

# Good practice note on improving the quality of central government annual report and accounts

Performance reports



Prepared for central government bodies and appointed auditors

26 February 2019

## Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



## About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

# Contents

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Introduction	4
<b>Part 1</b> A single story	6
<b>Part 2</b> How funding was used	9
<b>Part 3</b> What worries board members?	15
<b>Part 4</b> Consistency	20
<b>Part 5</b> Cut the clutter	23
<b>Part 6</b> Clarity	26
<b>Part 7</b> Summarise	28
<b>Part 8</b> Explain change	31

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# Introduction

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## Purpose

1. Audit Scotland promotes good practice in financial reporting in Scottish public bodies. Audit Scotland's Professional Support carry out reviews of annual accounts to identify and share examples of good practice reporting and highlight areas where improvements can be made.
2. This good practice note shares the findings from a review of the 2017/18 performance reports included within the annual report and accounts of central government bodies.

## Context

3. The purpose of a performance report is to provide information on a body, its main objectives and strategies, and the principal risks that it faces. They are required to provide a fair, balanced and understandable analysis of a body's performance. They are also essential in helping stakeholders understand the financial statements.
4. Performance reports were chosen for a good practice review because auditors often report that, while there are good examples of high quality reports, in other cases there is room for improvement. The aim of this good practice note is to bring the general standard of performance reports up the level of the best.
5. The review of the performance reports was carried out by a team with knowledge of the relevant financial reporting framework. However, the team does not have a detailed understanding of each body's particular circumstances or the specific underlying transactions.
6. Bodies are encouraged to use the findings in this report to assess and enhance their own disclosures to ensure they provide high quality information to stakeholders in their performance reports.

## Financial reporting requirements

7. Central government bodies are required to prepare their annual report and accounts in accordance with an accounts direction which generally requires compliance with the the Government financial reporting manual (the FReM). The FReM requires a performance report to be included within the annual report and accounts and sets out the following required content:
  - An overview of the purpose and activities of the body, key issues and risks, and a performance summary.
  - Information on how the body measures performance and a detailed analysis of performance during the year.
  - Information on environmental matters.
  - Information on social matters, respect for human rights, anti-corruption and anti-bribery.
8. The Financial Reporting Council's [Guidance on the strategic report](#) provides helpful guidance which can be used to assist in meeting the FReM's requirements.

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Bodies should use this good practice note to assess and enhance their own performance reports.

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The examples used in this note are all taken from 2017/18 performance reports.

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Unqualified audit opinions do not mean there is no scope for improving the quality of performance reports.

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9. The consideration of the 2017/18 performance reports of each body was carried out by appointed external auditors and was concerned with expressing opinions on whether the reports were consistent with the financial statements and included the content required by the FReM. As there were no qualified opinions, there is reasonable assurance that minimum disclosure requirements were met. However, it should not be inferred that there is no scope for bodies to improve the quality of their performance reports.

## Characteristics of good annual accounts

10. Beyond basic compliance with financial reporting requirements, there are a number of characteristics of financial reporting which Professional Support believe make for a high quality performance report. These are summarised in Exhibit 1.

### Exhibit 1

<b>Characteristics of a high quality performance report</b>	<p>A single story</p> <p>How funding was used</p> <p>What worries board members</p> <p>Consistency</p> <p>Cut the clutter</p> <p>Clarity</p> <p>Summarise</p> <p>Explain change</p>	<p>These characteristics are based on those used by the Financial Reporting Council adapted for the public sector context.</p>
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11. The remainder of this good practice note is structured around these characteristics, and it discusses and highlights some of the good practice adopted by bodies in relation to each one. The note also includes points for bodies to consider in striving to achieve good practice.

### Contact points

12. The contact points for this good practice note are Neil Cameron, Manager (Professional Support) - 0131 625 1797 or Helen Cobb, Senior Adviser (Professional Support) - 0131 625 1901.

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# Part 1

## A single story

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13. The performance report provides an opportunity for bodies to present a single, coherent narrative explaining and complementing the financial statements.

### Coherent narrative

14. The performance report should not be prepared in isolation from the other components of the annual report and accounts, particularly the financial statements. By taking an integrated approach, bodies can identify and highlight relationships between the performance report and items in the other components.
15. Preparers need to make judgements regarding where information would be best located. This should aim to ensure that only relevant and focussed information is included. The performance report should, generally, only include the content that is required to meet the FReM requirements unless further information is helpful in telling the full story.
16. The performance report should be structured in a way that allows a cohesive and clear narrative flow. Although the FReM identifies the requirements for a performance report as a list of bullets, a checklist approach is unlikely to achieve effective communication. Bodies should consider and challenge the structure of the performance report to ensure it tells an understandable story of their performance.
17. It may be helpful to group together similar or related disclosures, as this will help reduce duplication and enable linkages to be highlighted and explained. Information which the FReM requires to be included in the performance report may be included elsewhere in the annual report and accounts if that tells the story more effectively. However, where that is the case, a cross reference from the performance report must be included to satisfy the FReM's requirements.

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The performance report should be structured in a way that allows a cohesive and clear narrative flow.

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### Consistency with financial statements

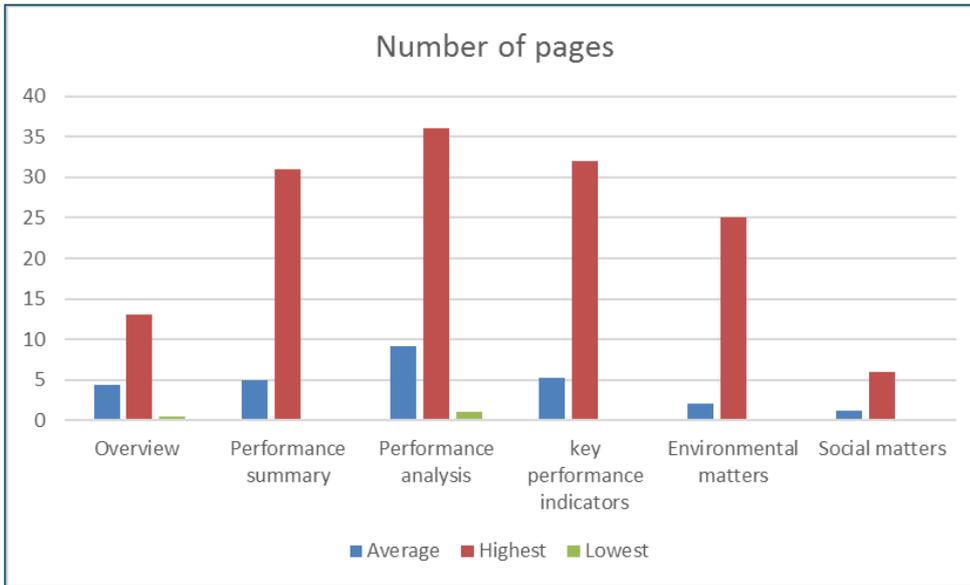
18. The narrative in the performance report should be consistent with the accounting information in the financial statements, and should highlight and explain significant points from the financial statements. This is discussed further in part 4.

### Length of report

19. A comparison of the lengths of each body's performance report showed a significant variation that was not always explained by the relative size of the bodies. The number of pages in each part of the performance report are summarised in Exhibit 2.
20. Bodies at the upper end of the range may wish to consider whether they can streamline their performance reports, while those at the lower end will want to satisfy themselves that they are providing users of the accounts with sufficient information.

## Exhibit 2

### Length of performance reports



The average length of the performance reports was 23 pages. The longest was 54 pages and the shortest 6.

### Issues identified in our review of whether the performance report provided a single story when considered with the financial statements were



- The performance reports did not always provide a coherent narrative.
- Disclosures sometimes appeared disjointed.
- Some reports contained significant duplication and repetition which made them longer than necessary.
- There were examples where material items were not fully explained while smaller amounts were explained in excessive detail.
- There was limited use of innovative presentation that helps to highlight linkages.

<b>Points to consider when telling a single story include</b>	
	<b>Stand back and consider whether the report tells a fair, balanced and understandable story.</b>
	<b>Avoid using a checklist approach which can lead to duplication and a disjointed narrative.</b>
	<b>Innovate and experiment with presentation and ways to best tell the story.</b>
	<b>Challenge the content and presentation of the performance report annually.</b>

## Part 2

### How funding was used

21. A clear and balanced review of how funding from the Scottish Government and other sources was used to deliver the body's objectives, set in the context of the strategy and business model, will assist users in understanding the body's performance.

#### Clear and balanced review

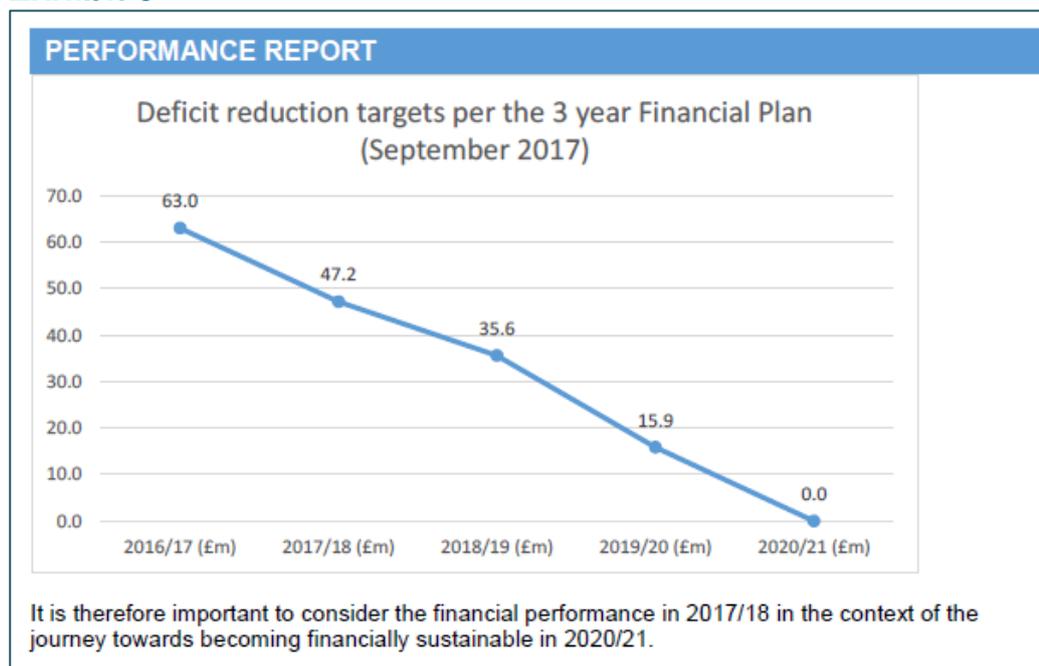
22. The FReM requires a fair and balanced review of the body's performance. The performance report should address the positive and negative aspects of the development, performance, position and future prospects of the body openly and without bias.

23. Bodies should seek to ensure that users of the accounts are not misled as a result of the presentation of, or emphasis given to, information in the performance report or by the omission of material information from it.

24. The example in Exhibit 3 sets out the financial performance of the body in the context of their progress towards improving financial performance.

The performance report should provide a fair and balanced review of performance.

#### Exhibit 3



The performance report should address the positive and negative aspects.

25. The example in Exhibit 4 sets out the performance of the body clearly detailing whether targets had been met. It also explains that those not met will be included in the next year's business plan, and where further information can be found.

## Exhibit 4

Performance measures	Target	Outcome	
The percentage of decisions on referrals made within 50 working days of receipt	78%	76%	A
The percentage of Hearings scheduled to take place within 20 working days	76%	76%	A
The percentage of initial Hearings proceeding to disposal	76%	80%	G
The percentage of working days lost to absence (long term)	2%	3.7%	R
The percentage of working days lost to absence (short term)	2%	2.2%	R
The percentage of SCRA core properties which comply with SCRA property standards	90%	90%	G
The variance in annual revenue spends as a percentage of the available revenue budget	within 1%	0.8%	G
The percentage of revenue savings achieved in the year	2.5%	3.5%	G
The variance in annual capital spends as a percentage of the available capital budget	within 5%	27%	R
The Scottish Government efficiency savings target will be met	0.9%	Met target	

Key - G Target met or exceeded A Target nearly met R Target missed

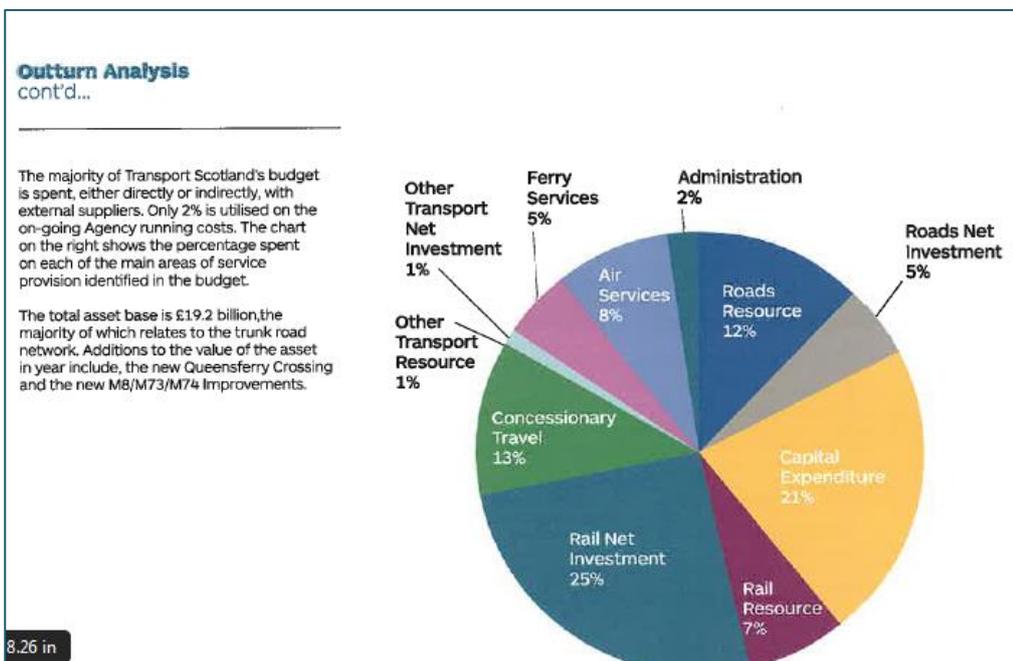
In addition to Key Performance Indicators, 89 Business Plan actions were tracked throughout the year. At the year-end, 66 actions are rated as green, 15 as amber and eight as red. In general, actions rated as amber or red have been moved into the 2018/19 Business Plan. Digital strategy work has been removed from the Business Plan information.

A more substantial review of our progress against these priorities can be found in the published SCRA Annual Report 2017-18.

## Explaining the strategy and the business model

- 26. The FReM requires a description of the body's strategy and business model. The description of the strategy for achieving a body's objectives should provide insight into its development, performance, position and future prospects.
- 27. The body's performance should be explained within a context of its strategy and business model.
- 28. Some bodies were able to link their expenditure to the strategic objectives of the Scottish Government and show how much of their expenditure contributed to achieving those objectives; an example is set out in Exhibit 5.

## Exhibit 5



Descriptions should provide insight into the development, performance, position and future prospects.

29. In addition, the disclosure of the body's objectives places the strategy in context and allows users of the accounts to make an assessment of its appropriateness. Exhibit 6 provides an example of a simple explanation of what the body does, and cross refers to where it is explained in more detail.

## Exhibit 6

### What we do

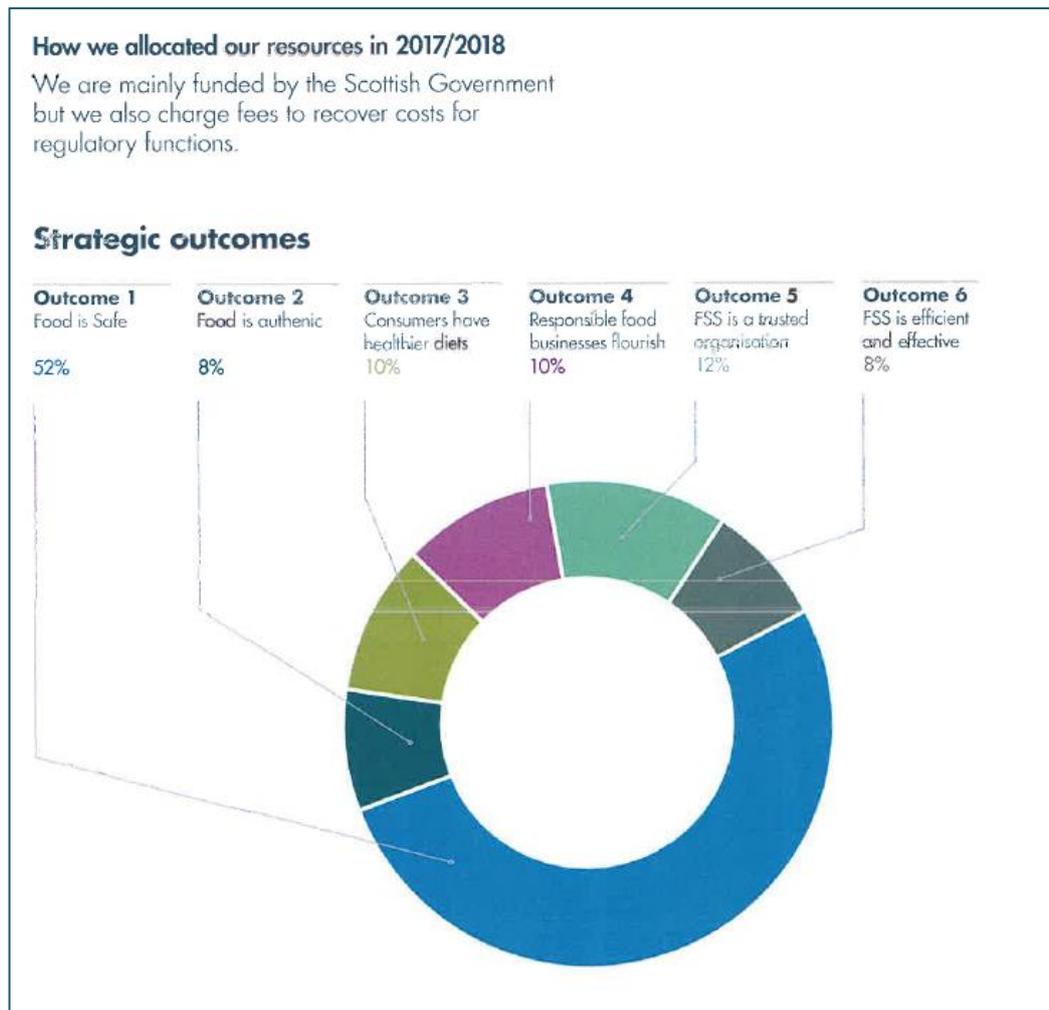
Our vision is to be trusted to care for the water on which Scotland depends (see page 8), and our customers expect us to provide excellent customer service by delivering high levels of water quality and environmental performance, all for an affordable price.

Using Scotland's natural resources and the skills of our people, Scottish Water is committed to improving our services for customers and communities while protecting and enhancing the environment of Scotland. How we do this is covered in more detail in the following sections:

Environment	pages 30 to 32
People	pages 42 to 44
Community matters	page 45
Customer service	pages 20 to 22

30. The description of the business model should set out how the body generates or preserves value over the longer term, and how it captures that value. It should describe what the body does and why it does it and should also provide a high level understanding of how the body is structured.
31. The review found that most bodies adequately disclosed information on their strategy and business model. The best disclosures linked spend with outcomes, as demonstrated at Exhibit 7.

## Exhibit 7



## Analysis of performance and position

32. The required review of the body's business should analyse the development and performance of the body during the financial year.
33. The FReM requires information on how the body measures performance i.e. what the body sees as its key performance indicators (KPIs), how it checks performance against those measures, and narrative to explain the link between the KPIs, risk and uncertainty.
34. The KPIs reported should be those that the board members judge to be most effective in assessing progress against objectives or strategy, monitoring key risks, or are otherwise utilised to measure the development, performance or position of the body.
35. The body should provide information that enables users to understand each KPI reported in the performance report. The FRC report [Performance metrics – Principles and practice](#) identifies five principles for reporting performance metrics. These principles are summarised in Exhibit 8 and can be used to ensure that the information provided on KPIs meets users' needs.

## Exhibit 8

### Aligned to strategy

- Give users an insight into the your performance and strategy and the sources of long term value

### Transparent

- Allow users to understand what the metric attempts to measure and how it does it

### In context

- Explains what you were trying to achieve and what it has achieved, with explanations for where this is good or poor

### Reliable

- Provide explanation of governance and oversight of the metrics used

### Consistent

- Report consistently across time to build credibility

The FRC identifies five principles for reporting performance metrics.

36. Helpful disclosures made by some bodies provided a high level introduction followed by a good balance of information.
37. A few bodies provided narrative explaining the results or action required to address performance issues. This helps the user to understand how well the body has performed. Providing further information comparing performance across years or to other similar bodies can help users assess performance. Exhibit 9 provides a good example.

## Exhibit 9

**Impact measure 1 – We will have increased the number and diversity of people playing sport in schools and sports clubs.**

### Distinct participants and playing club members



	<b>Comparable change since 2015-16</b>
<b>Distinct participants in Active Schools</b>	<b>+7%</b>
<b>Playing club members in supported clubs<sup>18</sup></b>	<b>+6%</b>
<b>Playing club members affiliated to SGBs<sup>19</sup></b>	<b>+0%</b>

Comparing performance across years can help users.

## Issues identified in our review of whether the performance report explained how funding was used

	<p>There was limited explanation:</p> <ul style="list-style-type: none"> <li>• that related outturn to targets</li> <li>• of poor performance, with greater focus placed on positive achievements</li> <li>• of action to address missed targets or poor performance.</li> </ul>
	<p>Financial outcomes were not generally given within the context of the strategy and objectives.</p>
	<p>There was generally limited reporting on performance. It was sometimes difficult to tell if the body had a good or bad year from the performance report. Bodies tended to focus on factual points such as the financial position at the end of the year rather than provide an analysis of how the body performed.</p>
	<p>Customer-facing bodies tended to be better at showing how they used their funding.</p>

## Points to consider when explaining how funding was used

	<p><b>Be clear whether it has been a good year or a bad year overall.</b></p>
	<p><b>Provide a balanced account of performance.</b></p>
	<p><b>Explain outcomes within the context of your body's objectives.</b></p>
	<p><b>Use the KPIs that the board judge to be the most effective in assessing performance.</b></p>
	<p><b>Clearly describe and explain the KPIs, including the basis for preparation.</b></p>
	<p><b>Explain the major sources of funding.</b></p>
	<p><b>Set out the actions required to address performance issues.</b></p>

## Part 3

# What worries board members?

38. The FReM requires the performance report to provide a description of the key issues and risks facing the body and how they might affect its future prospects.

### Key issues and risks

39. The key issues and risks included in the performance report should be limited to those considered by the body's board members to be material to the development, performance, position or future prospects of the body. They will generally be matters that the board members regularly monitor and discuss because of their likelihood or the magnitude of their potential effect on the body. The better performance reports highlighted a smaller number of key risks and issues but provided clear information about the supporting assumptions and sensitivities.
40. Board members should consider the full range of business risks, including both those that are financial in nature and those that are non-financial. Key risks should be disclosed and described irrespective of whether they result from strategic decisions, operations, organisation or behaviour, or from external factors over which the board may have little direct control. Exhibit 10 provides a good explanation of the key risks affecting the body and how these are being managed.

Key issues and risks will generally be those that board members regularly monitor.

### Exhibit 10

Risk or Uncertainty Trend	Description	Risk Appetite	Key Mitigations
<b>Developing the Business</b>			
PFI Operations 	Financial and operational risk should a PFI plant or operations fail to deliver in accordance with the contract terms.	Scottish Water seeks to deliver services in an efficient and cost-effective manner including via a number of PFI waste water contracts.	<ul style="list-style-type: none"> <li>- Maintaining ongoing strong relationships with the PFI companies.</li> <li>- Monitoring and management of PFI company performance.</li> <li>- Undertaking deep dive PFI plant audits.</li> <li>- Developing contingency plans for both the financing and operation of these contracts as they enter their final stages.</li> </ul>
There were no material changes to the risk faced across the PFI portfolio in 2017/18. Plans are underway to consider an approach to the maturity of these contracts as they enter their final stages over the 2021-27 regulatory period.			
Business Stream 	Risk of reducing value of the business due to competitive market conditions and the complex operating environment in the newly opened English retail market.	Business Stream will maintain a financially viable retail business.	<ul style="list-style-type: none"> <li>- Increased scale through targeted acquisition of customers to dilute cost to serve.</li> <li>- Targeted acquisition of customers in both the English and Scottish markets, for future profit growth.</li> <li>- Continued transformation of customer service and cost base.</li> <li>- Improvements to English market customer data sets and payment managements.</li> <li>- New regulatory framework providing additional tools to manage vacant charging risks.</li> </ul>
The Scottish market remains very competitive. The new retail market in England provides access to £2.5 billion of revenue opportunity. As anticipated, the market environment is complex, with low margins available, data quality issues and complex wholesale tariff arrangements.			

## Forward-looking

41. The performance report should have a forward-looking orientation. Most bodies identified trends and factors that are likely to impact on their ability to achieve their objectives in the future (see Exhibit 11).

### Exhibit 11

**Planning ahead**

On 28 March 2018 the Board of Trustees approved the budget for 2018-19 and considered outline plans for 2019-20 and 2020-21. As indicated in the table below, the current savings and income generation programme is expected in 2018-19 to meet the combined challenge of rising costs, falling government grant income and continued investment.

	2017/18	2018/19	2019/2020	2020/2021
	Actual	Budget	Plan	Plan
	£000	£000	£000	£000
<b>Income</b>				
Grant-in-Aid	21,672	22,367	21,267	21,267
Other income	9,459	10,070	6,972	6,885
<b>Total Income</b>	<b>31,131</b>	<b>32,437</b>	<b>28,239</b>	<b>28,152</b>
<b>Operational Expenditure</b>				
Salaries	15,747	16,441	16,881	17,434
Operational Costs	12,699	11,558	11,454	11,163
<b>Total</b>	<b>28,446</b>	<b>27,999</b>	<b>28,335</b>	<b>28,597</b>
<b>Major Projects Expenditure</b>	<b>2,630</b>	<b>4,437</b>	<b>350</b>	<b>350</b>
<b>Surplus/(Deficit)</b>	<b>55</b>	<b>1</b>	<b>(446)</b>	<b>(795)</b>

The performance report should have a forward-looking orientation.

## Specific descriptions

42. The descriptions of the key issues and risks should be specific so that users of the accounts can understand why they are important to board members. This might include a description of the likelihood of the risk, an indication of the circumstances under which the risk might be most relevant to the body, and its possible effects.
43. In our opinion, half of the bodies included specific risks.

## Action plan to mitigate risks

44. An explanation of how the key issues and risks are managed or mitigated should be included in the performance report to enable stakeholders to assess the impact on the future prospects of the body. Around half of bodies provided an explanation of what the body was doing to manage the risks in 2017/18. The body at Exhibit 12 helpfully provided the information in a table.

Specific descriptions of risks help users understand why they are important.

## Exhibit 12

Key Risks	Risk Mitigation
<p><b>HIGH RISK</b> If FSS does not have adequate time to prepare for Brexit due to tight timescales, this would affect our capability and capacity to achieve our strategic plan, for example through loss of statutory levers or through diverting resources away from carrying out the key activities agreed in the corporate plan.</p>	<p>Programme planning taking place alongside the resources needed to deliver FSS's statutory work and essential core activities. Budget and business planning work ongoing.</p>
<p><b>HIGH RISK</b> If FSS's budget is reduced or restricted in the future, there is a risk this could result in FSS having to focus solely on statutory requirements and scale back on a number of non-statutory key initiatives needed to achieve our strategic outcomes leading to detrimental impact on consumers.</p>	<p>Long-term financial plan adopted by the Board.</p>
<p><b>MEDIUM RISK</b> If sufficient resources are not available for consistent delivery of feed official controls, this could lead to the resources available not matching the statutory requirements. The lack of sufficient resource could result in environmental health and trading standards services becoming unsustainable, and there is a risk that FSS's ability to ensure consumer protection is undermined.</p>	<p>Alternative feed controls delivery mechanism being brought in.</p>
<p><b>MEDIUM RISK</b> If there is a failure of controls by food business operators that might reasonably have been detected, there is a risk of serious cases of human illness and other risks to public health, leading to a loss of confidence in the food supply chain and loss of trust in regulatory bodies.</p>	<p>Real time access to local Authority databases via Scottish National Database gives faster assurance for FSS. Local Authority (LA) audits by FSS now also focusing on capability and capacity.</p>

## Critical judgements and estimation uncertainty

45. The FReM requires disclosure in the notes to the financial statements of:

- critical judgements made in the process of applying the body's accounting policies that have the most significant effect on the amounts recognised in the financial statements
- information on the assumptions made about the future, and other major sources of estimation uncertainty, that have a significant risk of resulting in material adjustments within the next financial year.

46. The FRC guidance on the strategic report recommends that these judgements and uncertainties should be linked to key risks. In our view, users would find additional explanations in the performance report to be helpful. Exhibit 13 was one of the bodies that did so.

## Exhibit 13

<p>Public Finance and Accountability (Scotland) Act 2000, and in accordance with The HM Treasury Financial Reporting Manual (FRM). The financial statements are consolidated within the Scottish Government Consolidated Resource Accounts.</p> <p>These financial statements were authorised for issue on 22 August 2018.</p> <p>Our Annual Review is also published on our website at <a href="http://transport.gov.scot">transport.gov.scot</a> and the Scottish Government Consolidated Resource Accounts at <a href="http://scotland.gov.uk">scotland.gov.uk</a></p> <p><b>Significant accounting policies</b> The areas where accounting judgements have significant impact are outlined below:</p> <ul style="list-style-type: none"> <li> <p><b>Valuation of the Trunk Road Network</b> The trunk road network is valued on the basis of current replacement cost, adjusted to reflect the current condition of the road component and the depreciation of structures and communications assets. To produce this valuation requires the use of assumptions, estimates and professional judgement.</p> </li> </ul>	<p>currently undertaken by WSP Atkins using standard costs to value the individual components of the network asset and indices to revalue these on an annual basis through a joint contract with the other UK Road Authorities.</p> <ul style="list-style-type: none"> <li> <p><b>Recognition and the valuation of provision</b> Due to the long term nature of our road and rail improvement schemes certain assumptions and judgements are required to be made for the estimated cost of land acquisition and compensation claims. This is due to the often protracted negotiation periods involved and the initial uncertainty over both the financial value and the final payment date of any compensation.</p> </li> <li> <p><b>Valuation of accruals</b> Due to the timing and availability of final year end information from external suppliers for Concessionary Travel, Rail and Roads maintenance, certain assumptions and judgments are required to be made when determining final accruals.</p> </li> <li> <p><b>Public Private Partnerships (PPP)</b> We have three Public Private Partnerships (PPP) agreements in the form of Private Finance Initiative (PFI) contracts</p> </li> </ul>	<p>of service concession arrangements in accordance with the disclosure requirements of IPSAS 32.</p> <p>We also have PPP agreements in the form of Non-Profit Distributing (NPD) contracts for the M8/M73/M74 Motorway Improvements Project, with Scottish Roads Partnership (SRP) and Aberdeen Roads Limited (ARL) for the new AWPR / B-T. Both SRP and ARL are contractually obliged to provide the infrastructure and related services to the public on our behalf. We will retain overall control of the related assets and account for them on the Statement of Financial Position (SFP).</p> <p>We have reviewed the degree of control exercised by each of the parties in existing PPP contracts and conclude that the degree of control we retain satisfies the requirements that the related assets created are required to be accounted for on our SFP. Details of the accounting treatment can be found in notes 1 and 16 to the annual accounts.</p> <p>For details of the differences between NPD and PFI contracts, see the Scottish Futures Trust website at <a href="http://scottishfuturestrust.org.uk">scottishfuturestrust.org.uk</a></p>
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<h3>Issues identified in our review of whether the performance report explained what worried the board</h3>	
	<p>There was generally limited explanation of the key risks affecting the body.</p>
	<p>Bodies sometimes included risks and uncertainties that did not appear to be significant.</p>
	<p>Half the bodies provided only a high level generic indication of risks. The inclusion of generic information on its own is of limited use to stakeholders. Common risks identified included: Financial sustainability; Workforce planning; EU withdrawal; and IT related incidents. While these may pose a risk, it could have been clearer what the body considered to be the specific risk of these developments.</p>
	<p>Half the bodies did not set out the actions being taken to mitigate the risks.</p>
	<p>In some instances the body only provided a cross reference to the governance statement. The link between risks and performance was not clearly explained in the performance report.</p>
	<p>Bodies did not generally highlight their critical judgements in the performance report.</p>

<b>Points to consider when explaining what worries the board</b>	
	<p><b>Be sufficiently specific so that users can understand why risks are important. For example, explain that the specific risk related to EU withdrawal is workforce issues.</b></p>
	<p><b>Consider all risks but disclose and explain only those that are considered key.</b></p>
	<p><b>Describe the actions to mitigate key risks.</b></p>
	<p><b>Link critical judgements and estimation uncertainty to key risks.</b></p>
	<p><b>Address significant features in the external environment that will impact on your business e.g. funding constraints.</b></p>
	<p><b>Explain the risk to deliverability of business objectives, the likelihood of the risk and its possible effects.</b></p>
	<p><b>Link your key risks to your strategy and business model.</b></p>

## Part 4

### Consistency

47. It is fundamental to the annual report and accounts telling a single story that the performance report and financial statements are consistent.

#### Explaining significant points in financial statements

48. While the different components of the annual report and accounts have different uses, valuable insight can be achieved if the performance report highlights and explains information from the financial statements.

49. The FRC [Guidance on the strategic report](#) recommends that the performance report should include references to, and additional explanations of, amounts included in the body's financial statements. The references should explain the conditions and events that shaped the information contained in the financial statements.

50. Bodies generally explained important points in the financial statements such as significant under or overspends. Exhibit 14 provides an example.

Significant points should be explained so that there are no surprises hidden in the financial statements.

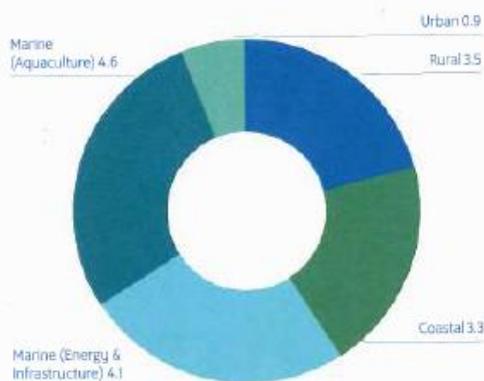
### Exhibit 14

#### 2.2.1 2017-18 revenue and valuation

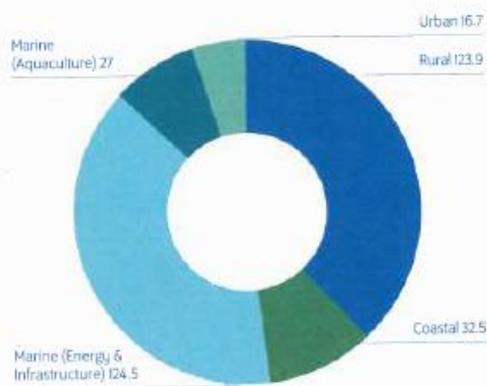
Table 6: Summary of revenue account (breakdown by asset available in Table 7)

	£m
Gross revenue	16.4
Direct costs <sup>18</sup>	(3.3)
Indirect costs <sup>19</sup>	(2.5)
Transfers to capital account	.(1.4)
Depreciation of tangible fixed assets	(0.2)
Net revenue	9.0

Gross revenue by operating division £m



Property valuation by asset £m



51. Although most bodies explained significant items in the financial statements, it was not always clear to users how figures disclosed in the performance report related to amounts in the financial statements.
52. This can be done by reconciling the figures as shown in Exhibit 15.

## Exhibit 15

The table below reconciles the deficit shown on the Statement of Comprehensive Net Expenditure (SCNE) to the surplus recognised for funding and budgeting purposes. This surplus is to be used for transitional funding as described earlier.

	Ref/note	2017/18 £000
Deficit per the SCNE	SCNE	11,486
Funding from grants and grant in aid	13a	(16,423)
Reverse IAS 19 pension accounting adjustments	5b table 2	4,550
To fund depreciation of assets	6a	(10)
<b>Surplus on funding and budgeting basis</b>		<b>(397)</b>

53. The description of the body's performance and position should be consistent overall with the segmental analysis provided in the financial statements.

## Adjusted measures

54. Highlighted or adjusted figures, KPIs and other measures referred to in the performance report should be clearly reconciled to the relevant amounts in the financial statements.
55. Any adjustments to the figures in the performance report should be clearly explained, together with the reasons why they are being made.
56. Where a line item from the financial statements, or a commonly used KPI, has been adjusted for inclusion in the performance report, the term used for that adjusted measure should be clear and, where practicable, a reconciliation to an appropriate financial statement line item and explanation of any material adjustments should be provided. Exhibit 16 provides an example.

## Exhibit 16

### Outturn Analysis

The DEL underspend of £61.3 million, comprises a cash underspend of £16.3 million and a non-cash underspend of £45.0 million. The cash underspend reflects the net position of savings and slippage offset by pressures and advanced expenditure and the reclassification of Fixed Track Access Charges (£160 million) from Operating Costs to Investment to ensure consistency across the Rail Control Period representing the most significant element of the variances in these categories.

The underspend in non-cash is a result of lower than anticipated depreciation of the road network. The AME outturn reflects the fact that provisions that were initially estimated were not required at year, with the negative expenditure representing a net overall reduction in these provisions. The ODEL resource underspend reflects deferred unitary charge payments on the Aberdeen Western Peripheral Route/Balmedie to Tippetry (AWPR/B-T) Project.

The total underspend of £106.8 million (16-17: £65.5 million underspend) represents approximately 4% (16-17: 2.0%) of the overall budget.

The Statement of Comprehensive Net Expenditure (SoCNE) identifies net operating costs of £1,840 million. Capital expenditure is not recognised as in-year expenditure within the SoCNE, but the following table provides a reconciliation of overall outturn to SoCNE.

### Outturn Analysis

Transport Scotland 2017-18	Budget £000's	Actual £000's	Variance £000's
Resource - Operating Costs	940,742	795,162	(145,580)
Resource - Investment	672,407	882,171	209,764
Resource Depreciation (non-cash)	97,511	52,526	(44,985)
Capital	559,687	479,205	(80,482)
<b>DEL total</b>	<b>2,270,347</b>	<b>2,209,064</b>	<b>(61,283)</b>
AME	20,000	(4,268)	(24,268)
PFI Resource (ODEL)	131,176	109,976	(21,200)
PFI Capital (ODEL)	5,000	4,958	(42)
<b>Total</b>	<b>2,426,523</b>	<b>2,319,730</b>	<b>(106,793)</b>

	£000's
<b>Net Operating Costs per SoCNE</b>	<b>1,839,837</b>
Add: Additions to Intangible Assets (note 7)	-
Add: Additions to PPE (note 6)	411,351
Add: Additions to Investments (note 9)	73,487
Less: Disposals of Intangible Assets (note 7)	-
Less: Disposals of PPE (note 6)	(785)
Less: Repayments of Investments (note 9)	(4,160)
Less: Disposals on Assets held for Sale (note 8)	-
Less: De-trunkings (note 6)	-
Add: De-trunkings depreciation (note 6)	-
<b>Outturn per Management Commentary</b>	<b>2,319,730</b>

## Issues identified in our review of whether the performance report was consistent with the financial statements



It was often not clear how figures disclosed in the performance report related to amounts in the financial statements.

Limited explanation was provided of the adjustments that were made to the amounts in the financial statements.

Some bodies reported budget figures on a cash basis, with no linkage to the figures in the financial statements.

## Points to consider when ensuring consistency include



Identify and explain where figures are presented differently from the financial statements.

Reconcile the figures in the performance report to the equivalent figure in the financial statements where different.

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## Part 5

### Cut the clutter

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57. There is a significant drive within the accounting profession to remove clutter and streamline the information presented in the annual report and accounts. Clutter is immaterial disclosures that inhibit the ability of users to identify and understand relevant information.

#### Comprehensive and concise

58. The performance report is required to be comprehensive, but it is also required to be concise. There does not have to be a tension between these two requirements.

59. Comprehensiveness reflects the breadth of information that should be included rather than the depth of information. The performance report does not need to cover all possible matters in detail to be considered comprehensive. It should include the information that is necessary for an understanding of the development, performance, position and future prospects of the body. There is a risk that performance reports include too much unnecessary information leading to the main messages being lost.

60. Conciseness is achieved through the efficient communication of all material information. Bodies should not confuse conciseness with excessive brevity in the level and type of information provided. There are risks that performance reports are overly brief and so do not include all the necessary information.

#### Relevance of disclosures

61. Financial reporting is not an end in itself and the information to be included in the performance report should be determined by the needs of users. A body should not include information in the performance report that is not relevant to its circumstances.

#### Materiality of disclosures

62. Only information that is material to users of the accounts should be included in the performance report. Materiality is an aspect of relevance that is specific to each body based on the nature or magnitude of the effect of the information, judged in the particular circumstances.

63. This requires the body's officers to apply judgement based on their assessment of the relative importance of the matter to the body's development, performance, position or future prospects.

64. Immaterial information should be excluded as it can obscure the key messages and impair understandability.

#### Use of cross-referencing and signposting

65. Good linkages between related disclosures is essential for the annual report and accounts to communicate a holistic story. Insufficient linkage between different components can make it appear disjointed. Cross-referencing and signposting are useful techniques that can assist bodies in highlighting linkages:

- The requirement to include information in the performance report can be met by setting out the item in another component of the annual report and accounts provided a cross-reference to the item is included in the performance report. This can lead to clearer communication, while ensuring disclosure requirements are met.

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Clutter is immaterial disclosures that inhibit the ability to identify and understand relevant information.

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Relevance is a fundamental qualitative characteristic of financial information.

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Materiality is an entity-specific aspect of relevance.

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Cross-referencing to required information and signposting to complementary information can highlight linkages.

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- Signposting can be used to direct users to complementary information that is not required to meet the disclosure requirements for the performance report. Signposted information can be located in another component in the annual report and accounts (e.g. an appendix) or elsewhere (e.g. on a website).

66. Most bodies made effective use of signposting to refer the user to further documents and information available. Exhibit 17 highlights a good example

## Exhibit 17



This body provided a link to allow the user to access further information.

67. However, where hyperlinks are included, bodies should ensure that the version of the annual report and accounts published on their website allows the user to follow these links. The level of information available on public bodies has increased significantly. Bodies should be careful not to overwhelm users with excessive use of signposting.

68. There may be scope for greater use of cross-referencing, which may allow bodies to remove some detail from their performance report, improve the narrative flow and reduce duplication.

## Issues identified in our review of whether the performance report contained clutter

	Some bodies reported all performance measures rather than those that were key to assessing performance.
	Excessive detail was sometimes provided on certain items.
	Content that was not necessary to meet the objectives of the performance report was sometimes included.
	There were instances of excessive signposting which reduced its effectiveness.
	Most of the hyperlinks in the performance report did not work for external users.

## Points to consider when reducing clutter

	<b>Include the necessary breadth of information in a concise way.</b>
	<b>Ensure disclosures are relevant to the body.</b>
	<b>Use judgement to assess the relative importance of relevant information.</b>
	<b>Consider the appropriate use of signposting to allow the user to access complementary information.</b>
	<b>Avoid excessive detail about a large number of projects and concentrate on overall performance.</b>

## Part 6

### Clarity

69. The FReM requires an understandable analysis of performance. To achieve this, it is essential that the language used is precise and issues are explained clearly.

#### Plain language

70. The language used to support and explain the disclosures in the performance report is fundamental to users' understanding of the information presented. The performance report should be written in plain language such as in Exhibit 18.

The performance report should be written in plain language.

#### Exhibit 18

##### Three: Children's rights at the centre of laws, policy and practice

We'll help make sure the Scottish and UK Governments keep the promises they made to children and young people when they signed up to international human rights laws. And we'll use the laws that exist in Scotland to make real changes that will improve children and young people's lives.

We'll use the Commissioner's legal powers to highlight where law, policy and practice isn't working, and to try and make sure things are different in the future. And we'll use our power of investigation to take action around issues that affect children's human rights.

#### Use of jargon

71. The excessive use of technical language (i.e. jargon) should be avoided where possible. Where the use of body-specific terms is necessary, they should be clearly defined and used consistently. Some bodies clearly explained terms which were not obvious to lay persons (see Exhibit 19).

#### Exhibit 19

Performance against our published targets during 2017-18 was:

Business Area	Target	Performance	
		2017-18	2016-17
Bail Cases: Serve Indictment*	Serve within timebar**	100%	100%
Take/Implement Decision	Process 75% within 4 weeks	77%	76%
Investigation of Deaths	Investigate 80% within 12 weeks	89%	89%
Investigation of Criminal Allegations against the Police	Investigate 90% within 12 weeks	92%	93%

\* An indictment is a document setting out the charge(s) of crimes or offences against an accused in more serious cases. A case on indictment is tried by judge sitting with a jury in the High Court (in the most serious cases), or the sheriff court. This is termed Solemn procedure.

\*\* There are strict time limits which regulate the maximum time allowed between an accused's appearance on petition (the normal first step in solemn procedure) and the service of an indictment on him/her. The time allowed depends on whether (s)he is granted bail by the court or remanded in custody.

## Boiler-plate wording

- 72.** Boiler-plate wording refers to generic disclosure which could apply to any body that gives no additional useful information to users of the accounts. Where standard wording is taken from another source, it should be tailored to the specific circumstances of the body.

Issues identified in our review of whether the performance report was clear	
	Jargon was prevalent but not always explained. For example, many bodies referred to annually managed expenditure without explaining what this meant.
	Bodies operating in specialist parts of the public sector were more prone to the use of jargon, while those operating in a more customer-focussed environment tended to use plain language.

Points to consider when providing a clear explanation of performance include	
	<b>Use plain language.</b>
	<b>Avoid using jargon, or explain it where it cannot be avoided. Consider providing a glossary of key terms.</b>
	<b>Avoid boiler plate wording and make sure standard wording is tailored to the circumstances of the body.</b>

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## Part 7

### Summarise

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**73.** In order to highlight the key messages, items should be reported at an appropriate level of aggregation. Tables of summarised information should be supported by accompanying narrative.

#### Aggregation

**74.** The performance report should not include so much detail that the main messages are lost. It is helpful if information is aggregated to an appropriate level as this helps users to see key themes without getting lost in excessive detail.

**75.** The performance report disclosures should provide a link to the segmental analysis provided in the financial statements.

#### Infographics

**76.** The method of presentation can significantly affect the understandability of information in the performance report. The most appropriate method of presentation will depend on the nature of the information but may include tabular, graphical or pictorial methods as well as narrative text.

**77.** The use of innovative presentation techniques such as infographics can emphasise a point and improve the disclosure. Information that can helpfully be presented graphically includes:

- geographic and demographic information
- performance against targets and financial information
- organisational structures and governance arrangements.

**78.** In most cases tables and other infographics should be supported by accompanying narrative. It is important that the narrative is consistent with the message conveyed by the infographic.

**79.** Although not widespread, a few bodies made effective use of innovative presentation (such as the examples in Exhibits 20 and 21).

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Items should be reported at an appropriate level of aggregation.

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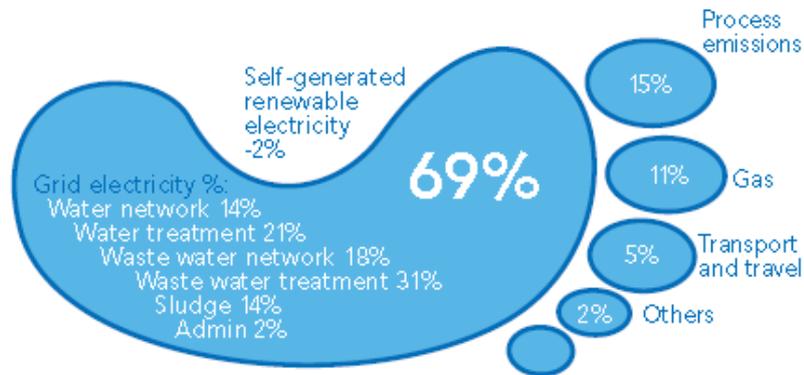
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Infographics can improve presentation and should be supported by narrative.

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## Exhibit 20

### Greenhouse gas emissions footprint – by source 2017/18



## Exhibit 21



## Case studies

80. The use of case studies can be an effective way to engage the user and to highlight performance developments and action to address issues.
81. Exhibit 22 provides an example of a body making effective use of case studies to give the user an insight into the achievements in the year and performance against the targets.

## Exhibit 22

### Equality and diversity: using casework to make a difference

Our casework allows us not only to reflect on our service but also to support improvements generally.

#### Case Study

In one case (201700486<sup>36</sup>) we identified that a policy did not appropriately provide parity between mental and physical health. A GP practice policy appeared to only allow for home visits if there was a physical health problem. In this case, they did not consider the complainant's significant mental health problem meant that he was housebound despite a letter from a psychiatrist confirming this was the case. We have asked the practice to apologise to the individual but also to review their policy to ensure it has due regard to mental as well as physical health which will have wider benefits.



We also look across our casework to identify themes and ensure our commitment to equality is reflected. Findings were reflected in our thematic report on "Making Complaints Work for Everyone" where we included specific support and guidance on equality issues and making reasonable adjustments (taking advice from the Equality and Human Rights Commission).

<sup>35</sup> <https://www.spsa.org.uk/statistics-2017-18>

<sup>36</sup> <https://www.spsa.org.uk/decision-reports/2018/may/decision-report-201700486-201700486>

### Issues identified in our review of whether the performance report summarised information



Some bodies provided an unnecessary level of detail which made it difficult to identify the key messages.

There was limited use of infographics.

Only a few bodies used case studies.

### Points to consider when summarising your performance



**Aggregate information at an appropriate level to highlight key messages.**

**Consider which information could be better presented using tables or a graphical presentation.**

**Consider using case studies to add valuable insight to performance.**

## Part 8

### Explain change

**82.** Significant changes from the prior year should be properly explained. Users can obtain important insight where performance is considered against previous years outcomes.

#### Explaining changes from comparatives

**83.** The financial statements are required to provide comparative information for the previous year to allow the user to identify significant changes in the performance over the year and position of the body at the year end. Significant changes between years should be flagged in the performance report, as in Exhibit 23.

#### Exhibit 23

##### 7. Financial Review

The aim of this section is to explain the financial results for the year.

The main headline for the 2017/18 financial year is that the Library has ended the year by adding £193k to its General Reserves. The equivalent in 2016/17 was a reduction in General Reserves of £58k. Within the financial statements, the place where this is best shown is at the bottom section of the Statement of Financial Activities on Page 24 and the Reserves Note at Page 44. Both these show the balance on the Library's Unrestricted General Fund reserve increasing from £347k to £540k over the year.

This result is partly deliberate and partly fortunate. It is partly deliberate since, after the deficit in 2016/17, the Library was aiming to replenish its reserves to a healthier level. It is partly fortunate since there were a small number of areas across the Library which spent less than planned or generated additional income. A good example here are the savings the Library made on legal costs – the result of competitive tender. Results like these had the effect of pushing general reserves slightly higher than planned.

Users find an explanation on changes from comparative information helpful.

**84.** Users should be able to distinguish between movements in performance resulting from one-off events and those that are expected to continue.

#### Explaining changes in policy and other key matters

**85.** Significant changes from the prior year in policy and other key matters should be adequately explained so that users of the accounts can assess the impact on the development, position, performance, or future prospects of the body.

**86.** For example, significant changes in key risks such as a change in likelihood, probable timing or possible effect, or the inclusion of new risks, should be highlighted and explained.

**87.** As bodies develop, different risks will emerge and they may need to change their policy or approach to manage these risks. Bodies should clearly explain these changes as they emerge.

## Issues identified in our review of whether the performance report explained change

	Only a few bodies compared performance to previous years.
	Explanation of changes was limited and did not highlight whether events were likely to continue or were caused by one off events.
	Trend information was only used by a few bodies.
	There was little evidence that risks had been updated.

## Points to consider when explaining change

	<b>Explain significant changes in the financial statements.</b>
	<b>Use comparative figures to explain changes in performance.</b>
	<b>Highlight significant one-off events that impact on performance.</b>
	<b>Explain changes in the KPIs disclosed.</b>
	<b>Explain the reasons for any changes in key risks.</b>

# Good practice note on improving the quality of central government annual report and accounts – performance reports

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