

**INFRASTRUCTURE, GOVERNMENT AND HEALTHCARE**

# **Mental Welfare Commission for Scotland**

Annual audit report for 2005-06 to members of the Mental Welfare Commission for Scotland and the Auditor General for Scotland

29 June 2006

**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.

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# Executive summary

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## Financial statements

On 29 June 2006 we issued an audit report expressing an unqualified opinion on the financial statements of the Commission for the year ended 31 March 2006 and on the regularity of the financial transactions reflected in those financial statements.

The Commission achieved the three financial targets set by the Scottish Executive Health Department for 2005-06.

There were no significant issues relating to financial position. The Commission achieved the financial targets despite a number of significant activities undertaken during 2005-06, including:

- the implementation of the new Integrated Information Management System from October 2005, replacing the patient record database and integrated electronic patient and corporate records previously held on paper; and
- implementation of the Mental Health (Care and Treatment) (Scotland) Act 2003, which created new duties and responsibilities for the Commission. The implementation of the Act required training provided to Commission staff and medical practitioners to ensure the new duties and responsibilities were carried out in accordance with the Act.

The Commission was required to implement Financial Reporting Standard (FRS) 17 *Retirement Benefits* during 2005-06 in respect of employees who are members of the local government pension scheme.

## Corporate governance

The 2005-06 statement on internal control prepared by management does not disclose any major weaknesses.

We have not identified any significant control weaknesses in relation to fraud and irregularity, standards of conduct or prevention of corruption during our audit.

The Commission's internal auditors have concluded that " the Commission has adequate and effective internal controls, subject to those matters disclosed in the SIC and the Director has a satisfactory framework in place to discharge his responsibilities as accountable officer".

One of our objectives is to use our knowledge of the Commission gained during the audit work to make useful comments and suggestions for you to consider. A summary of these performance improvement observations can be found at appendix 1. We have identified a single grade one (significant) weakness in financial controls related to maintaining supporting documentation for, and authorisation of journal entries recorded in the general ledger.

## Performance audit

No performance audit studies were identified by Audit Scotland for the Commission during 2005-06.

Management has made good progress in planning and implementing best value. Our assessment of arrangements to secure best value identified that the Commission's arrangements are well developed in seven of the 10 areas under review, two areas being under development and one area not yet planned.

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# Introduction

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## Background

2005-06 was the final 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 annual plan<sup>1</sup>. The scope of the audit was to:

- provide an opinion on, to the extent required by the relevant authorities, the financial statements and the regularity of transactions in accordance with the standards and guidance issued by the Auditing Practices Board;
- review and report on 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 the Commission's arrangements to manage its performance, as they relate to the economy, efficiency and effectiveness in the use of resources.

We focus our work on the areas most likely to give rise to a material misstatement in the financial statements. The significant risk areas identified may impact the Commission's financial statements or the regularity of its transactions and subsequently our audit opinion:

- the Commission may fail to meet its financial targets;
- the implementation of the new Integrated Information Management Project ("IIMP") may not function as intended and the expenditure capitalised by the Commission may not comply with Financial Reporting Standard 15 *Tangible Fixed Assets*.

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<sup>1</sup> Strategic planning memorandum: 2005-06 annual plan (2 December 2005)

## 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. You will appreciate that our audit work is designed to enable us to form an audit opinion on the annual financial statements of the Commission and it should not be relied upon to disclose all irregularities that may exist nor to disclose errors that are not material in relation to the financial statements.

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 Commissioners and their 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.

It is our intention to minimise the disruption to the Commission from a change in auditor through briefing and liaison on unresolved issues with the incoming auditor's staff.

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# Corporate governance

## Financial targets

The Scottish Executive Health Department sets three financial targets on an annual basis. These, together with actual performance for 2005-06, are summarised in Figure 1.

**Figure 1: outturn against financial targets**

Target	Achieved	2005-06 results	2004-05 outturn
Revenue resource limit ("RRL") – expenditure should not exceed the RRL	✓	Target: £3,586,000  Actual: £3,526,074  Outturn: £60,000	£1,263,000
Capital resource limit ("CRL") – capital expenditure should not exceed the CRL	✓	Target: £423,000  Actual: £421,367  Outturn: £1,633	£187,000
To remain within the cash limit	✓	Target: £3,912,000  Actual: £3,909,000  Outturn: £3,000	£1,450,000

Source: Mental Welfare Commission for Scotland (June 2006)

In internal management reporting during 2005-06 the Commission was projecting a small underspend; the actual underspend, prior to the adjustment, was £66,926 is in line with projections.

The main reason for the difference in outturn for 2005-06 compared to 2004-05 shown in Figure 1 is that funding had been awarded in 2004-05 to cover the Commission's proposed relocation to Falkirk which was not then required. This was carried forward into the following year.

The draft financial statements presented for audit on 15 May 2006 disclosed a surplus of £66,926, which was adjusted prior to the final financial statements being approved by the Commission on 26 June 2006. A reconciliation of the movement in the surplus was provided by management is shown in Figure 2.

**Figure 2: reconciliation of financial statement outturn**

	£'000
<b>Financial outturn in the draft financial statements on 15 May 2006</b>	<b>67</b>
Effects of FRS 17 adjustments	(7)
<b>Financial outturn in the final financial statements on 26 June 2006</b>	<b>60</b>

Source: Mental Welfare Commission for Scotland (June 2006)

The primary reason for the change in financial outturn is due to the implementation of FRS 17 *Retirement Benefits*. The Commission was required to implement FRS 17 for the first time in 2005-06, which required the recognition of pension assets/liabilities in the balance sheet. The result was a £350,000 pension liability adjustment to the general fund and a £7,000 increase in operating costs.



## Corporate governance (continued)

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### Systems and controls

During 2005-06 we reviewed the systems and controls over the following financial and non-financial systems:

- human resources and payroll;
- ordering and authorisation of goods and services;
- cash account reconciliation;
- IT access;
- journal entries; and
- budgetary controls.

The majority of controls were found to be operating satisfactorily. However, we identified weaknesses relating to the lack of supporting documentation and authorisation of journal entries. Appendix 1 details our findings from this work.

### Internal audit

In completing our audit, we sought, where appropriate to rely on the work carried out by the Commission's internal auditors<sup>2</sup>. The relevance of internal audit reports and changes to the internal audit plan have been subject to review throughout our audit to maximise the reliance placed on their work.

The Commission's internal auditors conducted an audit of the Commission's control environment and in a report dated 5 May 2006 concluded that "there is a robust system of control in place for preparing and issuing financial and non-financial policies and procedures."

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<sup>2</sup> Strategic planning memorandum: 2005-06 annual plan (2 December 2005)

The Commission's internal auditors also conducted an audit over financial control specifically related to payroll and the integrated information management project and issued a report on 4 May 2006. However, due to the limited nature of the review undertaken, we did not place reliance on their work.

### 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 statement provides details of the processes and controls highlighted by management where processes and strategies will be developed in 2005-06, including:

- ensuring that the planning and implementation of policies and procedures relating to the new Act were co-ordinated through the Mental Health Act Implementation Group comprising the senior management of the Commission;
- consulting with service users and service practitioners on the development of policies and procedures relating to the Commission's new duties and responsibilities under the new Act;
- completing an evaluation of the visit programme that identified weaknesses in the follow up procedures with individuals and services and implemented structures and procedures to improve on this situation;
- completing a training needs analysis for commissioners and practitioner staff to ensure that resources for training and development were targeted and prioritised; and
- starting a comprehensive strategic review of the organisation with the aim of producing a five year strategic plan by June 2006.

## Corporate governance (continued)

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### ***Fraud and irregularity and standards of conduct***

Our work over the five-year period of our appointment was outlined in our strategic planning memorandum. During 2005-06 we completed a review of the high level arrangements in respect of the prevention and detection of fraud and irregularity. 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.

No key weaknesses were identified related to fraud and irregularity and standards of conduct.

### ***Audit committee***

The Commission is supported by an audit committee comprising five part-time commissioners and is chaired by a part-time commissioner. The chair of the audit committee is a chartered accountant and was previously the financial director of a public body.

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# Financial statements

## Audit opinion

On 29 June 2006 we issued an audit report expressing an unqualified opinion on the financial statements of the Commission for the year ended 31 March 2006 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 3 the three key elements of the audit process with which we require the Commission to engage.

### Figure 3: key elements of the audit process

#### Completeness of draft financial statements

We received a draft of presentation financial statements for the Commission on 15 May 2006, in line with the agreed timetable. However, there were a number of disclosures that were not provided until approximately one week after the audit team commenced the financial statements audit fieldwork. Adjustments required in respect of implementation of FRS 17 were identified during the audit process.

#### 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. The documents provided were to a high standard.

#### Response to audit queries

We are pleased to note that the majority of audit queries were dealt with in a timely manner.

## Financial adjustments and confirmations

In Figure 4 we draw attention to adjustments to the financial statements made by management during the course of the audit.

### Figure 4: financial statement adjustments

	Operating cost statement £'000	Balance sheet £'000
Pension liability	-	(350,000)
Administrative expenses	(7,000)	-
<b>Net adjustment</b>	<b>(7,000)</b>	<b>(350,000)</b>

## Confirmations and representations

We have confirmed that as of 16 June 2006 (the date of the audit committee to consider the draft financial statements), in our professional judgement, KPMG LLP was independent within the meaning of regulatory and professional requirements and the objectivity of audit staff was not impaired.

In accordance with auditing standards, we obtained representations from the Commission's director on material issues prior to signing our opinion. Management have not adjusted a number of audit differences which they believe to be immaterial, both individually and in the aggregate to the financial statements taken as a whole. The summary of unadjusted audit differences was attached to the management representation letter.

# Financial statements

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## Significant accounting issues

### *Pension costs*

The Commission was required to implement FRS 17 for the first time in 2005-06 in respect of employees who are members of the Lothian Pension Fund, a local government pension scheme. This required the recognition of pension assets/liabilities in the balance sheet, and a restatement of prior year comparatives.

In preparing draft financial statements, Commission management had obtained an actuarial valuation for the purposes of FRS 17, but had not prepared and processed the required adjustments relating to full implementation of FRS 17. As finance staff were not familiar with the requirements, additional audit work required to be performed to ensure the prior year restatement and current year balances were properly reflected in the financial statements.

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# Performance audit

## Best value

We performed a baseline review of the Commission's arrangements to secure best value and continuous improvement and reported the results to Audit Scotland in May 2006. The Commission's arrangements were assessed as well developed in seven of the 10 areas under review, with two areas under development and one area not yet planned. Figure 5 provides our assessment and summarises the current position and areas for development.

**Figure 5: Best value**

<b>Securing best value (well developed)</b>
<p>There are good existing corporate governance arrangements in place to secure best value represented by formal business planning.</p> <p>The Commission has implemented a number of programmes to achieve continuous improvement including increasing the number of community visits and independent surveys of the Commission's activities.</p>
<b>Commitment and leadership (well developed)</b>
<p>Management have established a number of initiatives to deliver better services including a mid-year review of goals and objectives and measuring performance against the goals and objectives and independent surveys of how the community views the Commission.</p>
<b>Sound governance at strategic and operational levels (under development)</b>
<p>Management have recognised the importance of performance measurement and sound governance at strategic and operational levels will be well developed after completion of a corporate plan that will include key performance indicators and proper workload planning.</p>

<b>Accountability (well developed)</b>
<p>Internally there is a clear scheme of delegation ensuring clarity of the reporting structure underpinned by standing orders. The Commission has delegated authority to a number of sub-committees and members of the senior management team. Management have established a number of channels through which the Commission invites and encourages interaction with members of the public and third party organisations.</p>
<b>Sound management of resources and contractual arrangements (well developed)</b>
<p>There are strong budget monitoring controls to ensure that resources are managed appropriately.</p> <p>Whilst asset management is not critical to the business in the past, due to the recent implementation of the integrated information management system ('IIMS'), the Commission plans on developing an information technology strategy.</p>
<b>Responsiveness and consultation (well developed)</b>
<p>As noted under 'Accountability', management have established extensive channels through which key stakeholders can interact with the Commission. Management also host 'road shows' with service organisations, health boards and local authorities.</p>
<b>Use of review and options appraisal (under development)</b>
<p>Senior management have demonstrated commitment to improving service delivery through independent surveys, evaluation of the community visits programme, and a mid-year review of progress towards achieving goals and objectives.</p> <p>Arrangements for review and options appraisal will be well developed after completion of a corporate plan that will include key performance indicators and proper workload planning.</p>

## Performance audit (continued)

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### **A contribution to sustainable development (not yet planned)**

The Commission does not have a formal environmental policy, however, efforts towards sustainable development is evident through use of recycled paper and the implementation of IIMS to reduce maintaining patient information on paper files.

The Commission does not have plans for development of a formal environmental policy.

### **Equal opportunities developments (well developed)**

The Commission's commitment to equal opportunities is demonstrated through establishing an equality and diversity group to review compliance with equality, both internally and externally. There is also an equal opportunities policy in place, underpinning this commitment to equal opportunities.

### **Joint working (well developed)**

The Commission interacts with a number of third party organisations, primarily local authorities and local health boards through 'road shows' and regular meetings. The Commission also provide a telephone advice service regarding the rights of service users and the responsibilities of service providers under mental health legislation.

*Source: Mental Welfare Commission for Scotland (May 2006)*

We plan to issue a report to the Commission by August 2006 based on comparative information from NHS boards and other Scottish public sector organisations to be published by Audit Scotland.

### **Efficient government**

Audit Scotland did not require an efficient government return to be submitted in relation to the Commission.



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## Appendix I – Action plan

This appendix summarises the performance improvement observations we have identified during the financial statements audit. Each of our observations has been allocated a risk rating, which is explained in Figure 6.

**Figure 6: Risk rating for performance improvement observations**

<b>1</b>	<b>Grade one (significant) observations are those relating to business issues, high level or other important internal controls.</b> These are significant matters relating to factors critical to the success of the Board or systems under consideration. The weakness may therefore give rise to loss or error.	<b>2</b>	<b>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.</b> The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.	<b>3</b>	<b>Grade three (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors.</b> 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.
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Issue, risk and priority	Recommendation and benefit	Management response	Responsible officer and implementation timetable	
<b>1</b>	<p>The Commission does not maintain a designated file for non-standard journal entries to the ledger and a standard journal header sheet is not in use.</p> <p>Authorisation of journal entries is not always evidenced through an authorising signature. Additionally, supporting documentation for journal entries is not consistently maintained. After discussion with management, the reason for the 2 adjusting journal entries with missing support was adequately explained.</p> <p>There is a risk that unauthorised or inappropriate entries are posted to the ledger, resulting in inaccurate financial reporting.</p>	<p>It is recommended that the Commission formalise the procedures surrounding journal entries.</p> <p>A journal header sheet should be created which would allow the following information to be recorded: journal number; accounts and amounts to be debited; accounts and amounts to be credited; a narrative explanation to record the purpose of the journal; a signed as posted heading; and a signed as authorised heading by an individual other than the preparer. Any supporting documentation for the journal should be attached to the journal header sheet. All journals should be filed in a designated journal file.</p>	<p>Agreed a template should be established for the posting of journals and that all journals with supporting documentation should be filed in a separate file. This will be implemented with immediate effect.</p> <p>Whilst it is agreed that a small number of journals were not physically authorised, It should be noted that all journals posted are supported by appropriate documentation and are posted on the authority of the Finance Manager.</p>	Finance Manger with immediate effect

## Appendix I – action plan (continued)

		This will ensure that entries into the general ledger are appropriate and financial reporting is accurate		
<b>2</b>	<p>The Commission does not obtain an aged creditors listing from the SEAS system on a regular basis.</p> <p>There is a risk that the Commission is not able to accurately monitor its creditors' position throughout the year.</p>	<p>The Commission should seek to obtain this report and review it on a periodic basis.</p> <p>The Commission would benefit by ensuring more efficient monitoring of creditors and timely identification of errors or omissions.</p>	<p>The Commission continues to request this report. Currently 2 Scottish Executive staff have this request lodged with them. We will continue to request until the matter is resolved as it is recognised that this is a helpful tool in the management of the Finances of the Commission.</p> <p>We have not had any issues with unpaid creditors during this year, as suppliers contact if there is an issue regarding non payment of invoices.</p> <p>The Commission continues to enjoy a good payment record on supplier invoices (98%).</p>	<p>Finance Manager Ongoing</p>