

REPLY TO DRAFT AUDIT REPORT

Executive Summary

Main Findings

Scottish Executive and Programme Executive:

- We accept that details of final recipients of aid schemes should be advised to and retained by the PME and Managing Authority. We question whether the absence represents a serious weakness but will remedy matters for this current programming period.
- It is not clear what is meant by the term 'private partners'. Only public or similar organisations are eligible to apply directly for funding. Final beneficiaries are therefore public or quasi public.

Article 8 Body:

- In the absence of a specific requirement that all the Programme Executives (PEs) and Secretariats involved in the implementation of the Scottish Programmes be the subject of a systems audit, a sample of these were visited by Audit Services. The approach was based on the fact that the systems in place did not differ radically between the PEs and Secretariats, and, consequently, weaknesses in administration identified by the audit reviews carried out were addressed in the context of **all** the PEs and Secretariats. The Highlands and Islands PME (HIPP) and Strathclyde European Partnership (SEP) were visited as part of the 1999 audit. The East PME was visited as part of the 1996/97 visit (see Annexes A and B respectively).
- Follow-up reviews of the 1999 and 2000 audits were not performed at the request of the Head of the European Structural Funds Division. The reason given was that an extensive review of the PMEs was due to be carried out by ESFD and the recommendations relating to the PMEs would be taken forward as part of that review (see Annex C3).
- As part of the audit of HIPP, one of the major final beneficiaries, Inverness and Nairn Enterprise (INE), was visited. Although the final recipients were not visited, audit working papers confirm that, with one minor exception, evidence that all costs had been incurred was kept on INE's files.

Final Beneficiaries:

- Audit trails that were complicated or difficult to reconcile are not ideal but do not necessarily represent a weakness. There is no evidence that they do not exist. Nor any that they are inadequate. Nevertheless, we will encourage the final beneficiaries concerned to maintain records supporting the audit trail in a more structured and transparent way.
- Charging of running costs is eligible in certain circumstances. This can only be determined on a case-by-case basis.

Requests for follow-up

- Comments and explanations follow below.
- We share the auditors' disappointment and acknowledge that some material remains outstanding. This has now been sourced, collated and is attached in the annex for each of the respective projects. However, final beneficiary and our own records indicate that material being requested in the report has already been provided. Notwithstanding this, the attached documentation provides a comprehensive response to the report.

Section 6.1.2.

There are a number of inaccuracies in this section.

HIPP, the Programme Management Executive, is not directly linked to Highlands & Islands Enterprise. HIE, in common with other partner organisations, do voluntarily provide funding to HIPP and are members of the HIPP Board. This was chaired by the then Scottish Office (as Implementing Authority) and operated as a 'Joint Management Board' during the 1994 – 1999 Objective 1 programme period. While there was no formal delegation of responsibilities, the role and responsibilities of the PME were clearly set out in the application for technical assistance, approved by the Programme Monitoring Committee where the Commission were members and overseen / supervised by the JMB. The JMB was a sub-committee of the PMC and reported to it. There was therefore a clear line of delegation, responsibility and an explicit set of measurable tasks for the PME.

The description of the process for handling applications and claims omits important information. The text below describes the arrangements that applied for the 1994 – 1999 period.

The PME was the first point of contact for partner organisations. Applications were submitted to the PME and an assessment of eligibility carried out. Eligible applications were then appraised, against detailed scoring criteria approved by the Monitoring Committee, by an Advisory Group formed from partner organisations and chaired initially by the then Scottish Office. Chairmanship later passed to an independent 'consultant' engaged specifically for this. The Advisory Group appraisal produced a set of recommendations for all projects considered. These recommendations were considered by a Programme Management Committee although the work of the Management and Monitoring Committees was later combined. Decisions by the Management / Monitoring Committee on whether to approve or reject projects were then advised to Scottish Ministers. Subject to Ministerial approval, the PME issued grant offer letters to applicants (final beneficiaries). The PME did not have the power to reject applications.

'Fees':

PME funding was supported through voluntary contributions by partner organisations. These were known as Management Subscriptions.

The deduction by final beneficiaries of legal fees from payments to final recipients is inappropriate and we will both undertake remedial action on the project concerned and follow up on the practice generally.

6.1.3. Systems Audits

During the course of this review, we informed the auditors that, in the absence of a specific requirement that all the Programme Executives and Secretariats involved in the implementation of the Scottish Programmes be the subject of a systems audit, a sample of these were visited by Audit Services. The approach was based on the fact that the systems in place did not differ radically between the PEs and Secretariats, and, consequently, weaknesses in administration identified by the audit reviews carried out were addressed in the context of all the PEs and Secretariats. The Highlands and Islands public partnership (HIPP) and Strathclyde European Partnership (SEP) were visited as part of the 1999 audit. The East PME was visited as part of the 1996/97 visit. (See annexes A&B respectively.)

Follow-up reviews of the 1999 and 2000 audits were not performed at the request of the Head of the European Structural Funds Division. The reason given was that an extensive review of the PMEs was due to be carried out by ESFD and the recommendations relating to the PMEs would be taken forward as part of that review (see response from ESFD at Annex C1). A copy of this review is attached (see Annex C3) and we can confirm that this does address the points that Audit Services raised concerning HIPP during the 1999 audit.

The 2000 audit covered two small Community Initiatives (CIs) (Adapt and Konver). Audit Services did not act as the Article 8 body for either CI, but did provide information to the relevant UK government department (DfES and DTI) to allow them to provide an Article 8 statement. By the time that the follow-up was due, we had received requests from DfES and DTI for audit work to allow them to provide closure statements. The 2000 audit was followed up as part of this closure work.

As part of the 1999 audit of HIPP, Audit Services placed reliance on a report by HIE internal auditors, which related to Investors in People projects, where HIE was the lead partner (a copy is attached as Annex C2). This audit report does not represent an internal audit report of HIPP and was never intended to be read as such. HIE internal audit has not and do not provide this service to HIPP.

The Article 8 closure statement states that annual reviews of the VaC team took place. This does not mean that there were annual systems based audit reviews of VaC activity. During the course of each audit, we were concerned to ensure that the VaC team continued to comply with the requirements surrounding on-the-spot visits in the area under review and for each of the audits carried out during the life of the 1994-99 programmes there is a section dealing with VaC team activity (see Annexes A-E). The performance of the VaC team throughout the programme period was also examined in detail as part of the closure audit.

In Annex 2 of the EC audit report, the auditors have requested several other documents from Audit Services. The "Government Internal Audit Manual (GIAM) set out the standard methodology that all government internal auditors worked to at the time and a copy can be made available if necessary. The approach set out in GIAM was adapted to take account of the guidance in the EC Audit Manual. A copy of the 1994-1999 audit trails are attached at Annex G. Given the misunderstanding of the role of HIE's internal audit service, we have not provided, further reports from them and the peer review of HIE's Internal Audit function. There is no separate 1998 audit report. The audit fieldwork that was carried out in 1998 was reported on in the 1999 audit report (see Annex C). The follow-up of the 1999 and 2000 audits is dealt with in the proceeding paragraphs.

5% Checks

I note the confirmation that the 5% level of checks was met. Checks were carried out at the level of final recipient. Visits to final beneficiaries included a detailed check of grant claims, supporting documents and bank statements made to them by final recipients. Premises of final recipients were not visited. This has been changed for the current programme.

The Team covered all main beneficiaries in their control programmes. They accept they did not visit HIE under Objective 1 but they did cover other bodies in the Enterprise network. They also tested HIE's systems under the SME Programme. Guidance at that time did not specifically suggest that all years must be controlled and in an effort to ensure 5% checks on all Scottish Programmes were achieved, VAC concentrated on other Programmes once the H&I Objective 1 5% target was reached. VAC now works to the more explicit requirements in the new regulations and ensure that in current Programmes controls cover all measures, all years, and all main beneficiaries.

6.1.4. Aid Schemes

We accept that the Scottish Executive and PME should retain details of recipients of aid schemes. As already explained, the VAC team did as a matter of routine verify expenditure by final recipients by carrying out a full invoice and bank statement check. These were carried out at the premises of the final beneficiary in order to secure greater efficiency and undertake a greater number of checks.

Issues on Individual Files

The situation described is historical. Nevertheless it is the system that prevailed largely for the 1994 – 1999 programme. However, any criticism of the PME is misplaced. The audit visit did not extend to HIPP. It concentrated on the Implementing Authority and final beneficiaries.

Project detail including full documentation is retained by the PME. Scottish Office practice was also to retain a full audit trail. However, in cases where documents are missing from 'Implementing Authority' files, these should be available from the PME records.

Audit certification of projects sponsored by local authorities and Highlands & Islands Enterprise were subject to a derogation. There was no requirement for these organisations to have external certification of final claims. Instead, sample checks of Structural Funds projects were carried out by the statutory external auditors, the National Audit Office (now Audit Scotland).

On public procurement, again this reflects the historical position. New application procedures require confirmation and evidence that public procurement rules have been respected. Nevertheless, proof of compliance was required for the 1994 – 1999 programme and remedial action could have been taken to recover grant if necessary, albeit retrospectively.

Applications for grant clearly showed start and finish dates. Grant offers referred to these applications. Conditions of grant in annexes B and C were standard. There was therefore no need to retain copies on each file. Annex A which could vary from project to project was retained.

6.1.5. Irregularities

The system for reporting irregularities has been completely changed for the current Programmes with the VAC detecting but the Managing Authority reporting and recording. This gives a tighter control through checks and balances between the VAC and MA. It ensures transparency which we accept the previous system did not. All irregularities were however resolved; only the internal records were not updated simultaneously.

As for the irregularity concerning BD/98//026 we understand that this arose because recovery was made after initial declaration. This will be remedied.

6.1.6. Article 8 Statement

In light of the information provided in this response to the detailed points in the report and the need to correct several factual inaccuracies, we do not agree with the auditors assessments in the overall conclusion as to the Article 8 body. We consider that the results of the work done in relation to the reports findings go a significant way towards reducing the error rate reported by the EC auditors and therefore, at this stage, we do not wish to revise the opinion given in the Article 8 statement.

6.2 Systemic Issues during the project audit

There were no 'private partners' in the programme. There was a degree of private sector participation in projects but this was always done through the public sector as lead partner and applicant.

The basis for the suggestion that potential recipients were unaware of the availability of funding is unclear. In general, local awareness was high and aid schemes were largely fully subscribed. The programme itself was fully committed which also suggests high levels of awareness of the availability of funds.

6.3 Findings in Relation to Individual Projects

Responses to the detailed points on individual projects are set out on a project by project basis in the annex.

However, in relation to project THC/98/028 Cairngorm Funicular Park, I can confirm that no payments after the deadline feature in claims for grant. The amount referred to in the report (£231,466) did not clear the final beneficiary's bank account by 31 December 2001 however the expenditure was incurred within the eligible period for expenditure. Article 21 (1) of Council Regulation (EEC) No. 2082/93 provides for '...payments in respect of expenditure actually incurred.' Technically, the expenditure on this project was incurred when the contract was let. More practically, it was incurred when the cheque was raised on 7 December 2001. We contend therefore that the expenditure was legitimately incurred within the deadline and is eligible for grant.

The Eriskay and Sound of Barra Integrated Transport Project (CSN/99/221) was approved on 23 September 1999. Commitment to the project was therefore effective from 23 September. Financial and contractual arrangements were in place by 31 December 1999. The letter of 19 December 2001 confirms acceptance of increased costs on the project.