



INFRASTRUCTURE, GOVERNMENT AND HEALTHCARE

Mental Welfare Commission for Scotland

Annual audit report for 2004-05 to the Mental Welfare
Commission for Scotland and the Auditor General for Scotland

26 July 2005

AUDIT

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Notice: About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ('the *Code*') and *Statement of Responsibilities of Auditors and Audited Bodies*.

This report is for the benefit of only the Mental Welfare Commission for Scotland and is made available to Audit Scotland (together the beneficiaries), and has been released to the beneficiaries on the basis that it shall not be copied, referred to or disclosed, in whole or in part, without our prior written consent.

Nothing in this report constitutes a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives section of this report.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the beneficiaries) for any purpose or in any context. Any party other than the beneficiaries that obtains access to this report or a copy and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

1. Executive summary

Corporate governance

- The saving in year against the Commission's revenue resource limit was £1,263,000. This largely arose through receipt of additional funding of £1 million for costs relating to the proposed relocation of the Commission which was to be carried forward and used against expenditure incurred in 2005-06. A further saving of £263,000 arose from the delay in implementation of the Mental Health (Care and Treatment) (Scotland) Act 2003 until October 2005.
- During 2004-05 we have conducted a review of key risks associated with the proposed relocation of the Commission and considered the arrangements established by management to manage those risks. Our relocation risk assessment report was issued on 22 December 2004.
- In March 2005, Scottish Ministers instructed the Commission to relocate to Falkirk on expiry of their current lease in Edinburgh in 2006. In June 2005, the Commission decided to stay in Edinburgh as it was determined that under current legislation, the Scottish Ministers do not have the authority to relocate the Commission.
- The Commission's internal auditor service is provided by Fife, Tayside and Forth Valley Audit and Management Services. The internal auditors annual report concludes that the Commission has adequate and effective internal controls and the accountable officer has a satisfactory framework in place to discharge his responsibilities.
- The 2004-05 statement on the systems of internal control prepared by the Commission does not disclose any major weaknesses.

Financial statements

- On 26 July 2005 we issued an audit report expressing an unqualified opinion on the financial statements of the Commission for the year ended 31 March 2005 and on the regularity of the financial transactions reflected in those financial statements.
- During the audit process, we identified no significant adjustments required in the financial statements. A number of presentational and disclosure issues were identified within the first draft of the financial statements which were passed to the Commission for amendment.

2. Introduction

Background

2004-05 was the fourth year of our five year appointment as external auditors of the Mental Welfare Commission for Scotland ("the Commission"). This report summarises our opinion and conclusions and highlights significant issues arising from our work.

The framework under which we operate under appointment by Audit Scotland is as outlined in our *strategic (long-term) planning memorandum* issued on 3 March 2005. The scope of the audit was to:

- provide an opinion on, to the extent required by the relevant authorities, the Commission's financial statements and the regularity of transactions in accordance with the standards and guidance issued by the Auditing Practices Board;
- review and report on, to the extent required by relevant legislation and the requirements of the *Code*, the Commission's corporate governance arrangements in relation to systems of internal control, the prevention and detection of fraud and irregularity, standards of conduct, and prevention and detection of corruption; and the Commission's financial position; and
- review and report on, to the extent required by relevant legislation and the *Code*, aspects of the Commission's arrangements to manage its performance, as they relate to the economy, efficiency and effectiveness in the use of resources.

Our audit approach focused on the identification of strategic business risks and operational and financial risks impacting the Commission:

- relocation;
- implementation of the integrated information management project;
- delay in the introduction of the Mental Health (Care and Treatment) (Scotland) Act 2003; and
- failure to meet financial targets.

Basis of information

External auditors do not act as a substitute for the Commission's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

In addition to our work in relation to the financial statements, during the year we issued a relocation risk assessment report accompanied by an action plan, including management responses and dates for implementation of agreed recommendations in respect of 2004-05. This report covers the key points arising from that work.

To a certain extent the content of this report comprises general information that has been provided by, or is based on discussions with, management and staff of the Commission. Except to the extent necessary for the purposes of the audit, this information has not been independently verified. The contents of this report should not be taken as reflecting the views of KPMG LLP except where explicitly stated as being so.

Acknowledgement

Our audit has brought us in contact with a range of Commission staff. We wish to place on record our appreciation of the co-operation and assistance extended to us by staff in the discharge of our responsibilities.

3. Corporate governance

Financial position

It is the responsibility of the audited body to conduct its affairs and to put in place proper arrangements to ensure that its financial position is soundly based. We are required to consider whether the Commission has established adequate arrangements in this regard. The Scottish Executive Health Department set three budget limits for the Commission in 2004-05. The Commission's performance against these targets is summarised in Table 1.

Table 1: Performance against financial targets

Source: audited financial statements 2004-05	Target £000	Actual outturn £000	Variance £000
Revenue resource limit	4,298	3,035	1,263
Capital resource limit	555	368	187
Cash requirement	4,853	3,403	1,450

The main reasons for the savings shown in Table 1 are:

- £1 million of additional resource funding was received during 2004-05 to cover relocation costs for the Commission's proposed move to Falkirk. As at 31 March 2005, the Commission had agreed a carry-forward of this expenditure to be set against costs to be incurred during 2005-06;
- £263,000 of revenue funding was underspent due to the deferral of the implementation of the Mental Health (Care and Treatment) (Scotland) Act 2003; and
- the Commission's Integrated Information Management Project (IIMP) runs in conjunction with implementation of the Mental Health Act. The delay in implementation of the Act led to a capital underspend of £187,000.

Proposed relocation of the Commission

During 2004-05, the Commission was the subject of plans by the Scottish Executive to relocate the Commission outside Edinburgh, in line with its current relocation policy. In March 2005, a Ministerial decision was taken to relocate the Commission to Falkirk in 2006.

In June 2005 the Commission decided to remain in Edinburgh following advice from the Scottish Executive that the Commission's independent status, under current mental health legislation, did not provide the Scottish Ministers with the authority to relocate the Commission. The Commission's decision to remain in Edinburgh was supported by its relocation option appraisal carried out in 2004-05.

Relocation risk assessment

Prior to the final decision on relocation, we assessed the Commission's risk framework in response to the proposed relocation. This involved reviewing the key risks associated with the relocation and considering the arrangements established by management to manage those risks. The risk assessment produced the following results:

- eighteen headline risks were identified;
- three of these risks were assigned 'business critical' status:
 - loss of directly employed staff resulting from a move out side the central triangle
 - delay in implementation of the Act and consequent implementation of Integrated Information Management Project compressing time between implementation and relocation
 - loss of administration staff;
- a further nine risks were identified as 'important', with the remaining six risks assessed as 'other'; and
- the majority of control strategies in place at the Commission in relation to the proposed relocation were recognised as weak or incomplete.

Our report was issued on 22 December 2004.

Financial position Systems of internal control Standards of conduct Fraud and irregularity Prevention and detection of corruption

3. Corporate governance (cont'd)

Systems of internal control

Control environment

During 2004-05 we reviewed the key controls operating over systems for:

- payroll; and
- ordering and certification of goods and services.

Our findings from this work are included within appendix 1 of this report.

Internal audit

In completing our audit, we sought, where appropriate to rely on the work carried out by the Commission's internal auditors. During 2004-05 we placed reliance on internal audit in respect of their work on:

- monitoring financial performance and budgetary control;
- accounts receivable;
- asset register maintenance and capital charges;
- travel and subsistence; and
- purchase/sale/disposal of fixed assets.

The Commission's internal auditors have issued an annual report which states that the Commission has adequate and effective internal controls and the accountable officer has a satisfactory framework in place to discharge his responsibilities.

Statement on internal control

As part of the development of corporate governance, public sector bodies are required to make a statement of how they have applied the principles of corporate governance. We are required to review this to assess whether the description of the process adopted in reviewing the effectiveness of the system of internal control appropriately reflects the process. We are not required to provide an opinion on the Commission's systems of internal controls.

The 2004-05 statement on the systems of internal control prepared by the Commission does not disclose any major weaknesses. The processes described within the statement on internal control are consistent with our understanding of the Commission's corporate governance arrangements.

Fraud and irregularity

During 2004-05 we had regard to Statement of Auditing Standards 110: *Fraud and Error* and International Standards on Auditing 240: *The Auditor's Responsibility to Consider Fraud in the Audit of Financial Statements* when completing our work in this area.

Standards of conduct and prevention and detection of corruption

Public business should always be conducted with fairness and integrity, including matters such as the avoidance of personal gain from such business, even handedness in the appointment of staff, open competition in the letting of contracts and the avoidance of waste and extravagance. We are required to consider whether the Commission has put in place adequate arrangements to maintain and promote proper standards of financial conduct and detect corruption. Our work over the five-year period of our appointment in relation to this element of the *Code* was reflected within our long-term plan.

3. Corporate governance (cont'd)

Performance audit

The terms of appointment from Audit Scotland include a requirement for a proportion of our audit time to be spent on performance audit work. Performance audit work covers a variety of areas, both financial and non-financial, including both Audit Scotland centrally directed studies and locally determined studies based on agreement between each organisation and their auditors.

No performance audit studies were identified by Audit Scotland for the Commission during 2004-05.

4. Financial statements

Audit opinion

On 26 July 2005 we issued an audit report expressing an unqualified opinion on the financial statements of the Commission for the year ended 31 March 2005 and on the regularity of the financial transactions reflected in those financial statements.

Audit completion

An important measure of proper financial control and accountability is the timely closure and publication of audited financial statements. We have summarised in figure 4.1 the three key elements of the audit process with which we require the Commission to engage.

Figure 4.1: Key elements of the audit process

Completeness of draft financial statements

A fully completed set of draft financial statements were received at the start of the audit on 6 June 2005.

Quality of supporting working papers

In accordance with our normal practice, we issued a 'prepared by client' request that set out a number of documents required for our audit of the financial statements. Documentation provided was of a good standard.

Response to audit queries

Audit queries were dealt with in a timely manner.

Source: KPMG LLP (June 2005)

Audit adjustments and confirmations

In figure 4.2 we draw attention to adjustments to the financial statements made by management following the audit process.

Figure 4.2: Audit adjustments

There were no significant audit adjustments required for the 2004-05 financial statements. A number of minor adjustments were identified from the draft financial statements which required correction.

In addition, a number of presentational and disclosure issues were identified on review of the draft financial statements against the NHS Unified Board Accounts Manual and general good practice. Management processed all changes following identification during the audit.

Source: KPMG LLP (June 2005)

Confirmations and representations

We confirm that as of 15 July 2005, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of audit staff is not impaired. Appendix two provides a copy of a statement to the Commission to this effect.

In accordance with auditing standards, we have obtained representations from directors on material issues prior to signing our opinion.

4. Financial statements (cont'd)

Significant accounting issues

Summarised in figure 4.4 are the significant accounting matters impacting the 2004-05 financial statements.

Figure 4.4: accounting issues

Issue	Commentary
Fixed assets	<p>During 2004-05, the Commission capitalised £368,000 in relation to its Integrated Information Management Project ("IIMP"). We considered the appropriateness of the accounting policies adopted by the Commission in relation to its fixed assets and confirmed that expenditure was capitalised in line with those policies. Included within the capital costs are information technology hardware purchases totalling £37,000. These assets are capable of use and so were depreciated in accordance with the Commission's adopted accounting policy.</p> <p>The remainder of the project is classed as assets under construction as the IIMP is due for completion in line with implementation of the Mental Health Act. Assets under construction were valued at expenditure to date, in line with the NHS Unified Board Manual 2004-05. These include staff costs of £65,000 which have been capitalised under FRS 15 as costs directly attributable to bringing the asset into working condition for its intended use.</p>
Additional income for relocation	<p>Following the Commission's decision to remain in Edinburgh, we considered the treatment of the resource funding of £1,000,000 provided in 2004-05 to be carried forward and used against expenditure incurred in 2005-06. Our understanding from Commission management is that SEHD has no plans to remove this funding allocation from the Commission's revenue resource limit for 2004-05. Since the Commission has already incurred costs against relocation in 2005-06, unused funds will be set against the Commission's budget settlement for 2005-06. At the time of drafting this report, written confirmation of the Commission's 2005-06 budget had not yet been received from SEHD.</p>

Appendix 1 – Action plan

This appendix summarises the performance improvement observations we have identified from the work performed to prepare this audit highlights memorandum. Each of our observations has been allocated a risk rating (as explained below)

Priority rating for performance improvement observations raised

	<p>Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the Lottery or systems under consideration. The weakness may therefore give rise to loss or error.</p>		<p>Grade two (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.</p>		<p>Grade three (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the controls to meet their objectives in any significant way. These are less significant observations than grades one and two, but we still consider they merit attention.</p>
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No	Grade	Observation	Recommendation	Management response	Responsible officer / completion date
1	1	<p>Payroll information and reconciliation</p> <p>During 2003-04, the Commission was required to perform significant manual reconciliation of its payroll information to identify accurately its salaries, social security and superannuation costs due to limited information being received from its payroll supplier. While the external payroll supplier has changed from April 2005, we understand that the Commission is still not receiving payroll prints with sufficient detail to allow accurate and effective monitoring of payroll costs.</p>	<p>The Commission should continue to investigate the payroll information provided by the external payroll supplier to ensure that adequate information is received to allow the Commission to monitor its payroll costs effectively.</p>	<p>The Commission is now receiving basic payroll information. Further information will be requested.</p>	<p>Finance officer 30 September 2005</p>
2	3	<p>Reconciliation of the fixed asset register</p> <p>During 2003-04, the Commission reconciled its fixed asset register to the financial ledger on a monthly basis. The reconciliation was not, however, subject to review by an independent officer.</p>	<p>The Commission should require the monthly reconciliations to be signed and dated on preparation and on review. This will provide evidence of timely completion of the reconciliation and provide assurance that the reconciliation is subject to an independent check.</p>	<p>Agreed.</p>	<p>A McRae 30 September 2005</p>

Appendix 1 – Action plan

No	Grade	Observation	Recommendation	Management response	Responsible officer / completion date
3	3	Trade creditors The Commission does not routinely receive a trade creditors listing from the SEAS system. This limits the information available to the Commission for monitoring its balance sheet position. In particular, without review of trade creditors listing, the Commission cannot accurately separate capital and trade creditors at the year end.	The Commission should consider requesting a regular trade creditors listing from the SEAS system. This will assist with monthly monitoring of the balance sheet position and, in particular, aid with the completion of the financial statements at the year end.	The need for such a report is questionable. We will however obtain it quarterly and review.	Finance officer 30 September 2005

Appendix 2 – Confirmation of independence

To: Mental Welfare Commission for Scotland and the Auditor General for Scotland

Effective for periods commencing after 15 December 2004 professional ethical standards require us to communicate to you in writing at least annually all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place that, in our professional judgement, may reasonably be thought to bear on KPMG LLP's independence and the objectivity of the audit team. This statement is intended to comply with this obligation earlier than required.

We have considered the fees paid to us by Audit Scotland and the Mental Welfare Commission for Scotland for professional services provided by us during the reporting period.

We are satisfied that our general procedures support our independence and objectivity.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP staff annually confirm their compliance with our Ethics and Independence Manual including in particular that they have no prohibited shareholdings or interests. Our Ethics and Independence Manual is fully consistent with the requirements of the Ethical Standards issued by the UK Auditing Practices Board. As a result we have underlying safeguards in place to maintain independence through:

- instilling professional values;
- communications;
- internal accountability;
- risk management; and
- independent reviews.

Please inform us if you would like to discuss any of these aspects of our procedures in more detail.

There are no other matters that, in our professional judgement, bear on our independence which need to be disclosed to the Commission.

Confirmation of audit independence

We confirm that as of 15 July 2005, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the audit director and audit staff is not impaired.

This report is intended solely for the information of the Mental Welfare Commission for Scotland and the Auditor General and should not be used for any other purposes.

Yours faithfully

KPMG LLP