

RESPONSE FROM DIRECTOR-GENERAL ECONOMY OF THE SCOTTISH GOVERNMENT, DATED 31 JANUARY 2017

Thank you for your letter to the Permanent Secretary of 6 December about European Structural funds, following up on the evidence provided to your Committee in writing and in person at the end of 2016 on a range of issues associated with the Scottish Government's Consolidated Accounts 2015/16. I have been asked to reply.

You have posed a series of questions which I will aim to cover in my response, but first it is important that I clarify the context for the issues set out in your letter of 6 December – specifically in relation to the £14 million provision in the Scottish Government's Consolidated Accounts 2015/16. Firstly, the £14 million is a provision set aside to pay an anticipated but as yet unknown amount to the European Commission (EC) related to the 2007/13 programme. In doing so we consider that we have taken a prudent approach to this in the accounts.

Secondly, within the £14 million provision, £3 million is to repay what was effectively an advance from the EC and therefore does not as such represent a loss to the Scottish Government. Whilst this is categorised as a provision in the accounts, the timing of it being paid is linked closely with the closure of 2007-2013 programmes which I describe in more detail below. Thirdly, the remaining £11 million of the provision is an estimate based on on-going audit work and engagement between SG and the EC. This work is anticipated to result in a final confirmed figure in financial year 2017/18 at which time a final sum due to the EC will be advised and will need to be paid.

There is a great deal of work in hand at the moment to reconcile and report on the performance of the 2007-2013 programmes, ready for the EC deadline for closing the programmes of 31 March 2017. The EC will assess the information and the EC officials who will be carrying out these checks tell us they aim to finalise this within a year, including any financial changes. The actual loss depends on the final calculation of errors where we are unable to claim reimbursement from the EC nor achieve recovery from the implementing or sponsoring bodies. We will keep the Committee informed on progress towards this final figure.

- *The number of Scottish bodies that committed errors in respect of structural funds, the amount of the error, when the error was first uncovered and confirmation that the Scottish Government formally contacted each body in question with a view to addressing the error.*

Of the 2007-2013 programmes, from over 250 beneficiaries who received funding, fewer than ten had no errors with their projects. Typical errors included failure to keep adequate audit trails of documentation, not following procurement rules or making changes to the projects being funded without keeping sufficient records. These came to light as a result of both normal project engagement and audits completed throughout the life of the projects. These were raised with each body that had errors and each was offered the opportunity to provide evidence to address the error. Where these could not be satisfactorily rectified or explained, a financial recovery was sought.

- *The Auditor General stated in oral evidence that the Scottish Government “is intentionally passing European funding through to what are often quite small community organisations, which spend the funding on important community based projects involving people who are not used to complying with significant audit requirements”. Who was responsible for making the decisions that led to this situation and have you calculated how many people may have been involved in spending European funding who were not provided with the appropriate auditing training?*
- *Have any groups of people and/ or geographical areas suffered disproportionately?*

European Structural Funds have for over 25 years, across the EU, supported social and civic partners and community organisations as well as local authorities, agencies and governments in fostering social and economic development in the less developed regions of EU. In applying these EU policies on structural funding, successive Scottish administrations have invited small and community based organisations to apply for and receive Structural Funds grants.

The Regulations and guidance covering how structural funds must operate are laid down by the EC and are very detailed. Training was available to all beneficiaries on the rules, processes and IT systems associated with Structural Funding, and whilst many beneficiaries are small organisations, our funding offer made clear the terms and conditions attached to the funding. Responsibility lay with the applicant to determine whether the terms could be met. Projects under the 2007-2013 programmes are located across the whole of Scotland. An overview of the programmes and case studies of projects funded is available at <http://www.gov.scot/Topics/Business-Industry/support/17404/2007-2013PublicityInfo/E-bookESIF>.

- *With reference to your remark that “some people are trying deliberately to use the money for unintended purposes”, how many people fall into this category and have they have faced any kind of disciplinary action?*

We found evidence of fraudulent behaviour relating to the use of funds in two projects. In each case a financial recovery was made and disciplinary action taken against individuals.

- *Have any projects in Scotland had to be abandoned or downgraded as a result of the loss of structural funds?*

We have seen no evidence of this being the case. However as any decision to make different investment or project funding decisions as a result of ESF would be for the beneficiary to make, we are unable to confirm or quantify any impacts.

- *In your oral evidence you noted that the Scottish Government may be able to claw back elements of the funding from the projects’ sponsors that were responsible for overseeing the programmes. If that is the case, have you assessed:*

- a. *whether some project sponsors have a demonstrably poorer track record than others;*
- b. *the likely impact on the bodies in question;*
- c. *the sum of money that may be recoverable by this means?*

A small number of beneficiaries had a greater error rate compared with others. In recovering funds, the ability of the beneficiary to pay and / or the impact on its operations has been considered and options for paying back funds have included paying in instalments. In some instances our own audit and reconciliation work has found that money is due to be paid to the beneficiary, and this has been done, whilst in others losses have been written off where appropriate.

- *Should the above option not be viable, is it feasible that the Scottish Government would cover the losses from other budgets? If so, has any analysis been carried out into where that money would be found and the opportunity cost?*

The starting point is that all recoveries should be pursued. As set out above, we do consider a number of factors in deciding whether indeed to undertake that course of action. Until the final positions are known, we will not be able to evaluate the opportunity cost.

- *Has there has been any impact on the 2014-2020 programmes as a result of the problems with the 2006-2013 programmes, in particular, the time available to the Scottish Government to spend the funds associated with the current programmes?*

Staff time has been under pressure as teams have had to address 2007-2013 issues at the same time as the 2014-2020 programme is established. Further to this, some lead partners have chosen to wait until we have been in a position to commit to expenditure contractually, which happened throughout 2016. This has had the effect of delaying the start of some projects.

A positive impact on the 2014-2020 programme has been using the lessons from the 2007-2013 programme to inform the design of the new programme.

- *On a point of clarification, you stated that you would not know the final outturn of the programme or the reconciliation by Europe for sure until 2018. However, Audit Scotland's oral evidence suggested that the position would be clear by Spring 2017.*

We must submit a complete, audited report on the closure of the 2007-13 programmes to the EC by the 31 March 2017. As I have set out above, the definitive amount will be known when the EC agree the final position, anticipated to be within a year of 31 March. It can however take longer, for example the final closure positions on two of the 2000-06 programmes were only finally settled in 2014.

Lessons Learned

You make several points in respect of what lessons have been learned from the experience of the 2007-2013 Programmes and how these have influenced the

design and implementation of the 2014-2020 Programmes. With both the 2007-2013 and 2014-2020 programmes, the Regulations and guidance covering how they must operate are laid down by the EC. The experience of the 2007-2013 programmes led to changes in the design of the 2014-2020 programmes. The detailed management and control system for the programmes within Scotland has been audited on behalf of the EC and formal designation was provided in July 2016. The principles on which the new systems were based include:

- a two stage approval process - strategic interventions and operations - to concentrate funds and to try to ensure complementarity rather than competition between projects;
- fewer, larger projects;
- larger lead organisations with administrative and audit capability to manage projects of scale and receive funds – SG and its agencies and local authorities;
- less reliance on complicated audit trails through much greater use of procurement, flat rates or challenge funds;
- a risk assessment process enshrined in the project consideration and approval stages, and close involvement of procurement and state aid officials in the consideration processes; and,
- risk rating of operations and production of risk-based verification plans for each operation to shape and govern the initial compliance and verification visits.

Some issues were also addressed specifically. For example, one of the major causes of compliance errors was the lack of adequate time sheet records for project staff. To address this directly, no lead organisation will be permitted to propose or claim for staff under the 2014-20 programmes unless the staff are engaged on Structural Funds projects for all of their contracted hours. Similarly, one of the largest causes of errors in the previous programmes lay in difficulties with procurement. Having fewer, larger lead partners who have existing developed procurement systems is designed to mitigate this in future.

Yours sincerely

Liz Ditchburn
Director General Economy