8
	Jobseeker's Allowance	9.6*	9.6
	Disability Living Allowance	41.7*	41.7
	Attendance Allowance	5.7**	3.6 **
	Carer's Allowance	7.3*	7.3
	Housing Benefit	13.4*	13.4
National Insurance FundContributory	Retirement Pension & Bereavement Benefits	4.7**	10.5 **
	Incapacity Benefit	5.7**	3.6 **
Social Fund	Payments, grants and loans	1.5**	1.2 **
	TOTAL (excluding pension credit)	120.4	121.7
	% of benefit expenditure (excluding pension credit)	3.3%	3.4%
Non–contributory	Pension Credit ***	12.7**	-

* Benefit Review figures reported from previous years – no new Benefit Reviews completed during 2004-05 (see paragraph 2.9)

** Financial Accuracy figures – internal Agency error only, i.e. does not include external fraud and error (see paragraph 2.13)

*** Pension Credit was introduced during 2003-04 and was not subject to the financial accuracy process until 2004-05.

Source: Figures provided by the Department

Total levels of estimated fraud and error

2.12 In order to assist me in determining my opinion on the Department's accounts, I have prepared (see Figure 1 above) an estimate of the total level of fraud and error for 2004-05 which indicates a level of £120.4 million. Due to the unavailability of benefit reviews for 2004-05, I have used the latest available benefit review figures. For those benefits that do not have a recent benefit review, I have used the latest financial accuracy figures.

2.13 The level of fraud and error of £120.4 million represents 3.3 per cent of total benefit expenditure for the year, indicating a small decrease from the 3.4 per cent of total benefit expenditure reported in 2003-04. I have not included the estimated internal Agency error of £12.7 million for Pension Credit reported by the 2004-05 financial accuracy process as the fraud and error amount included for Income Support in 2004-05 was the 2003-04 Benefit Review figure (due to the absence of Benefit Review reports as explained in paragraph 2.9) and would therefore include an element of Income Support for the Elderly which Pension Credit on the whole replaced. The level of double counting of internal financial error is not known.

2.14 The following issues should be taken in to account when evaluating the estimated level of fraud and error of £120.4 million (see Figure 1):

- no value has been included for the level of error on Pension Credit for the reasons noted in paragraph 2.13 above;
- the absence of recent benefit reviews for Pension Credit, Retirement Pension & Bereavement and Incapacity benefits restricts the fraud and error figures referred to in Figure 1 above to only internal Agency amounts. Therefore, this prevents me from considering any potential external Agency fraud and error levels for these benefits; and
- the absence of recent benefit reviews for Income Support, Jobseekers Allowance, Disability Living Allowance, Carers Allowance and Housing Benefit as explained in paragraph 2.9 above.

2.15 The Agency advised me that its Benefit Review process has a more comprehensive programme than that employed by the Department of Work and Pension (DWP). It noted that DWP has, in the past, concentrated its benefit review process on Income Support and Jobseekers Allowance and no other reviews had been carried out on a regular basis.

2.16 I am concerned that the overall levels of fraud and error have remained above 3 per cent despite the considerable efforts and resources committed by the Department to address fraud and error, and, it is my view that these levels are unacceptably high. I note that losses have decreased, albeit marginally, and would urge the Department to continue its efforts to reduce losses further. The Northern Ireland Affairs Committee has also raised concerns on the high levels of benefit fraud and error. In its report on the Northern Ireland Departments' 2002-03 Resource Accounts, [1] the Committee stated, "We are disappointed that the Department's efforts to improve performance have not resulted in significant improvements. We expect the government to put in place effective measures to ensure that the present unacceptable haemorrhage of public funds is stemmed." The Agency indicated that the current level of fraud and error of 3.2 per cent is a reduction of 35 per cent from 2002-2003 when the level of fraud and error was 4.9 per cent. When Housing Benefit is added the level of fraud and error rises slightly to 3.3 per cent. The Department noted that these results indicated that progress had been made.

2.17 In response to the reported high levels of fraud and error the Department has told me that a review of the current benefit security strategy has recently concluded and it is anticipated that its recommendations will include continuing with and reinforcing the current comprehensive regime of Programme Protection Plans across benefits administered by the Agency. The NIHE will continue to implement its Housing Benefit Security Strategy which was updated in 2004 to address particular risk areas identified through its monitoring processes.

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1 HC 173 Northern Ireland Departments' 2002-03 Resource Accounts –Third Report of Session 2004-05

2.18 Furthermore, the Department has told me that benefit review is not necessarily the best method of establishing levels of fraud and error for all benefits. The Department believes it is an intrusive measure and the approach to it needs to be proportionate to the risk. The Department noted that it is developing a new strategy on benefit reviews (see paragraph 2.9 above) which will be completed by November 2005 at which time NIAO will be consulted over the proposed new approach.

Financial Accuracy

2.19 Figure 2 below indicates the total estimated level of internal error reported by the Financial Accuracy process. This process is a continuous programme of measurement of the level of internal Agency error in the main social security benefits. Figure 2 also contains the estimated monetary value of error and the financial accuracy correctness as a percentage of expenditure for each benefit and the targets set by the Agency for the main benefits. The Department told me that while there is no financial accuracy target set for Housing Benefit, the NIHE currently include a Processing Accuracy Target which is set at 95 per cent of claims. The Department informed me that this target relates to the percentage of cases for which the calculation of the amount of benefit due was correct on the basis of the information available. The Department told me that the outturn for 2004-05 was 90.4 per cent. An analysis of the sample of cases examined during 2004-05 is being carried out with a view to improving processing accuracy for the incoming year.

2.20 The 2004-05 Financial Accuracy programme has indicated an estimated level of internal error of £67.1 million. Although there has been no increase in the percentage of error from 2003-04, I am concerned by the level of internal Agency errors as this type of error is within the Agency's control and significant resources have been committed to reducing these errors. I would expect to see a decreasing trend when I consider these figures during my 2005-06 audit.

2.21 Figure 2 indicates that six financial accuracy targets covering the major benefits were set by the Agency. In 2004-05, only two of these targets were achieved. The Agency notes that it set the financial accuracy targets at very high levels for 2004-05 increasing the targets for Income Support, Jobseekers Allowance and Incapacity Allowance from 95 per cent in 2003-04 to 98.5 per cent in 2004-05. However, I noted that of these benefits only Jobseekers Allowance increased its financial accuracy performance from 2003-04. I asked the Agency to comment on these results. The Agency told me that it considers an overall error rate of only 2% to be a reasonable achievement given the difficulties it faced last year due to the protracted civil service pay dispute. However the Agency indicated that it is not complacent and has set even more stretching targets for financial accuracy for the 2005-06 year and has drawn up service improvement plans to underpin their achievement.

Figure 2: Internal Agency Financial Accuracy

Benefit	2004-05 Monetary Value of Error £ million	2004-05 Financial Accuracy correctness as a % of expenditure	2004-05 Target	2003-04 Monetary Value of Error £ million	2003-04 Financial Accuracy correctness as a % of expenditure	2003-04 Target
Non – contributory						
Income Support	11.0	97.8%	98.5%	10.1	97.9%	95.0%
Jobseeker's Allowance	1.6	98.4%	98.5%	1.9	98.0%	95.0%
Disability Living Allowance	36.0	93.5%	95.0%	33.5	93.5%	95.0%
Attendance Allowance	5.7	96.9%	not available**	3.6	98.0%	not available**
Carer's Allowance	0.9	98.9%	not available**	0.5	99.4%	not available**
National Insurance Fund Contributory						
Retirement Pension & Bereavement Benefits	4.7	99.6%	95.0%	10.5	99.1%	not available**
Incapacity Benefit	5.7	98.2%	98.5%	3.6	98.8%	95.0%
Social Fund						
Payments, grants and loans	1.5	97.8%	not available**	1.2	98.0%	not available**
TOTAL (excluding pension credit)	**67.1**	**98.0%**		**64.9**	**98.0%**	

* Pension Credit was introduced during 2003-04 and was not subject to the financial accuracy process until 2004-05

** Not available as targets not set for these benefits

2.22 As noted in paragraph 2.10 my staff reviewed the progress made by the Agency in respect of the following social security programme debtor and creditor balances:

Contributory and Non Contributory Benefit Overpayment Debtors - £46.3 million (Gross)

2.23 Overpayments to customers arise as a result of fraud or error on the part of the customer, and to a lesser extent errors by officials. When an overpayment is identified, local social security offices notify Debt Management Unit (DMU). DMU records the amount of the overpayment on their debt management system, the Overpayment Recovery System (OPREC) and pursue recovery. However, these and subsequent movements in debts outstanding are posted to the PACS general ledger in total rather than by the individual debt amounts. As a result, no listing of individual customers owing money was available from the PACS general ledger system in relation to 2004-05 for my staff to test.

2.24 At 31st March 2005 the debtor balance recorded in the PACS general ledger did not agree with the balance from the OPREC collated database. The Agency considered the PACS general ledger balance of £46.3 million to be the more accurate and, being lower, the more prudent balance.

2.25 In the absence of a satisfactory audit trail between the PACS general ledger and the more detailed information held on the OPREC system, my examination of overpayment debtors was again severely limited. Therefore, having taken account of evidence that the information held on the OPREC system is unreliable and incomplete, I conclude that there is significant uncertainty over the accuracy and completeness of the debtors balance held on the PACS general ledger. I am disappointed that non – system weaknesses in the OPREC system still exist despite the efforts of the Agency during the year.

2.26 The Agency has told me that it regards the issue of uncertainties over certain debtor balances as a priority in its work schedule and it has already taken a number of steps to address these issues. The Agency also told me that it continues to examine and validate the records held on OPREC to ensure that the information held is complete and accurate and to address the discrepancies between OPREC and PACS. The Agency noted that it has embedded a number of new processes to address the non-system weaknesses and work to validate the information held on OPREC is now a priority activity using a number of sources. The Agency has indicated that these activities have resulted in improvements which will be consolidated in the forthcoming months.

2.27 Furthermore, the Agency has told me that the Debt Modernisation Project, which was established in April 2005, aims to introduce new and improved business processes for the management of debt. In addition, a new IT system (Debt Manager) will replace OPREC and should be operational by October 2006. This system has the capability of passing information electronically between various computer systems including a direct interface with PACS and it will resolve the issue of debt identification and the fact that OPREC is a stand alone computer system. Prior to migration to Debt Manager, a reconciliation exercise will be carried out for existing cases to reconcile the accounts on both systems. The Agency has noted that this will resolve the present concerns regarding the differential between PACS and OPREC.

Encashment Control Creditor – Removal of Previous Qualification

2.28 The encashment control creditor balance represents the Agency's estimate of the total value of cheques, which have been issued to customers and are due for encashment at Post Offices or Banks, but remained unencashed at the year end.

2.29 In previous years, the Agency was unable to confirm the actual encashment of individual order book foils and the majority of girocheques as encashment data from the Agency's paying agents did not provide this level of detail. Although the Agency's accounting systems could capture detailed accounting information for individual order book foils and girocheques that are system generated and issued, it could not capture similar information for order books and girocheques that are produced and issued manually to customers. As a result the Agency was unable to perform a full reconciliation between the general ledger balances and statements from paying agents. However, in 2004-05 the Agency was able to obtain sufficient information to allow the encashment control balance to be individually identified at customer level, hence providing my staff with sufficient detail to perform audit work on the year end balance.

2.30 The Agency expects that the ongoing implementation of Direct Payment of benefits[2] should continue to reduce this creditor balance.

2.31 I acknowledge the Agency's efforts in this area and, as a result of my testing, can conclude that it is appropriate to remove this element of my previous qualification.

Summary of audit findings

Fraud and Error in Social Security Benefits

2.32 I have estimated the total level of fraud and error for 2004-05 as £120.4 million, which represents 3.3 per cent of total benefit expenditure.

Debtor Balances

2.33 As a result of weaknesses in the Department's audit trails mainly arising from deficiencies in the interaction between the Department's Programme Accounting Computer System and its various benefit information systems, there were serious limitations in the evidence to support my audit of the benefit overpayment programme debtor balances within the DSD Resource Account. There is significant uncertainty over the accuracy and completeness of these amounts, which total around £46.3 million.

Conclusion

2.34 In forming my audit opinion I am required to confirm that the account is free from material misstatement, whether caused by error, fraud or irregularity. I have qualified my audit opinion due to the significant level of estimated fraud and error in social security benefits and the impact of the uncertainty over significant debtor balances.

2 PSA Target 1.5 is to make significant progress towards modernising welfare delivery so that by December 2005 85% of customers have their benefit paid into their bank accounts. This target has been exceeded with 93% being achieved by March 2005.

Part 3: Schedule 2 – Expenditure in Relation to Grants to Registered Housing Associations

Request for Resources B: Promoting Measurable improvements to Housing in Northern Ireland

Introduction

3.1 During 2004-05, the Department paid out £102.1 million (2003-04 £78.8 million) in respect of Housing Association Grant. There are currently 38 Housing Associations in Northern Ireland providing social housing for rent, and one, the Northern Ireland Co-Ownership Housing Association, which provides the opportunity for those on low income to become homeowners.

3.2 I have qualified my audit opinion in this area since 2001-02 on the basis of inadequate control and monitoring of expenditure. My audit of 2004-05 expenditure has revealed that the previous recommendations for improvements in control and monitoring by the Department and in Housing Associations are now being realised.

3.3 My audit of 2004-05 expenditure on Housing Associations has indicated a high level of awareness of the issues from previous years on which I had qualified my audit opinion. Issues which had led to qualification included concerns over the non-adherence by Housing Associations to departmental procedures and the absence of sufficient evidence to support key decisions taken. I recognise that the Department has worked effectively with Housing Associations to ensure proper procedures are followed and tight controls are established and maintained. In addition the Housing Associations, some of which are relatively small organisations, have positively responded to the recommendations for improvements in control procedures.

Review of the Regulatory Framework

3.4 In my report last year the Department told me that the New Regulatory and Inspection Unit (the Unit) would commence operations with effect from 1st April 2004. At 1st April 2004 responsibility for regulation inspection was transferred to the Unit, which is based within the Department's Housing Finance Branch. The Unit then drafted a Regulatory Framework which was based upon the previous inspection regime and best practice in England and Scotland. After a period of consultation the Regulatory Framework was formally launched in November 2004. Since then, the Unit have been gathering data on Housing Associations and recently selected three pilot Associations for detailed inspection under the Framework. These pilots have just commenced and no conclusions are yet available.

3.5 During the development, and prior to the full implementation of the Regulatory Framework the Department's existing monitoring and control of Housing Association Grant has continued. The main component of the existing arrangements is the Scheme Audit Team which was established in 1998. The process followed by Scheme Audit ensures that Associations are accountable for the public funds they receive and provides assurance to the Department's Accounting Officer that funds are not being exposed to unreasonable risk. Since April 2002, Scheme Audit work has been divided into:

- Development Compliance Audit which focuses on the development issues of schemes with emphasis on the certification process and ensuring that schemes are controlled and monitored by Associations in line with the Housing Association Guide; and
- Minor Works and Validation Audit which aims to confirm that minor issues agreed during the previous development compliance audit have been fully addressed. This includes issues on procurement and procedural requirements and scheme design requirements.

3.6 Where Scheme Audit highlights any significant weaknesses the Department may impose sanctions on a Housing Association by way of reducing financial support or removal from the grant scheme. As at 31st March 2005 there were four (five in 2003-04) Housing Associations suspended (a further three have restrictions placed on them) from receiving further scheme approvals as a result of Development Compliance Audits until they can demonstrate that they have introduced acceptable remedial action.

3.7 The development of the Regulatory Framework arose from a review of the role of Scheme Audit, carried out by the Department's Business Improvement Unit over two years ago, which recommended that Scheme Audit's remit should be extended to provide a quality assurance function. I fully endorse the purpose of the Regulatory Framework which is to improve the accountability of Housing Associations. Therefore, I would encourage the Department to fully implement the Regulatory Framework across all Housing Associations as soon as possible. In my view, it is essential that the Regulation and Inspection process is fully embedded so the Department obtains greater assurance that Housing Associations maintain good systems of control and are following proper procedures.

3.8 In response to this, the Department told me that it is fully committed to implementing and embedding the new Regulatory Framework and associated inspection regime and that it has plans in place to achieve this. It pointed out that the Development Compliance Audits, Maintenance and Minor Works Validation Audits, Performance Management Reviews and follow-up reviews continued until the pilot exercises commenced. It has gathered substantial up-to-date information on the majority of associations and used this to inform its risk assessment of the individual associations and to develop the long-term inspection strategy and programme. The Department also acknowledges that this is a developing process and it will accordingly continue to engage with Housing Associations and the NIAO as the process rolls forward. Formal monitoring and control arrangements will be established in respect of the inspection process when the final inspection programme has been agreed.

The Department welcomes the recognition in this report of the positive efforts that have been made by both the Department and Housing Associations to strengthen and maintain effective controls.

Conclusion

3.9 On the basis of my audit findings I have concluded that the Department's financial controls and monitoring of grants to Housing Associations is satisfactory. Therefore I have decided not to qualify my audit opinion on this area of expenditure.

3.10 I am encouraged to see that the Department is implementing an enhanced oversight and governance regime over Housing Associations through the new Regulatory Framework and has already been proactive in ensuring previous audit recommendations and good practice are being promoted in and applied by Housing Associations. I will continue to monitor this area of expenditure and in particular the timely and full implementation of the Regulatory Framework and its effectiveness.

Part 4: Schedule 2 – Qualified Audit Opinion Arising from Weaknesses in Financial Control and Monitoring of Expenditure in Relation to Urban Development and Community Development Grants to Voluntary and Community Bodies

Request For Resource C : Urban Regeneration And Community Development

Introduction

4.1 One of the Departments key strategic objectives is "to tackle disadvantage amongst individuals, communities and neighbourhoods, with particular emphasis on greatest need and encouraging developing and supporting community development". During 2004-05 the Department paid out £66.8 million (2003-04 £67.8 million), in respect of expenditure on Urban Regeneration and Community Development grant.

4.2 The Departmental Resource Account (Request for Resource C) includes expenditure by the Department for Social Development on urban regeneration and community development. This covers physical and social regeneration by way of Urban Development grant in Belfast and Londonderry, expenditure on Comprehensive Development and Environmental Improvement Schemes, grants under the Community Regeneration Improvement Special Programme in urban areas outside Belfast and grant in aid to Laganside Corporation. In addition it covers the implementation of the Making Belfast Work and Londonderry Regeneration Initiatives and more recently the Neighbourhood Renewal Programme, the payment of grants to voluntary and community organisations and has responsibility for the facilitation of payments from certain European Funds and Programmes. Much of the expenditure is administered through third parties such as: Intermediary Funding Bodies; community groups; voluntary organisations; and statutory bodies.

4.3 I have qualified my audit opinion in this area for the past five years on the basis of significant weaknesses in the Department's financial controls and monitoring of expenditure in this area. My audit of the 2004-05 expenditure in this area has revealed that, although there has been some progress made, the Department's control and monitoring of grants made to voluntary and community bodies is still not adequate. I explain the basis of my opinion in paragraphs 4.4 to 4.26 below. I have also reported, in paragraph's 4.28 to 4.33 on major new initiatives that have been introduced or developed in 2005-06 that should improve the Department's distribution and administration of expenditure to tackle disadvantage in Northern Ireland.

NIAO Audit Opinion

4.4 I have formed my audit opinion on the basis of the following audit approach;

- a review of the findings of the work completed by the Department's Internal Audit Unit and in particular the annual assessment made of this area of the Department's expenditure (paragraphs 4.5 to 4.9);

- specific testing of the operation and adequacy of key financial controls by examining a sample of projects funded by the Department during the year (paragraphs 4.10 to 4.13);
- a review of the work carried out by the Quality Assurance and Improvement Units (paragraphs 4.14 to 4.25).

Review of Internal Audit findings

4.5 The Department's Internal Audit Unit prepares an annual audit plan, based on a risk assessment for each major part of the Department's activities. The Head of Internal Audit then reports progress and findings to the relevant audit committees and presents an annual assurance report to the Department's Accounting Officer. The annual assurance report includes an overall opinion, based on internal audit's findings from the agreed programme of work. The opinion ranges from no assurance[3], then limited assurance[4], substantial assurance[5] and full assurance[6].

4.6 The Head of Internal Audit's annual assurance report for 2004-05 concluded that the overall assurance rating for the Urban Regeneration and Community Development Group (URCDG) is 'limited assurance'. The limited assurance rating is a better rating than the previous year's 'no assurance' opinion but the Head of Internal Audit concluded he had concerns at the continuing level of non-compliance with procedures. This conclusion was an overall evaluation of the URCDG's activities based on the audit testing which included administration and programme expenditure. Programme expenditure includes the grants made to the voluntary and community sector and forms the largest element of URCDG's expenditure. As a consequence of its significance Internal Audit focuses its resources on testing programme expenditure.

4.7 A significant part of Internal Audit's work on URCDG programme expenditure is a review of project payments. The Head of Internal Audit has indicated in his annual report that some areas of real progress were noted during testing, he has also noted that in the other areas where project payments were tested that 'initial findings are indicating a continuing high level of non-compliance with procedures and this is reflected in the overall assurance rating'. The Head of Internal Audit has recommended that the detail of the changes made in these areas where progress has been realised are examined to see what lessons can be learned for passing to other, weaker parts of URCDG.

4.8 In considering his overall assurance for programme expenditure the Head of Internal Audit further commented 'In summation, although I have concerns at the level on non-compliance, I am satisfied that the Group (URCDG) has made sufficient progress to merit lifting the assurance rating to limited assurance'.

4.9 The various weaknesses in key financial controls and monitoring of expenditure identified by Internal Audit in the testing of projects once again correspond closely to the

3 No assurance – control is generally weak, leaving the system open to significant error or abuse and /or non –compliance with basic controls leaves the system open to error or abuse.

4 Limited assurance – weaknesses in the system of control are such as to put the system objectives at risk and / or the level of non-compliance puts the system objectives at risk.

5 Substantial assurance – while there is, basically, a sound system, there are weaknesses which put some of the objectives of risk and /or there is evidence that the level of non-compliance may put some of the system objectives at risk.

6 Full assurance – there is a sound system of control designed to achieve the system objectives and the control are being consistently applied.

findings of my audit (paragraphs 4.10 to 4.13). Where appropriate, the issues raised by Internal Audit have been highlighted in the Statement on Internal Control provided by the Accounting Officer in the Resource Account.

NIAO examination of project payments

4.10 My staff examined a sample of projects funded by the Department during the year within the different areas under investigation. Although, I noted a decreasing number of weaknesses in the testing of the projects from that in previous years, I am still concerned at the level and nature of the weaknesses found despite the best efforts made by the Department in recent years. In particular I am concerned that many of the weaknesses found during my testing were due to non-adherence to the Department's own procedures. For instance, during audit testing, my staff noted some instances where the Letter of Offer / Contract for Funding (LOO/CFF) was either inadequate or where the terms and conditions within the LOO/CFF had not been adhered to.

4.11 The adequacy of the Department's control over expenditure in this area is key if public funds are to be protected. The Department's control and monitoring of expenditure made to the voluntary and community sector needs to be effective and many of the Department's procedures have been developed to ensure this is the case. However my testing of projects indicated that although the appropriate procedures and safeguards have been issued, the Department is, in some instances, failing to apply them and thus exposing funds to unnecessary risk.

4.12 One project examined, Fernhill Museum which was awarded a grant of £94,175, particularly concerned me not only because key procedures were not followed and also because, in my view, Department of Finance and Personnel approval was not obtained for what was, in my view, novel and contentious expenditure. Furthermore I have concerns on value for money aspects of this project. I will report, in more detail, on this project at a later date. The Department has already advised me that it contests a number of points raised in this case. The Department noted that it will have the opportunity to include these details when the final report is being agreed.

Conclusion on project testing

4.13 As noted above my audit testing of project payments indicated a smaller number of weaknesses than in previous years. Nonetheless the types of weaknesses my staff found continue to be within the Department's control and therefore I remain concerned that, despite a number of initiatives undertaken and substantial resources expended to strengthen controls, only limited progress has been made in addressing the weaknesses in controls over this expenditure.

Review of the Quality Assurance & Improvement Units

4.14 There are currently three Quality Assurance and Improvement Units (QAIU) within URCDG. These Units were set up with an aim to provide management with independent assurance on the quality of evidence to support decision making and the accuracy of the payments made and where necessary, to make recommendations to improve quality by addressing any significant concerns identified. The Units are within the Belfast Regeneration Office (BRO), the North West Development Office (NWDO) and the Regional Development Office (RDO). There are currently three other areas within URCDG with no QAIU.

4.15 My review of the Quality Assurance and Improvement Units included consideration of any reviews of the Units completed by Internal Audit during the year and an examination of reports produced by the three Units. As the Units currently operate independently each one is considered separately in the paragraphs below.

Belfast Regeneration Office

4.16 The QAIU within BRO was the first established in response to audit criticisms a number of years ago. In October 2002 a 'Review Panel' was also set up within BRO. The remit of the Review Panel was to provide management with sound independent assurance on the completeness of evidence held on project files to support and justify the recommendation to approve funding. The QAIU supports the Review Panel in its role of quality assuring project files and presenting its findings to the Review Panel.

4.17 During 2004-05 Internal Audit reviewed both BRO QAIU and the Review Panel. The Internal Audit report on QAIU indicated that 'the methodologies employed by the unit gave a sound basis on which to move forward'. However Internal Audit voiced concerns in respect of the other activities QAIU were being asked to complete within BRO which they saw as a threat to the Unit's independence and also a dilution of their resources. Internal Audit also noted that during their review of project files 'some occasions when not all issues (including some issues which were fundamental) were identified'. Internal Audit also identified some absences in management checks but in particular they strongly recommended the production of a collated report which would summarise QAIU findings and allow management to assess their effectiveness. As a result of Internal Audit's findings they assigned a 'limited assurance' opinion and this remained after the follow up review of the Unit. In response to Internal Audit's findings, in relation to management checks, the Department told me that the Central Advice and Guidance Unit have devised a system of checks for use across the Group, staff have received training on the importance, relevance and need to properly perform and record timely management checks and that URCDG Management has emphasised the importance of first line management checks to all staff and will monitor performance in this area. A number of the issues raised by Internal Audit on the QAIU also impacted on its assessment of the BRO Review Panel as the Review Panel is dependent upon QAIU. Internal Audit also considered that 'limited assurance' was appropriate for the Review Panel and this rating remained after the follow up review.

4.18 In my report for 2003-04 (HC 1153 NIA 107/3) I noted that BRO QAIU had not completed post payment checking for the full year. In 2004-05 my staff noted that payment checking had been suspended for one quarter of 2004-05 to allow a pilot exercise to be completed to consider the introduction of payment accuracy targets within URCDG. I examined the results of the exercise and agree with the principle of having such a target. However I would recommend that the basis for measuring the performance against the target and the methods of gathering information are clearly defined at the outset. In response to this recommendation the Department told me that the pilot exercise for the introduction of Payment Accuracy Targets will be fully evaluated before it is introduced throughout URCDG. The Department noted that this exercise will involve clearly defining the basis for measuring the performance against target and methods of gathering information. I will review the progress and performance on payment accuracy targets in my 2005-06 audit.

4.19 I am encouraged by the improvements in the adherence to Departmental procedures Internal Audit found within the Belfast Regeneration Office and acknowledge that QAIU and the Review Panel have had a role in these improvements. I would strongly recommend that management examine the role both QAIU and the Review Panel currently have and address the issues raised by Internal Audit to ensure further improvements are recognised and reported upon. The Department informed me that, following the introduction of the Neighbourhood Renewal Programme, BRO has replaced its Review Panel with an Approval Panel with effect from April 2005. The Department also told me that the Approval Panel comprises BRO's Senior Management Team and its ultimate role is to make the final decision to approve or reject applications. The Department indicated that in order to inform the final decision, the Approval Panel critically assesses the project appraisal, ensures compliance to current procedures and reviews the adequacy of supporting documentation. I will assess the effectiveness of the Approval Panel during my 2005-06 audit.

North West Development Office

4.20 The QAIU in the North West Development Office (NWDO) was established in October 2003 and in my report last year I noted that the QAIU was already meeting its aims. I also noted in my report last year, that I was concerned that there was a limited number of staff available in QAIU and that no Review Panel had been established. The Department indicated that the staffing issue was being addressed and that a Review Panel was operational from September 2004.

4.21 No specific review of the NWDO QAIU was completed by Internal Audit during 2004-05. However in respect of Internal Audit's review of NWDO project payments they concluded that 'Based on the results of our testing, I am satisfied that NWDO have effective quality control measures in place to support sound decision making and payment. NWDO management and staff should be commended for their progress'. I note that NWDO QAIU undertake post payment checks and the results of these are reported to management on a quarterly basis. QAIU also performed pre approval checks on projects during the year, this began as checks on all applications but was reduced to 20 per cent of projects by the year end. The Department told me that the pre approval checks were reduced because the low level of errors found and the substantial level of internal audit assurance provided evidence that the 100 per cent check was no longer required. The Review Panel examines a sample of pre approval projects and makes recommendations on funding.

4.22 NWDO has made good progress in the past year and the impact of the QAIU has undoubtedly contributed to the improvements found by Internal Audit. I would encourage other parts of URCDG to look to NWDO to see what lessons can be learned from the processes and procedures it has introduced. Furthermore NWDO should continue to ensure the good work commenced is developed so as to further enhance controls.

Regional Development Office

4.23 The Regional Development Office (RDO) formed a QAIU during the 2004-05 year as part of a major restructuring of the Directorate. New staff were recruited and assigned to quality assurance functions but they are also responsible for other activitites. The bulk of the work has been on pre payment checks to ensure sufficient information has been provided by newly established area offices. A report produced by RDO QAIU, based on the initial period of review from August 2004 to May 2005, indicated that the error rates fluctuated and as a consequence the QAIU recommended a continuation of 100 per cent pre payment checking post year end. No Review Panel has been established within RDO. The Department has told me that the Senior Management Team within RDO decide collectively, as an approval panel, whether to accept or reject applications for grant assistance after receiving recommendations from area offices.

Conclusion on the Review of the Quality Assurance and Improvement Units

4.24 The establishment of the Quality Assurance and Improvement Units has undoubtedly impacted upon the improvements in control realised by URCDG during 2004-05. I understand the Department intends to establish a centralised Quality Assurance and Improvement Unit to cover all areas within URCDG. In my opinion a centralised Quality Assurance and Improvement Unit will further enhance quality control within URCDG and I will review the operation of the new Unit during my 2005-06 audit. The establishment of a central QAIU would ensure the same standards are applied throughout URCDG and that best practice is promulgated in the most effective manner.

4.25 In response to my comments on QAIU within URCDG the Department told me that the centralisation of the quality assurance function will initially involve a transfer of existing staff from BRO, RDO and NWDO to form a new unit under the control of URCDG's Financial Controller, a formal Terms of Reference will be agreed for QAIU throughout the Group. Furthermore the Department told me that the new unit will phase in a QAIU process for the areas within URCDG which do not currently have this function and that a key issue for the new unit will be to ensure that continuous improvement remains a priority. In addition the Department told me there will be a system of regular reporting on findings and remedial action proposed and taken.

Overall Conclusion

4.26 As part of my audit of the Department's financial statements, I am required to satisfy myself, in all material respects, that the expenditure and income shown in their accounts have been applied to the purposes intended by Parliament and conform to the authorities[7] which govern them, that is, that they are "regular". It is my view, based upon my audit findings in paragraphs 4.5 to 4.25 above, that, although progress has been made, the Department's financial controls and monitoring of expenditure in this area are still not adequate. These system weaknesses are sufficiently significant for me to have insufficient assurance that URCDG expenditure has been applied to the purposes intended by Parliament and conforms to the authorities which govern them. I have therefore decided to qualify my audit opinion on the regularity of this expenditure.

4.27 In paragraphs 4.28 to 4.33 below, I have summarised some of the new initiatives that

7 authorities include the legislation authorising the expenditure, the regulations issued to comply with that legislation, Parliamentary authority and DFP authority

are being actioned in 2005-06. I would hope that these initiatives are successfully and fully implemented as soon as possible together with the centralisation of the quality assurance function noted above. While there has been a reduction in the level of non compliance with laid down procedures in some areas, problems still exist, notwithstanding that I have qualified expenditure in this area since 1999-2000. I would expect to see substantial improvements in the 2005-06 year.

New Initiatives Introduced in 2005-06

New Common Systems Project

4.28 The New Common Systems Project was set up to provide URCDG with a standardised system for grant administration. The project commenced in June 2004. The Department informed me that it was fully implemented by June 2005. One of the most important outputs from the project was the production of a procedural guide and desk aids to assist staff operating the new system and to promote a consistent approach. The project has now established a Central Advice and Guidance Unit who have a varied remit which includes providing timely and accurate information to staff within URCDG, updating procedural guidance as necessary, providing training and monitoring accuracy levels throughout URCDG. I have examined the outputs from the project and my staff have attended some of the training given to URCDG staff. I am encouraged that such an approach provides a sound basis for ensuring that projects are subjected to a consistent and robust system of control. I will review the operation of the New Common Systems during my 2005-06 audit.

Risk Based Assessment

4.29 The Department indicated in my report on last year's audit that it was introducing a risk management approach to the verification and monitoring of grants. The approach was being piloted within the Voluntary and Community Unit of URCDG. At the outset each recipient of grant was considered using a structured process and then a risk assessment was awarded. The extent of Departmental oversight of the recipient activities depended upon the initial and subsequent risk rating awarded. However overall the introduction of the risk based approach aimed to reduce both the level of verification / monitoring undertaken and also the amount of original documentation the recipient of grant needed to send to the Department. The approach also involved on site verification and monitoring visits.

4.30 My staff examined one project that had been included as part of the pilot exercise to test the risk based assessment. The process of awarding the risk rating was completed satisfactorily and the level of monitoring and verification was reduced accordingly. However the on site verification and monitoring visit that was recommended was not carried out due to a shortage of staff. The Department has indicated that the pilot exercise is ongoing and that an evaluation of the pilot is due to be carried by the end of 2005 at which time any necessary improvements will be made to the system. Furthermore the Department indicated that it considers it is essential to proceed with the implementation of risk based assessment in a measured way. I reiterate my comments from last year that I would like to see the Department easing the burden of grant administration on the voluntary and community sector and making greater use of risk assessment in its consideration of monitoring and verification. This issue was also raised by the National Audit Office in its recent report: Home Office Working with the Third Sector[8]

8 Report of the Comptroller and Auditor General HC75 Session 2005-2006

where one of the recommendations stated " Monitoring processes should be proportionate – tailored to the amount of funding, good financial management and risk to value for money on specific cases."

4.31 The Department has told me that it is committed to extending the risk based approach to other parts of URCDG following the evaluation of the pilot and enhancing the model as necessary. I will continue to monitor developments in this area during my next audit.

The Funding Database

4.32 The Funding Database was formally launched in July 2005 by the Department's Minister. However the database has been available to trained staff in all departments from 1st April 2004. The Department's Voluntary and Community Unit in partnership with other departments developed the database with the aim of having a comprehensive record of government funding to the voluntary and community sector. The key benefits of the database have been identified as; should be:

- a centralised and uniform source of accessible information and reports;
- ability to better target Government support through analysis of the information;
- greater transparency in terms of where Government grants are going;
- greater accountability for Departments in being able to track payments;
- the ability to prevent duplication of funding and prevent potential fraud;
- less administration and bureaucracy for the voluntary and community sector;
- greater access by the public to sources of support available from Government.

I endorse the aims of the database and encourage all funding bodies to make optimum use of the facility to realise the valuable benefits outlined above.

Best Practice in Finance and Governance Manual

4.33 The Best Practice in Finance and Governance Manual has been developed for the voluntary and community sector by the Department in association with the Department of Finance and Personnel, other departments and representatives from the voluntary and community sector. The Manual details best practice principles which Government would expect to find in a well run organisation when considering funding. The Manual was also launched in July 2005 and will be used across Government Departments and within the Voluntary and Community Sector. I have reviewed the contents of the manual and agree that it provides a good statement of best practice in governance for use by the voluntary and community sector and government funders.

Part 2

Executive Agency and Non-Departmental Public Body Accounts

Northern Ireland Child Support Agency – Client Funds Account 2004-05

Executive Summary

Introduction

1. The Northern Ireland Child Support Agency is an Executive Agency of the Department for Social Development.

2. The Agency's Client Funds Account shows that £12.9 million was received from non-resident parents during 2004-05, £9.1 million was paid to persons with care and £3.5 million was paid to the Department for Social Development, where persons with care are in receipt of income support. At 31 March 2005, the value of maintenance balances outstanding from non-resident parents, and considered collectable, totalled £14 million.

3. I am required under section 11(3) of the Government Resources and Accounts Act (Northern Ireland) 2001 to examine and certify the Northern Ireland Child Support Agency Client Funds Account. This report brings to Parliament's attention significant matters arising from my examination of the Account for 2004-05.

Audit Examination of the Client Funds Account for the year 2004-05

4. I have qualified my audit opinion on the Agency's Client Funds Account for 2004-05 because, following my examination of a representative sample of cases, 4 per cent of receipts from non-resident parents, 40 per cent of full maintenance and maintenance calculation debt balances and 33 per cent of interim maintenance and default maintenance debt balances were for the wrong amount. This is mainly as a result of errors in the underlying maintenance assessments and incorrect adjustments to customers' accounts.

5. Based on the 2004-05 results, I estimate that overpayments by non-resident parents amounted to £513,800. There were no underpayment errors noted in our sample this year. I also estimate that at 31 March 2005 recoverable debt relating to full maintenance assessments and maintenance calculations contained overstatements of £2,946,900 and understatements of £1,981,000, and debts relating to interim maintenance assessments and default maintenance decisions contained overstatements of £103,800 and understatements of £124,900.

6. I have further qualified my audit opinion on the limited evidence available to me to assess the validity of the Agency's assumptions that all new scheme debt and final maintenance assessment debt with a liability order are fully collectable. The Agency has indicated the basis of the assumptions at Note 6.2 to the Account and I explain my opinion on these matters at paragraphs 2.20 to 2.22 below.

Current and future developments in the Child Support Agency

7. The Child Support Reforms became effective from 3 March 2003 after some delay because the testing of the new computer system had not been satisfactorily completed. Further delays in migrating all cases to the new computer system and applying the Child Support Reforms have occurred because of functionality deficiencies with the system. This has impacted upon the Agency's performance to the extent that the reduced error rates and improved service delivery expected from the Reforms have still not yet materialised.

Part 1 : Background to the Agency

Introduction

1.1 The Northern Ireland Child Support Agency is an Executive Agency of the Department for Social Development. It was established in April 1993 to operate a system of child maintenance introduced by the Child Support (Northern Ireland) Order 1991 and implement changes within the Child Support (Northern Ireland) Order 1995 and the Child Support, Pensions and Social Security Act (Northern Ireland) 2000. The principal activities of the Agency are as follows:

- **establishing child support** – contacting non-resident parents, arranging the resolution of paternity disputes and calculating child maintenance;
- **establishing regular payment patterns** – notifying non-resident parents and persons with care of the amount of maintenance to be paid and arranging a payment method between both, monitoring payments to ensure that a pattern of regular payments is established, collecting and relaying payments at the request of either party, pursuing late or missed payments promptly and taking action to recover arrears using the full range of the Agency's enforcement powers; and
- **maintaining child support** – by keeping assessments up to date when a change is reported, preparing and presenting appeals to be heard by the Appeals Service and liaising with other Government Departments, Agencies and public bodies.

1.2 Prior to the introduction of the Child Support Reforms, which became effective from the 3rd of March 2003, child maintenance was calculated on the basis of formulae laid down in legislation. This report refers to maintenance assessments under the legislation as 'old scheme' and assessments calculated under the Child Support Reforms as 'new scheme'. The official terminology for cases under 'old scheme' is initial and final maintenance assessments and those cases under 'new scheme' are default maintenance decisions and maintenance calculations. Note 5.2 to the Client Funds Account gives wider definitions to these terms.

1.3 The majority of transactions in the CSA Client Funds Account for 2004-05 are based on the old scheme as the new scheme is being phased in and is only used for new cases. The old scheme calculations were inherently complex as it was necessary to obtain personal details of both non-resident parent and the person with whom the child mainly resides (the 'person with care'). This involved gathering information on income, housing costs and other expenses from customers who may have been reluctant to provide it. Consequently there was significant risk of error occurring in the assessment process. The aim of the new scheme is to substantially simplify the calculation of maintenance assessments with a view to speeding up the process and reducing the level of errors.

Part 2 : Examination of the Client Funds Account

Introduction

2.1 This part of my report outlines the form of the Client Funds Account, sets out the basis of my examination of the account, summarises the outcome of my audit of transactions and balances and explains why I have qualified my audit opinion on the Account.

The Northern Ireland Child Support Agency's Client Funds Account

2.2 The Northern Ireland Child Support Agency's Client Funds Account is prepared on a cash basis and shows the amounts received by the Agency from non-resident parents, the maintenance subsequently paid over to persons with care and the sums paid to the Department for Social Development, where persons with care are in receipt of income support. The Agency maintains accounting records on its Child Support Computer System and on the Child Support 2 (CS2) system for individual non-resident parents. The maintenance outstanding at 31 March 2005 disclosed at notes 6.1 and 7.1 to the Client Funds Account is derived from the balances on these individual accounts from the two systems.

2.3 The Client Funds Account shows that during 2004-05 the Agency received £12.9 million (2003-04 £12.7 million) from non-resident parents. Based on this amount £9.1 million (2003-04 £8.5 million) was paid over to persons with care and £3.5 million (2003-04 £4 million) to the Department for Social Development, where persons with care are in receipt of income support. Further payments of £0.3 million (2003-04 £0.2 million) comprised refunds of overpayments to non-resident parents.

2.4 At 31 March 2005, the balance of full maintenance assessments and maintenance calculation debt outstanding totalled £11.4 million (£7.9 million at 31 March 2004) while the balance of interim maintenance assessments and default maintenance decisions debt outstanding totalled £2.6 million (£1.1 million at 31 March 2004). The balances disclosed in notes 6.1 and 7.1 in relation to full maintenance, maintenance calculations, interim maintenance and default maintenance decision amounts outstanding exclude balances that the Agency regards as probably uncollectable.

2.5 Notes 6.1(iv) and 7.1(iv) to the Account show that probably uncollectable debt has resulted in full maintenance assessment and maintenance calculation balances shown in note 6.1 being reduced by £22.3 million and interim maintenance assessment and default maintenance decision balances shown in note 7.1 being reduced by £16.5 million at 31 March 2005.

2.6 The probably uncollectable amounts relate to amounts which are likely to be very difficult to collect due, for example, to the lack of recent payments from the non-resident parent or the personal circumstances of the non-resident parent. However, the amounts outstanding on individual cases still remain due in full and the Agency continues to consider any new facts brought to its attention regarding collectability. It has not waived its discretion to take action in the future to collect any amount outstanding which becomes collectable. My staff tested a sample of cases from the debt analysis exercise to ensure that the Agency had properly classified the total debt as at 31 March 2005.

Audit Results

Basis of Testing

2.7 I have examined representative samples of receipts from non-resident parents and maintenance debt balances. The results of these examinations allow me to confirm the existence of material error within the account but are subject to margins of statistical uncertainty. In 2004-05 my staff examined 50 receipts, 47 full maintenance assessments / maintenance calculations involving some 190 assessments (2003-04; 141 assessments), and 30 interim maintenance assessments / default maintenance decisions involving 32 assessments (2003-04; 36 assessments).

Receipts and Payments

2.8 From the representative sample of receipts from non-resident parents in 2004-05, I found that in 96 per cent of cases examined the receipts were correct. In 4 per cent of cases the receipts were unable to be tested as the supporting case papers could not be located by the Agency.

2.9 The Agency's independent Case Monitoring Team reported that the accuracy of the cash value of decisions made on old scheme cases in 2004-05 was 89 per cent against a target of 82 per cent. This is a decrease in performance from 2003-04 where a 92 per cent accuracy rate was achieved. The accuracy performance achieved for new scheme cases was 92 per cent against a target of 90 per cent. This performance for new scheme cases was the same as that achieved in 2003-04. However, the performance on new scheme cases is subject to a caveat by the Agency due to its inability to be confident of the information provided by CS2.

2.10 The Agency's method of calculating cash value accuracy was changed from 2001-02 so that only the accuracy of the last decision on an assessment is measured, rather than looking back over decision making throughout the life of the claim. My audit, on the other hand, examines the cash value of client funds received each year and subsequently paid out by the Agency, together with the amount of maintenance outstanding at the year end. This involves examining each assessment decision over the life of the claim. Due to this difference in approach and reporting methodology the Case Monitoring Team's results are not directly comparable to my results in respect of receipts. Nevertheless, in my view, both sets of results show unacceptable levels of inaccuracy.

2.11 I note that the Agency's annual report includes a target for 2005-06 in respect of cash value accuracy. The target set for the old scheme is 85 per cent and is 91 per cent for the new scheme. As the Agency has exceeded both these levels in the past two years I am concerned that the targets set are less than previously achieved. I asked the Agency to explain the basis for setting the targets at a reduced level. The Agency told me that it set the cash value accuracy targets at 91 per cent for new scheme and 85 per cent for old scheme, both an increase on those set for 2004-05, because when the targets were agreed it was believed that the Agency would be involved in a migration and conversion pilot exercise in 2006-07 that could adversely impact accuracy levels.

2.12 The regular reports produced by the Case Monitoring Team are examined by the Standards Committee. The Standards Committee is chaired by an independent chairperson and reports annually to the Agency's Chief Executive. A copy of the report is also laid in the

Northern Ireland Assembly. My staff met with the Standards Committee Chairman during 2004-05 to discuss our respective review and reporting methodologies and to discuss the findings of my audit and the results of the Case Monitoring Team's work during the year. This proved to be mutually beneficial.

2.13 The sampling techniques used in the audit have enabled me to extrapolate the results to provide an estimate of the level of monetary error in the receipts and payments account. I estimate that overpayments by non-resident parents amounted to £513,800 (4 per cent of total receipts). There were no underpayment errors found. On this basis, the total estimated overpayments is a material sum and I have therefore qualified my opinion.

Maintenance Balances

2.14 I examined a representative sample of balances due from non-resident parents in 2004-05. This required verification of all transactions supporting each balance and a re-performance of the assessments, charges, transactions and adjustments made throughout the lifetime of the case. This examination identified errors in 40 per cent of full maintenance and maintenance calculation balances and 33 per cent of interim maintenance and default maintenance decision balances. However, as interim maintenance and default maintenance decision assessments are set at punitive rates which do not take into account the non-resident parent's ability to pay, these balances have been reduced by approximately 86 per cent in the Account as probably uncollectable.

2.15 Extrapolation of the audit results indicates that the £11.4 million shown in note 6.1 to the Account as due from non-resident parents for full maintenance assessments and maintenance calculations at 31 March 2005 is likely to include overstatement errors amounting to an estimated £2,946,900 (26 per cent of the amount outstanding) with understatement errors amounting to an estimated £1,981,000 (17 per cent of the amount outstanding).

2.16 Similarly, I estimate that the £2.6 million shown in note 7.1 as due for interim maintenance assessments and default maintenance decisions at 31 March 2005 is likely to include overstatement errors amounting to an estimated £103,800 (4 per cent of the amount outstanding) with understatement errors amounting to an estimated £124,900 (4.8 per cent of the amount outstanding).

2.17 Figure 1 below indicates an increasing level of errors per assessment from 2003-04 for both categories of assessment tested. In my opinion, the Agency should be concerned by these results which seem to indicate a deterioration in performance. I asked the Agency to comment on this upward trend in errors. The Agency stated that during the year it was necessary to move experienced members of staff from old scheme work to work on transitional and new scheme cases. This, combined with staff turnover, increased the numbers of new and inexperienced staff processing the maintenance calculations. The Agency has since introduced Technical Checkers within teams and it is anticipated that this will reduce the number of errors that occur.

Figure 1 : Analysis of Percentage Errors found per number of assessments examined from 2004-05 examination of Full Maintenance / Maintenance Calculation and Initial Maintenance / Default Maintenance Decisions

Type of Assessment	Number of Assessments Examined	Number of Errors	2004-05 % of Errors per Assessments Examined	2003-04 % of Errors per Assessments Examined	2002-03 % of Errors per Assessments Examined
FMA / MC[1]	190	44	23%	18%	50%
IMA / DMD[2]	32	14	44%	19%	31%

[1] FMA /MC – Final Maintenance Assessment / Maintenance Calculation
[2] IMA / DMD – Initial Maintenance Assessment / Default Maintenance Decisions

Source: Northern Ireland Audit Office audit examination

2.18 In the light of these results, I have concluded that the amounts reported in notes 6.1 and 7.1 as being due from non-resident parents at 1 April 2004 and 31 March 2005 are materially misstated. Consequently in my view these notes do not properly present the maintenance balances due, I have qualified my audit opinion.

Causes of Error

2.19 The majority of errors in receipts from non-resident parents in 2004-05 referred to in the above paragraphs were caused by mistakes in the underlying maintenance assessments. Most maintenance assessment errors arose from mistakes by the Agency’s staff in calculating the income element of assessments, applying the incorrect effective date and incorrect balances on the computer system caused by clerical errors (Figure 2). Errors in receipts will also have an effect on the accuracy of outstanding balances. A major contributor to poor performance has been insufficient evidence recorded by decision makers to substantiate their decisions.

Figure 2: Analysis of the Causes of Error in receipts and maintenance balances in 2004-05

	Number of errors			
Causes of Error	**Receipts**	**FMA/ MCs[1]**	**IMA/ DMDs[2]**	**TOTAL**
Incorrect benefit rates used	-	-	2	2
Incorrect earnings applied	-	8	-	8
Incorrect housing costs applied	-	2	-	2
Incorrect effective date applied	-	12	5	17
Incorrect adjustments to computer system	-	15	-	15
Incorrect number of assessment units	-	3	-	3
Incorrect number of qualifying children	-	1	-	1
Periodic /other reviews outstanding	-	1	-	1
Missing case papers	2	-	1	3
Information on case papers not actioned	-	-	5	5
Other	-	2	1	3
Total	**2**	**44**	**14**	**60**

[1] FMA /MC – Final Maintenance Assessment / Maintenance Calculation
[2] IMA / DMD – Initial Maintenance Assessment / Default Maintenance Decisions
Source : Northern Ireland Audit Office audit examination

Limitation of Audit Scope

2.20 I have also qualified my audit opinion this year in respect of the limited evidence available to me to support the Agency's assumptions that new scheme debt (see paragraph 2.21 below) and final maintenance assessment debt with a liability order (see paragraph 2.22 below) are fully collectable.

2.21 As indicated in Note 6.2 to the Client Funds Account, the Agency has included all new scheme debt as being fully collectable. This assumption by the Agency is based on an exercise carried out by the Department of Work and Pensions (DWP). My staff examined the DWP papers supporting this exercise and were unable to agree with the conclusions reached due to the size and attributes of the sample selected for proving this assumption, the definition of collectable debt used in the exercise and the statistical methods used. The limited functionality of the CS2 system has meant the Agency is unable to produce a full listing of new scheme debt at the year end. Whilst I recognise that the Agency is fully dependent upon its Great Britain counterpart for this information, the Agency was unable to provide me with any alternative, sufficient evidence to support the assumption that all new scheme debt is fully collectable. I recommend that the Agency implements procedures as soon as possible to ascertain the collectability of new scheme debt as the volume of debt balances on CS2 increases.

2.22 The Agency uses a theoretical model to determine the collectability of old scheme debt. This model is examined by my staff to determine the validity of the assumptions made within it. The model used to calculate the collectability of final maintenance assessment debt for 2004-05 included an assumption that if debt has a liability order attached (the legal recognition that a debt exists which allows the Agency to take enforcement proceedings on the debt) it is deemed collectable. Whilst I acknowledge that the existence of a liability order means the debt is legally enforceable, the Agency was unable to provide me with evidence to sufficiently convince me that a liability order increases substantially the likelihood of collectability. I would encourage the Agency to seek methods for monitoring the impact that the existence of a liability order has on the collectability of final maintenance debt.

2.23 In response to my qualification of these matters the Agency told me that it is satisfied with the information and detail given in Note 6.2. However, further investigative analysis would be carried out in 2005-06 with a view to removing any audit concerns.

Conclusion

2.24 The levels of error in receipts, payments and maintenance balances continue to be unacceptable. The implementation of the Child Support Reforms and the CS2 system has been problematic for the Agency and this has impacted upon the accurate processing of cases both on the old and new schemes. My audit has indicated an increased level of errors from 2003-04 both in monetary value and in percentage terms which is concerning. I include further comments on the implementation of the Child Support Reforms and CS2 in the final part of this report.

Part 3: Current and future developments in the Child Support Agency

Introduction

3.1 The operational difficulties within the Agency have been well documented and have drawn adverse media attention over the last few years. In the earlier days of the Agency the difficulties were seen to mainly come from the legislation which made child maintenance assessment overly complex. In order to address this, Government set out its plans for the Child Support Reforms in a White Paper published in July 1999.[1] It recognised that the system had failed to deliver regular maintenance and had become discredited, and concluded that the complex rules did not fit with the lives of separated families or with other systems of support. The Child Support Reforms, as subsequently set out in the Child Support, Pensions and Social Security Act 2000, were intended to be introduced in October 2001. However Government decided that such far reaching reforms required a new computer system (CS2) and thus the implementation of the Reforms was delayed until 3 March 2003. The Northern Ireland Child Support Agency (NI CSA) is totally dependent on its Great Britain (GB CSA) counterpart for the development, testing, implementation and maintenance of both the old and new computer systems it currently operates. The new computer system was procured under a Private Finance Initiative scheme and Electronic Data Systems Limited (EDS) was contracted to design, develop, test and implement the new system. This part of my report considers the position of the Agency in respect of the implementation of the Child Support Reforms, the problems it has been having with the new computer system and some aspects impacting upon the Agency's performance.

The House of Commons Work and Pensions Committee

3.2 The House of Commons Work and Pensions Committee (the Committee) undertook an inquiry with the aim of examining the performance of the Child Support Agency with particular reference to the Agency's compliance and enforcement regime. The inquiry was announced on 5th May 2004 and, after hearing oral evidence from a number of witnesses and undertaking two visits (one of which was a visit to the Australian CSA), the Committee produced their report[2] in January 2005. Although the Committee's report was based on the GB CSA, many of the issues directly impact the NI CSA. The Government response to the Committee's report was produced in March 2005[3] and outlined a number of developments which again directly impacts upon the operations of the NI CSA.

3.3 I have used the Committee's findings and the Government's responses to those findings to focus on a number of issues which are currently prevalent in the NI CSA within this part of my report.

1 'A New Contract for Welfare: Children's Rights and Parents' Responsibilities', July 1999.
2 HC 44-1 House of Commons Work and Pensions Committee 'The Performance of the Child Support Agency'
3 HC 477 House of Commons Work and Pensions Committee 'The Child Support Agency: Government Response to the Committee's 2nd Report of the Session 2004-05'

The New Computer System (CS2)

3.4 At 31st March 2005 the Agency estimates that 11,926 cases were on the new system (6,178 being processed under old scheme and 5,748 under new scheme rules). However the bulk of the Agency's caseload, some 23,625 cases, still remains on the old system and therefore remains based on old scheme rules. Therefore approximately 84 per cent of the total caseload continues to be processed under old scheme rules.

3.5 The Committee, in its report, has clearly indicated that many of the problems faced by the CSA are caused, or at least affected, by a lack of a fully operational IT system. The Government has stated that it will not risk interrupting the flow of money and potentially put at risk the old system cases by migrating them to the new system until it is confident the new system is robust. To date the GB CSA has not given a date for total migration. It is important to note that this is not only a case of moving cases to the new computer system but also moving cases to the new scheme. Thus customers on the old system are missing out on all the benefits the Child Support Reforms had intended.

3.6 In the Government's response to the Committee's recommendation that the CSA draw up a contingency plan including an abandonment option for CS2, Government has indicated that it is not its intention to work up abandonment plans at present and that the Agency continues to work closely with EDS to develop plans to remove residual system defects and missing functionality. I acknowledge that the NI CSA are dependent upon GB CSA for developments in respect of the computer system.

Improving accuracy

3.7 Part 2 of this report indicated the levels of cash value accuracy achieved by the NI CSA in 2004-05. The Committee focused on the new scheme accuracy rates and recommended that a strategy for increasing the accuracy rate of maintenance calculations is developed. Whilst I recognise that NI CSA have achieved higher rates of accuracy than GB CSA (2003-04 target 90 per cent, achieved 82 per cent) I strongly encourage the NI CSA to focus further resources in this area to ensure improvements and thus a better service for their customers. The Government's response to the Committee on this issue indicated a number of measures that are being developed in an effort to improve accuracy. These measures include standardising forms, implementing a risk based checking system, enhanced training and introducing quality support officers.

Costs of Collection

3.8 The Committee's report also highlighted the ratio of administration cost the GB CSA incurred to the amount it received from non-resident parents. The ratio for 2003-04 was 1:1.86 that is, for every £1 spent the GB CSA collected £1.86 from non-resident parents. The NI CSA's ratio for 2004-05 is 1:0.86 or, for every £1 spent by the Agency, £0.86 is collected from non-resident parents. The Committee's report indicates an equivalent Australian ratio of 1:8.01, for every £1 the Australian CSA spends it collects £8.01 from non-resident parents. I asked the Agency why the NI CSA cost of collection was comparatively higher than GB CSA. The Agency told me that the main difference is as a result of Northern Ireland having a higher percentage of benefit cases (78 per cent in Northern Ireland compared to 65 per cent in GB in November 2004 and 85 per cent and 67 per cent respectively in February 2003). The Agency explained that benefit cases require similar assessment and case maintenance work as private cases and yet have significantly lower assessments and, consequently, give rise to much lower receipts.

3.9 The Agency also said that the cost of the Child Support Reform programme in Northern Ireland, £3.3 million in 2004-05, added disproportionately to costs and if this is removed the Agency collected £1.11 for every £1 spent. Furthermore, the Agency also assesses cases which result in payments being made directly between the non-resident parent and the parent with care. During 2004-05 the Agency arranged for £4.3 million of old scheme assessments to be paid directly to parents with care.

Debt levels

3.10 The Committee also recommended that the GB CSA publishes a debt reduction target and a strategy to reduce debt. In its response the Government indicated that a debt reduction target would be set for 2005-06 and published in its business plan and that the GB CSA were currently working on a debt strategy. I share the Committee's concerns at the rising levels of debt in the Agency. The level of collectable debt in the Agency was £14 million at 31st March 2005 and £8.9 million at 31st March 2004. The Agency has indicated that the actual level of collectable debt was £12.3 million at 31st March 2004, the difference being adjustments made in 2004-05 which related to 2003-04 balances outstanding (Note 6.1(ii) and 7.1(ii) to the Account refers). In addition there was a further £38.8 million deemed probably uncollectable (£35.4 million at 31st March 2004). The total debt due from non-resident parents therefore represents over four years outstanding receipts. The annual report of the Agency does not include a debt reduction target for 2005-06. I asked the Agency to respond to my concerns that the levels of debt are not being adequately addressed. The Agency told me that it will fully consider the GB debt strategy when it is produced and will seek to apply similar measures, if appropriate. In the meantime, in line with GB, it has introduced an internal target to collect arrears equivalent to 30 per cent of the total arrears accrued.

Child Maintenance Premium

3.11 The Child Maintenance Premium was introduced with the new scheme to encourage compliance from both parents. Child Maintenance Premium enables parents with care on the new scheme assessment basis to keep up to the first £10 of any child support paid while they were claiming Income Support. As detailed above, due to difficulties with migrating cases to the new system and thus the new scheme, a large number of parents with care have been unable to benefit from the premium. The Committee's report recommended that Government should introduce the Child Maintenance Premium for old scheme cases due to the delay in migration. Government rejected this recommendation by concluding that it would not be possible, operationally to make this payment. Once again this emphasises the urgency of moving all cases to the new system and new scheme.

Conclusion

3.12 The Committee concluded that the GB CSA is a 'failing organisation which is currently in crisis'. The Government's response recognised that much more work was needed to bring the GB CSA to an acceptable level of service for all its clients. Whilst I recognise that the Agency is dependent upon GB CSA for its information technology services, it is disappointing that the new computer system has not been successfully implemented during this year and as a result the Agency's performance has been unsatisfactory. Fundamentally the Agency's performance impacts upon one of the most vulnerable groups in society, the children who are reliant upon its services. I would recommend the Agency continue to address the difficulties outlined within this report as a matter of urgency and I will monitor its progress during my next audit.

Invest Northern Ireland – Report on the 2004-2005 Financial Statements

Purpose of the Report

1. In 2002-03 and 2003-04, I qualified my opinion on Invest Northern Ireland's financial statements as insufficient evidence was available to me in relation to the recording and use of funds by Third Party Organisations (TPOs). Many of these contracts were inherited from Invest NI's predecessor organisations and some were not supported by an adequate system of controls.

2. I have not qualified my opinion on the 2004-05 accounts in respect of this matter as Invest NI has now introduced a structured inspection programme of TPO books and records as I recommended in my 2002-03 report. This has provided me with sufficient evidence to conclude that funds provided in 2004-05 to TPOs have been used for the purpose intended. Invest NI paid some £9.7 million (2003-04: £4 million) to 49 TPOs in 2004-05.

3. In my report on the 2003-04 qualification, I noted that I would review the outcome of these investigations during my audit of the 2004-05 accounts. The results of my review are detailed in paragraphs 12 to 18 below.

4. In response to the NIAO recommendation, Invest NI carried out a wide review of all types of contractual relationships and undertook a structured and risk based inspection programme. The inspection programme focused on 28 organisations which were assessed with the highest risk and funding since Invest NI was established. These included 16 TPOs accounting for £9.1 million of the 2004-05 spend. In total these 16 TPOs have accounted for 96% of the funds which Invest NI provided to TPOs over the past three years.

Background

5. TPOs are private sector or voluntary bodies which Invest NI contracts to deliver initiatives by means of financial assistance, advice or other services to customers who otherwise would have received such assistance directly from Invest NI.

6. TPOs are therefore organisations which have the ability to make funding decisions or have responsibility over public funds. This responsibility can extend to the disbursal of public funds, payment collection or the management of publicly owned assets. TPOs include bodies which have a strategic partnership with Invest NI for which they are provided with core funding. They also include a number of financial institutions which operate loan funds using funding provided by Invest NI.

7. TPOs do not include organisations which are mainly involved in service delivery or which provide strategic advice and which have limited or no funding decision capability.

8. In 2002 Invest NI commissioned consultants to conduct a review of the TPO contractual relationships inherited from the Local Enterprise Development Unit (LEDU). The main findings were that:

- contracts were not clear as to the services required and the expected outputs were often omitted;
- a number of contracts were let without any tendering process; and
- there were no formal monitoring systems to provide Invest NI with assurance that TPOs were complying with the terms and conditions of the contracts.

In response to these findings, Invest NI introduced revised procedures over new contracts in 2003-04. Further guidance was issued in February 2004 and an Audit and Control function set up to manage the budget to TPOs.

9. These monitoring arrangements did not include the structured inspection programme of TPO books and records which I recommended in my report on the 2002-03 accounts. They also did not address the contractual and other weaknesses in existing arrangements.

10. To ensure completeness of the scope of the inspections, a review was carried out by Invest NI of the extent and adequacy of its contractual relationships in respect of 247 separate initiatives identified as potential TPOs, some 49 of which were confirmed as TPOs, as defined above. A risk assessment exercise then identified 28 organisations for inspection. A programme of work was designed to be carried out by external consultants on each of the 28 organisations. This programme covered corporate governance, financial controls, related parties, as well as compliance with the funding agreement and proper use of funds.

Results Of My Review of Invest NI Inspections

11. All of these 28 inspections have been undertaken and initial or final reports drafted. This exercise has identified a number of issues including compliance with conditions in funding agreements, and provision of adequate supporting information.

12. In all but one of the 28 organisations reviewed to date, the overall conclusion of the Invest NI assessment was that funds had been used for the purpose intended. However a range of problems were identified by the inspections. These included:

- Contractual outputs need to be more carefully monitored before funding payments are made, and particular care taken that payments are not in advance of need;
- A small number of organisations had inadequate systems of control over issuing grants or loans using funding provided by Invest NI. As a result agreed project expenditure by these organisations was not always adequately supported by documentation;
- There are questions over the viability of five of the organisations which may cease operation if Invest NI funding is not continued;
- There is scope for improvement in the corporate governance arrangements to assist organisations in demonstrating that funding was managed to the standard of probity required by publicly funded bodies; and

- There are still instances where Invest NI staff members are on the Boards or other decision making committees of external organisations. This can lead to the risk of perceived or actual conflict of interest.

13. I asked Invest NI what steps were being taken to address the issues arising from the inspections and they advised me that:

- As existing contracts expire, the future of the initiative is reviewed and if appropriate, new contracts are put into place updating Invest NI's contractual position. These new contracts follow Invest NI's revised guidelines which will be periodically reviewed;
- The information gathered during the review and Invest NI inspections has been used to develop a new framework for classifying and dealing with TPO relationships;
- Where specific weaknesses have been identified these have been highlighted to the TPO concerned and action plans drawn up to deal with them;
- New guidance and template documents are being prepared for wider use throughout Invest NI;
- New contracts have been drafted which will be used as a basis for these templates; and
- Invest NI's operating manual will be updated and training will be provided to all relevant staff.

14. In one organisation, which is a strategic partnership arrangement originally funded by LEDU, more significant concerns were noted during the inspection. These included difficulties in obtaining the necessary evidence to confirm that the core funding provided by Invest NI had been spent appropriately. There were inconsistencies and lack of clarity in the documentation which has led to the original inspection being superseded by a wider forensic investigation. This investigation is currently ongoing to determine whether any impropriety has occurred. £1.7 million of public funds has been made available to this company over a period of nine years. Total funding was approximately £350,000 in the year 2004-05.

15. I am pleased to note the actions being taken by Invest NI as a result of the evidence gathered as part of the Invest NI inspections exercise. This, of course, was one of the main reasons for my recommending the need for this exercise in my 2002-03 report. The 2002-03 and 2003-04 accounts were qualified because these reviews had not been conducted and evidence on the proper use of funds was not available to me at that time.

16. As noted in paragraph 10 above, the scope of the Invest NI review covers all organisations with which it had a significant contractual relationship when Invest NI was established in April 2002 or since that time. Contracts with LEDU, IRTU or IDB which expired prior to the existence of Invest NI were not included in the review. This approach ensures the use of Invest NI funding is subject to review. It does not identify organisations which received funding prior to that date and continue to deliver a service based on previous arrangements or which may hold assets funded by the previous organisations.

17. I have since noted one further organisation, funded some years ago by LEDU which was not included as a TPO in the scope of Invest NI's investigation and where there are allegations of irregularity. There has been no funding since Invest NI was established and these allegations are currently being investigated.

Emerging Business Trust

18. Invest NI, in January 2003, commissioned a separate investigation into the establishment and management of Emerging Business Trust (EBT Loan Fund) and EBT Venture Fund Limited (EBT Venture Fund). The Trust was established in 1996 with funds of public money on behalf of LEDU and the International Fund for Ireland. The Trust assisted in the financing of emerging businesses from disadvantaged areas in Northern Ireland.

19. In my report on the 2002-03 accounts (issued in July 2004) I noted that the Invest NI investigation was still in progress and significant governance and regularity issues including LEDU's handling of potential conflicts of interest were still being explored. I received a final report from Invest NI into the establishment and management of EBT on 4th April 2005. Both EBT Loan Fund and EBT Venture Fund went into Creditors Voluntary Liquidation on 11th April 2005. Invest NI told me that it continues to take all necessary steps to maximise recovery of funds previously provided.

20. I am preparing a separate report on the matters arising out of Invest NI's own investigation into the EBT Loan Fund and the EBT Venture Fund, which should be presented to Parliament in the near future.

Conclusion

21. In my opinion the structured programme of inspection introduced by Invest NI has provided me with sufficient evidence upon which to conclude on the use of funds in 2004-05. While a number of issues have been raised as a result of the inspection programme undertaken by Invest NI, these predominately reflect problems with previous years' funding. Where concerns have been raised in relation to the current years funding, in my view, these are not sufficiently material to warrant qualification.

22. Most of the problems noted by the inspections in paragraph 12 above and the ongoing investigations relate to bodies which received funding from LEDU. This body ceased to exist in 2002 when its functions and staff became part of Invest NI. I will continue to monitor the outcome of these investigations.

23. I have not qualified my opinion on the 2004-05 accounts as, in my view, I have now obtained sufficient evidence on the recording and use of funds paid to TPOs during the year.

Accountability to Parliament and Financial Control by Education and Library Boards

Introduction

1. I previously reported on Accounting to Parliament by Education and Library Boards in Northern Ireland in my General Report 2002-03 (HC 673, Session 2003-04, NIA 41/03) and my General Report: Financial Auditing and Reporting 2003-04 (HC 96, Session 2004-05). The reports dealt with delays in finalising Education and Library Boards' (Boards) accounts and related matters.

2. The move from cash to accruals accounting by Boards from 1999-2000 onwards was protracted because draft accounts required major adjustments, new arrangements were introduced to account for income, there were delays in getting valuations for the Boards' extensive land and buildings and delays occurred in agreeing balances. I undertook to keep progress under review and I now report accordingly.

Finalisation, audit and laying of accounts

3. At the time of my last report several years' accounts remained to be finalised and audited for each of the five Boards. Between then and 31 March 2006 I certified Boards accounts as shown in the Table below.

Figure 1: Years of account certified since General Report: Financial Auditing and Reporting 2003-04

Board	Years of account certified
Belfast	2001-02, 2002-03 and 2003-04
North Eastern	2001-02, 2002-03, 2003-04 and 2004-05
South Eastern	2002-03
Southern	2001-02, 2002-03, 2003-04 and 2004-05
Western	2003-04 and 2004-05

4. The following accounts remain to be finalised:

- Belfast Education and Library Board (BELB) – 2004-05,
- South Eastern Education and Library Board (SEELB) – 2003-04 and 2004-05.

5. BELB anticipates that its 2004-05 accounts will be finalised before the end of May 2006. SEELB has advised the Department of Education (the Department) that the 2003-04 and 2004-05 accounts should be signed in early June 2006.

6. Three of the five Boards' accounts are now up to date. Notwithstanding the advances made by BELB and SEELB in clearing prior years' accounts, they need to demonstrate sustained improvement. The Department told me that it had given high priority to resolving the outstanding issues, assigning an accountant to concentrate on this task and work closely with the Boards, and had stressed the importance of finalising the accounts at its six monthly Accountability Reviews with Board Chairs and Chief Executives. The Department also assured me that this focus on ensuring Board accounts are completed in a timely manner will be maintained.

7. The Boards' 2005-06 accounts will be the first accounts prepared under the Government's "faster closing" initiative. It is intended that the dates by which Government Departments' accounts are laid before Parliament will be brought forward progressively until 2007-08 when accounts will be laid before Parliament rises for its summer recess. The Department has correspondingly asked the Boards to prepare their 2005-06 accounts by 16 June 2006. This is two weeks earlier than was required in previous years and the timetable will be brought forward again in 2006-07 and 2007-08. Preparing high quality accounts in line with the accelerated timetable will be a significant and increasing challenge for the Boards. Guidance issued by the Department to Boards sets out the expectation that the publishing and laying of annual accounts should be completed by the end of November annually. It will be a significant step forward for Boards to meet this target.

Financial Overspends and Budgetary Control

The scale of two Boards' overspending

8. I reported briefly last year on significant issues of accountability and financial control which emerged when BELB and SEELB informed the Department that they had overspent their budgetary allocations for the 2003-04 financial year. I now report more fully below.

9. I also reported last year on the potential effects of job evaluation costs on Boards' financial outturns. Job evaluation costs are clearly a factor which has made financial planning in the education service difficult. I am undertaking a separate study in this area at present.

Belfast Education and Library Board

10. The Education and Libraries (NI) Order 2003 prohibits Boards incurring expenditure in excess of amounts approved by their sponsoring departments. Consequently I qualified my opinion on the regularity of the excess expenditure in BELB's 2003-04 accounts.

11. The Department has calculated that the accumulated deficit at 31 March 2005 is £10.8 million for BELB. It also informed me the latest expenditure report provided by BELB for 2005-06 projects a small surplus of £0.5 million, after repayment of overspend to the Department of £3 million.

12. It has taken two years for BELB's accounts for 2003-04 to be finalised and for the true level of overspending in that year to emerge. I also observe that, in late 2005, when BELB was finalising its 2001-02 accounts, it emerged that its expenditure on education services in that year had exceeded the budget approved by the Department by £1.2 million.

13. It is unacceptable that overspending in 2001-02 only came to light so recently and that the scale of overspending in 2003-04 could not be determined accurately for so long. I re-iterate the importance of all Boards producing high quality accounts on time. Expenditure shown in these accounts must be reconciled to outturns against approved budgets to demonstrate that the accounts and budgetary control statements are consistent.

South Eastern Education and Library Board

14. The Department told me the estimated in-year overall deficit in SEELB, based on the draft accounts was £5.6 million in 2003-04 and £4.3 million in 2004-05. However, the Department also told me that, after taking account of its net schools' reserve surplus, the Board's estimated cumulative deficit at 31 March 2005 is £21.6 million, based on final 2002-03 accounts and draft 2003-04 and 2004-05 accounts.

15. SEELB's accounts for 2003-04 and 2004-05 remain to be finalised so I cannot confirm these amounts.

16. The total planned schools' recurrent expenditure detailed in the 2005-06 SEELB January 2006 Budget Statement is £230 million. External consultants have been investigating the Board's financial position in 2005-06. I asked the Department for its most up to date estimate of the Board's financial outturn against the approved budget for 2005-06. The Department advised me that the financial outturn is still under review by external consultants but that the latest expenditure report provided by the SEELB for 2005-06 projected that the Board would remain within its resource allocation and realise a small surplus of around £0.5 million. This does not include any repayment to the Department.

The response to the overspending

17. In November 2004, when the incidence of overspending in 2003-04 had become clearer, the Department initiated an enquiry into financial management and control standards at BELB and SEELB. The enquiry was conducted by Dr Jack, a former Comptroller and Auditor General for Northern Ireland, under Article 108 of the Education and Libraries (Northern Ireland) Order 1986.

18. The terms of reference set by the Department for Dr Jack were to assess the adequacy of financial controls in place at the two overspending Boards; to consider whether the responsibilities and accountabilities of the Boards were discharged appropriately and effectively; and to assess the extent to which the Chief Executive at each of the Boards fulfilled their Accounting Officer responsibilities.

19. The Jack enquiry's findings and recommendations were reported to the Department in April 2005 and was the subject of a Parliamentary statement by the then Minister for Education. It identified serious failings within both Boards and made 49 specific recommendations for improvements relating to the conduct of business by the Boards and senior officials. The Jack enquiry found that officers were not providing Board members with the financial information needed for informed decision-making and the financial information being used for in-year reporting did not reflect all the expenditure incurred by the Boards. The full report is available on the Department's website. [1]

1 www.deni.gov.uk/index/8-admin_of_education_pg/8-administration_of_education-jackreport_pg.htm

20. On staffing, the Jack enquiry found that during 2003 and 2004 there were serious weaknesses in BELB's finance department as many professional staff were not available. The reports commissioned by BELB and SEELB themselves also drew attention to the staffing of the Boards' finance departments as an issue contributing to their problems. BELB told me that it put arrangements in place for three additional professionally qualified accountants to cover the absences.

21. BELB suspended its Chief Executive and Chief Finance Officer (CFO) after the overspending came to light. BELB Chief Executive was reinstated following legal action and the BELB CFO was reinstated. The Board has emphasised that no disciplinary action has been taken against him. SEELB suspended its CFO and he has now returned to work. As part of its response to the Jack enquiry the Department advised the Chief Executives of both Boards that their Accounting Officer status would continue only on a probationary basis until June 2006, when it will be reviewed formally by the Department. (Since then, the Chief Executive at SEELB has retired and a new Chief Executive has been appointed.)

22. BELB and SEELB were asked by the Department to produce action plans for the implementation of Dr Jack's recommendations and these plans have been approved by the Department. Both Boards are now being closely monitored by the Department. The other three Boards in Northern Ireland have also reviewed their arrangements in light of the Jack enquiry's findings and recommendations.

Financial relationships between the Boards and their sponsoring departments

23. On devolution, responsibility for the Boards' expenditure was split between the Departments of Education (for education and youth services), Culture, Arts and Leisure (for public library services) and Employment and Learning (for student awards in the Further Education sector).

24. Following my earlier report on Accounting to Parliament by Education and Library Boards, the Department also commissioned a firm of consultants to review the five Boards' arrangements for resource budgeting, accounting and financial control.

25. The consultant's report considered cultural issues which are relevant to financial relationships. It found, amongst other matters, that:

- Boards concentrated on service provision without adequately considering the availability of resources;
- The Department's success in obtaining additional funding for the Boards in earlier years had created an environment in which Boards "overspending was legitimised through supplementary provision";
- The introduction of accruals accounting (from 1999-2000) and end-year flexibilities (in 2001-02) confused and inhibited service heads in their responsibility for budgetary management and allowed overspending to occur without penalty; and

- The nature and extent of reporting financial matters in some Boards was inadequate and there was a perception that financial matters were best dealt with by Finance Officers.

26. On Departments' monitoring arrangements, the Department's consultants commented adversely on the quality and accuracy of the information provided to the Departments and the scrutiny to which it was subject. They also felt that more feedback could have been given to Boards and more explanations sought from them on variances against budgets.

27. The risk of overspending is now included in Boards' risk management processes at the corporate level. I welcome this development in light of the overspending at BELB and SEELB. Nevertheless, scope remains for all three sponsoring departments and the five Boards to share risk assessments to promote a common understanding of the likely problems in prompt financial and budgetary reporting. The Department told me that as part of the process for developing its own statement of internal control it obtained and reviewed the Boards' risk registers. The guidance for completion of risk registers issued within the Department emphasises the need to ensure that financial and other risks associated with the Boards' operations are appropriately reflected. The Department also indicated that its risk management processes are subject to regular review and improvement. A draft Management Statement, to be applied to all Boards, suggests that each Board will share its risk register with all three departments on a quarterly basis. It is anticipated that the draft Management Statement will be sent to each Board for consideration shortly.

Previous overspending by Boards

28. Significant overspending in the order of £3 million occurred before in SEELB in 1996-97. In 1997-98 the Western Education and Library Board also overspent by some £3.6 million. Consultants investigated the overspending, action plans were produced by the Boards and assurances were given by them to the Department that there would be no recurrences, and the findings were built into the Department's arrangements to oversee the Boards. Taking that into account, I asked the Department why its monitoring arrangements had not picked up the scale of overspending by BELB and SEELB in 2003-04 before it was told of it by the Boards in June 2004.

29. I was told that a Departmental Internal Audit review on the response to the 2003-04 overspends, which was completed in March 2005, had identified a number of deficiencies in the monitoring system for Board finances. The key deficiencies related to the quality of financial information supplied to the Department. The information provided as part of the monthly financial monitoring returns was often out of date by the time it was received, was on a cash (rather than an accruals basis) and did not include profiled expenditure and projected outturn. Separate returns received from the Boards relating to projected outturn were later found by the Department to be extremely inaccurate. These deficiencies were also present in the Board's internal financial reporting mechanisms and were highlighted by Dr Jack in his report on the Board overspends. As a result of these deficiencies in the quality and accuracy of financial information the Department told me it was unable to pick up the overspends before they occurred.

30. In examining why the lessons which should have been learned from Boards' overspending in the late 1990's had not prevented the overspending in 2003-04, Internal Audit found that much work had been done by the Department including taking a more comprehensive view of the accountability and financial control arrangements in place. However, Internal Audit

also reported that similar systems issues contributed to the 1996-98 and 2003-04 overspends, suggesting that recommendations in the late 1990's were not effectively implemented and (or) sustained.

31. I asked the Department of Education, as the Department responsible for the most of the Boards' expenditure, what steps it had taken to improve the information it received from the Boards and its monitoring arrangements and to prevent further recurrences of overspending by Boards. I was told that, following the 2003-04 overspends in BELB and SEELB, the Department established a taskforce to quantify the extent of the overspends, the actions necessary to contain expenditure, recover the overspends and prevent recurrences. The Taskforce worked closely with the Boards until it was replaced by an Overspend Advisory and Support Team (OAST) in January 2005. Since then, OAST has advised and supported the Boards in managing their budgets and preparing financial and manpower plans and has supported monthly accountability meetings between the Boards' Chief Executives and Senior Management Teams and the DE Permanent Secretary. More detailed and improved financial reporting arrangements have been established to facilitate enhanced oversight through these accountability meetings and these arrangements have now been rolled out to other Boards. As a consequence of these scrutiny arrangements, and the efforts made by the Boards to constrain expenditure, the Department told me it has secured repayment of £3 million from BELB in 2005-06 and has taken further repayment of £3 million from the BELB and £4.5 million from the SEELB in 2006-07 through reduction of these amounts from their funding allocation. The Department told me this has enabled an additional £10 million to be provided to the education sector in 2006-07.

32. There have been a considerable number of changes and adjustments made between the draft and the certified accounts. It is important that the Department reviews the level of deficits in both Boards, in light of my observations at paragraphs 10 to 16, and of outturn figures reported in final accounts when these become available. This will ensure accumulated deficits are correctly calculated and an appropriate level of repayments agreed.

33. The Department also told me it had initiated a Planning and Accountability Review in January 2004, before it was informed of the overspends. This has been established as an ongoing Planning and Accountability Project that encompasses a wide range of actions to improve the management and oversight of Board and other education finances and incorporates the recommendations made in the Jack Report of April 2005 and also those recommendations made in the consultant's report (paragraphs 25 – 27, above). The Department told me these actions have strengthened the links between planning, financial allocations and monitoring, and accountability for outcomes between the Department and its funded bodies and have resulted in improved monitoring arrangements within the Department. In particular, the Department told me the financial reporting systems have been substantially overhauled and improved financial reports, incorporating budget, spend to date and projected spend information for each of the main education service lines, is provided regularly and is a main agenda item at the six monthly Accountability Reviews between Board Chairs and Chief Executives and the Department. The Planning and Accountability Project Plan is regularly reviewed to record progress and add new actions.

34. The reforms initiated by the Department are wide-ranging. As regards budgetary control, a good measure of their effectiveness will be whether in future years they allow reasonably accurate forecasts of the financial outturns actually achieved by Boards.

35. The Department also told me about steps it had taken following the reconstitution of the five Education and Library Boards in 2005 to ensure that Board members are fully aware of their roles and responsibilities, including the fundamental responsibility to stay within budget. The Department, in conjunction with the Charted Institute of Public Finance and Accountancy in Northern Ireland, organised a series of induction seminars aimed at Board members. The seminars included a strong focus on roles and responsibilities of Board members of public bodies and on corporate governance in the public sector. They also included presentations from the Departments of Education and Culture, Arts and Leisure explaining the policy and accountability frameworks within which Boards operate and from my Office and the Department of Finance and Personnel on audit and accountability and the public expenditure process. The Boards have also provided training to their Board members on finance and budgeting, corporate governance and accountability issues.

Local Management of Schools (LMS)

36. The Public Accounts Committee in its Report on Local Management of Schools (HC 565, Session 2005-06) noted aggregate deficits in schools in 2002-03 of £11 million and aggregate surpluses of £31 million. The Committee concluded, amongst other matters, that, given these balances, Boards had not struck the right balance in monitoring and challenging schools' resource management decisions.

37. The Boards have published LMS outturn statements for 2002-03 and 2003-04. Many schools continue to carry forward significant surpluses and deficits. In some schools, at the margins of the range of surpluses and excesses, the balances could not be regarded as anything other than clearly excessive. Final outturn statements for 2004-05 have not all yet been received. The 2004-05 report is expected shortly.

38. The schools with the ten largest deficits in monetary terms at 31 March 2004 had cumulative deficits between £0.1 million and £0.8 million. Six of the schools were in the BELB area. The overspends at the end of 2003-04 in the ten schools with the highest percentage overspend represented deficits of between 65 and 166 per cent compared to the annual budget for these schools. The Department told me that the school with the largest deficit of £0.818 million has reached agreement with its funding authority on outstanding payments in recognition of the costs associated with its split-site operation and has submitted a financial recovery plan designed to return it to a breakeven position by 2008-09.

39. The ten schools with the highest percentage underspend had cumulative underspends between 50 and 68 per cent compared to their annual budgets. 98 schools had underspends of more than £75,000 in 2003-04. 51 per cent of the schools with a surplus in excess of £75,000 were within the SEELB's area. In the case of one school in the Board's area, it was £0.9 million (26 per cent) under budget. These surpluses on LMS budgets masked the overspend on the Board's centre budget which contributed to the Board's overall deficit referred to in paragraph 14 of this report.

40. In its Report on Local Management of Schools the Public Accounts Committee found that it was unacceptable that there had been delay in implementing an interface between the financial management systems of schools and the Boards. The Committee drew attention to the need for better automated information to assist in early intervention in schools with deficit and surplus funding problems. The Department told me that developing this financial interface

is a priority. An Outline Business Case has been developed and accepted by the Department, funds have been obtained through the budget process and this project is being taken forward as a matter of urgency. It is planned that the project will be completed by Autumn 2007.

41. The Department also told me that it issued Guidance on Financial and Management Arrangements for Controlled and Maintained Schools Funded under the Common Funding Scheme in March 2005. This now makes clear that large surpluses or deficits must be avoided and that schools should aim to remain within budget. Schools should not have accumulated surpluses in excess of 5 per cent or £75,000, whichever is the lesser, of their delegated budget unless they are being accumulated for specific purposes and these are detailed in their plans and approved by the relevant funding authority. No school may plan for a deficit without the consent of the Board. Such overspends will be subject to:

- the Board not exceeding its recurrent budget;
- an upper limit of 5 per cent of a school's budget share or £75,000, whichever is the lesser; and
- a submission by the school's Board of Governors demonstrating that the planned deficit can be cleared or substantially reduced during the period of the 3 year budget plan.

42. It is a continuing challenge for the Department, the Boards and Governors of schools to ensure that the recovery plans for schools with significant surpluses and deficits are eliminated and that systems are in place to detect and intervene in emerging problems. The Department told me it recognises the importance of ensuring that school budgets are managed effectively and has been considering how to improve support for school governors. A major reconstitution exercise during 2005 focused specifically on attracting governors with financial and/or business skills. The Department also asked the Boards to build up a school governor skills database and to ensure that training for governors included a focus on finance. In April 2006, the Department held the first of what is planned to be an annual event for school governors, focusing particularly on financial and human resources management in schools.

Conclusions

43. The Boards' move from cash to accruals accounting in 1999-2000 and the subsequent transition to resource budgeting proved to be a major hurdle for them. It led to a long backlog of statutory accounts as problems emerged which had not been anticipated and for which no mechanism for ready resolution existed. The Department has worked with the Boards to tackle this backlog and, while considerable progress has been made, further work remains to be completed.

44. The accounting and budgetary monitoring systems which operated when the Boards were accountable to one Department on a cash basis persisted into the complex new environment where Boards were accountable to three Departments on a resource basis. Sufficient provision was not made either by the Departments or by two of the Boards to support effective budgetary control and monitoring in the new environment, or to make it a corporate responsibility for Boards. Boards relied on additional resources becoming available to meet increasing costs and management's ability to make judgements about the scale of these costs for inclusion in cash-

based budgetary monitoring. When cost pressures mounted due to poor monitoring and/or because costs had been wrongly judged and extra resources to recover the situation were not forthcoming, combined with inappropriate accounting treatment particularly in relation to accurals, the financial crisis emerged.

45. Overspending by two Boards occurred as far back as the 1990's, remained undetected in BELB in 2001-02 due in part, to delays in producing accounts, and emerged at crisis levels in BELB and SEELB in 2003-04 and 2004-05. It is clear from this that the lessons which should have been learned by the Department and overspending Boards were not learned and that effective preventive measures were not taken or sustained.

46. Given that the Boards do not have integrated financial and budgetary systems it is particularly important that they have sufficient staff with the financial and management skills to manage large and complex budgets, to produce good quality accounts in line with the accelerated timetable and to discharge financial duties effectively. The Jack enquiry and the Department's consultants both commented on low levels of staffing in finance departments as a factor contributing to the (undetected) overspending in BELB and SEELB. In circumstances where budgetary control is still significantly dependent on the ability of Boards' senior finance staff to identify and adjust budgetary reports for significant accrued expenditure, the risk of undetected overspending remains in all five Boards.

47. It is of course important that the overspending Boards should continue to work intensively with the Department to reinstate financial discipline and the Department must continue to scrutinise the Boards closely to ensure sound financial management. This needs to be balanced with the requirement to produce prompt and good quality accounts for public and Parliamentary accountability. While significant inroads have been made into resolving outstanding accounts, the Department must not allow the delays in resolving Boards' accounting issues and finalising their accounts and annual reports to persist or recur.

Recommendations

48. The Jack enquiry and the consultant's report contain recommendations to tackle Boards' accounting and budgetary problems. The Department has made sure that BELB and SEELB have action and recovery plans in place which are monitored closely and the other three Boards have also considered what lessons they can learn. The Department has implemented a Planning and Accountability Project designed to improve and align planning, monitoring and accountability arrangements between itself and the education service and to strengthen internal Departmental monitoring arrangements. There are important points for the Departments in the Jack enquiry and the consultant's report and it is important that these internal improvements are kept in view, and that officers with responsibility for liaising with and monitoring the Boards have sufficient experience, skills and support to do so effectively.

49. The Department has also given a series of undertakings to the Public Accounts Committee in connection with its Report on Local Management of Schools. The Department must give high priority to these.

50. I have observed that until recently the Department did not have professional accountancy skills at its senior management level. The most highly graded professional accountant in the Department was at Grade 7 (in the Accounts Branch). I consider, in view of the Department's

substantial net resource requirement (estimated at £1.8 billion for 2005-06, together with responsibility for the Teachers' Superannuation Scheme), the complex and demanding financial environment in which the Department operates (including a substantial number of large NDPB's), and the financial and other challenges facing the education service in Northern Ireland, that the Department should further strengthen its professional accountancy skills, particularly at senior management level. The Department told me that in recent years it has increased the number of accountants dealing with Board matters and has just implemented a re-organisation of the branch dealing directly with the Boards, further augmenting the professional accountancy expertise available in this area. The Department also told me that it has completed the process of recruiting an accountant to fill its Finance Director position, in line with policy across the NICS.

51. I asked the Department what lessons it had learned from the incidence of overspending at Boards. I was told that the overspends had highlighted the critical importance of accurate and timely financial reporting mechanisms and appropriate oversight arrangements, informed by professional financial and accounting advice, both within the Boards and between the Boards and the Department. Clear understanding by Board members and Chief Executives of their roles and responsibilities and sound accountability arrangements involving regular and detailed scrutiny by the Department were also essential to ensuring that public money is protected. These issues have been addressed by the Department through its Overspend Advisory and Support Team arrangements, the Jack Report and the Planning and Accountability Project and are reviewed and updated on a regular basis. The Department of Education is also working closely with the Boards' other two sponsoring departments to ensure that revised procedures and lessons are implemented and shared between them.

Part 3

Northern Ireland Consolidated Fund

Northern Ireland Consolidated Fund

Revenue Accounts

1. The total revenue paid into the Northern Ireland Consolidated Fund in 2004-05 amounted to £10,285 million analysed as follows:

	2004-2005 £ million	2003-2004 £ million
Receipts from the United Kingdom Government:		
Block Grant	8,950	8,505
Other revenues:		
Rates	717	651
Interest on loans and advances	150	153
Excess Accruing Resources	75	37
Share of receipts from petroleum licenses	--	13
Other Receipts and Transfers	393	335
	10,285	9,694

2. During the year a draw down of supply of £124 million was issued to the Department of Health, Social Services and Public Safety, £21 million of which had not been authorised by Parliament. This overdrawn supply position was resolved by the approval of the Spring Supplementary Estimates. However, this does indicate a serious breakdown in controls in both the Department of Health, Social Services and Public Safety, which requested the unauthorised draw down, and the Department of Finance and Personnel, which approved and issued the draw down. Both Departments have told me that they have taken steps to address weaknesses in controls.

I have sample checked the correctness of the sums brought to account and I have no further comment to make thereon.

3. A summary of the outturn in the year of rate levy and collection is:

	2004-2005 £ million	2003-2004 £ million
Arrears at 1 April	24	24
Assessments during the year	803	744
Credit carried forward to next period	3	3
Discharged during the year by:		
Credits brought forward from last period	3	2
Net receipts	717	654
Vacancies	38	57
Rebates	21	18
Allowances/Disabled Person's Allowance	5	5
Discounts	3	3
Written-off as irrecoverable	2	2
Residential Home Relief and other Reliefs	6	6
Arrears at 31 March	35	24

4. Assessments rose by £59 million and net receipts by £63 million during the year. Arrears at 31 March 2005 represented 4.2 per cent of the collectable rates for the year, compared with 3.1 per cent in the previous years.

Included within Vacancies in the 2004-05 year is £12 million relating to Vacant Rating Relief (2003-04: nil).

Consolidated Fund Issues

5. Issues from the Consolidated Fund fall into two categories:

- those to meet expenditure on services for which financial provision is voted annually by Parliament (Supply Services); and
- those to meet expenditure on services for which Parliament, by statute, has authorised a continuing charge not subject to annual vote procedure (Consolidated Fund Services).

Issues for Supply Services are accounted for in the Resource Accounts and issues for Consolidated Fund Services are accounted for in the Public Inocme and Expenditure Account which is certified by me under Section 2 of the Exchequer and Financial Provisions Act (Northern Ireland) 1950.

Consolidated Fund Services

6. The Public Income and Expenditure Account has been published separately as a White Paper Account, (HC509). The account broadly distinguishes:

(i) issues for payments deemed to have been made out of public income for the year which includes interest on borrowings, district councils' share of revenue from rates, statutory charges on the Consolidated Fund for certain salaries and expenses and advances to funds and bodies;

(ii) issues for payments of a capital nature made out of borrowings which include public dept repayments, advances to funds and bodies to meet capital expenditure; and

(iii) investments of surplus monies in the short-term money market and temporary advances for Civil Contingencies to fund urgent services on which spending by departments cannot await approval in a Supply Estimate.

7. Total issues in 2004-2005 amounted to £8,715 million compared with £8,637 million in 2003-2004. This increase of £78 million relates to increases in the amounts issued to District Councils (£27 million) and amounts invested temporarily (£314 million), offset by a decrease in issues in respect of the redemption of public debt and borrowings (£263 million).