



INFRASTRUCTURE, GOVERNMENT &
HEALTHCARE

Scottish Prison Service

Annual audit report to the
Scottish Prison Service and the
Auditor General for Scotland
2006-07

21 June 2007

AUDIT

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If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact Grant Macrae, who is the engagement leader for our services to the Service, telephone 0131 527 6611, email grant.macrae@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Lorraine Bennett, our Head of Audit in Scotland, either by writing to her at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 222 2000 or email to lorraine.bennett@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Russell Frith, Director of Audit Strategy, Audit Scotland, 110 George Street, Edinburgh, EH2 4LH.

Executive summary

This report summarises our work for the 2006-07 year and our findings in relation to our audit of the financial statements, corporate governance arrangements, and performance management arrangements.

Financial statements

On 21 June 2007 we issued an audit report giving our unqualified opinion on the financial statements of the Service for the year ended 31 March 2007 and on the regularity of transactions reflected in those financial statements.

Total provisions as at 31 March 2007 are £81 million (2006: £64 million), of which £73 million (2006: £58 million) relates to prisoner claims. There is a comprehensive process to consider the completeness, existence and accuracy of provisions based on changes in circumstances during the year.

Corporate governance

Internal audit have provided an assurance statement to the accountable officer and concluded that “our review of the corporate governance and control environment, management of risk and reliance placed on the work of other review bodies enables us, in forming our opinion, to offer a reasonable level of assurance”. The annual internal assurance programme supports the assessment of the operation of the system of internal control. Responsible officers provide a statement of assurance to the chief executive to assist in his preparation of the statement.

Our testing of the design and operation of controls over entity level controls and significant risk points in key financial processes confirms that, subject to the minor weaknesses reported, controls are designed appropriately and operating effectively.

The 2006-07 reportable spend, including capital and revenue, shows a net underspend against funding of £14 million. The actual average cost per prisoner place for 2006-07 was £30,989, within the £35,000 target and an increase of 2% compared to 2005-06.

Performance management

There are strong performance management arrangements in place and performance against performance indicators is monitored on a monthly basis. The Service has also established a series of internal performance contracts with establishments, providing a suitable framework of accountability for financial and operational performance.

Introduction

Audit framework

This was the first year of our five-year appointment as external auditors of Scottish Prison Service (“the Service”). This report to the Service and the Auditor General for Scotland outlines our opinion and conclusions and highlights significant issues arising from our work.

In accordance with Audit Scotland’s *Code of Audit Practice* (“the Code”), the scope of the audit was to:

- provide an opinion on the Service’s financial statements and, as required by relevant authorities, the regularity of transactions;
- review and report on (as required by relevant legislation, the Code and any guidance issued by Audit Scotland):
 - the Service’s corporate governance arrangements as they relate to: its review of systems of internal control; the prevention and detection of fraud and irregularity; standards of conduct, and prevention and detection of corruption; and its financial position
 - the Service’s arrangements to achieve Best Value
 - other aspects of the Service’s arrangements to manage its performance, as they relate to economy, efficiency and effectiveness in the use of resources.

The framework under which we operate under appointment by Audit Scotland was outlined in the audit plan for the year discussed with the Service’s risk monitoring and audit committee.

Responsibilities of the Service and its auditors

External auditors do not act as a substitute for the Service’s own responsibilities for putting in place proper arrangements to account for its stewardship of resources made available to it and its financial performance in the use of those resources, to ensure the proper conduct of its affairs, including compliance with relevant guidance, the legality of activities and transactions, and for monitoring the effectiveness of those arrangements and, through accountable officers, to make arrangements to secure Best Value.

Acknowledgement

We wish to place on record our appreciation of the co-operation and assistance extended to us by Service staff during the first year of our work in the discharge of our responsibilities.

Financial statements audit

Audit opinion

On 21 June 2007 we issued an audit report expressing an unqualified opinion on the financial statements of the Service for the year ended 31 March 2007 and on the regularity of transactions reflected in those financial statements. We bring the following issues to the Service's attention.

Public Private Partnerships

Her Majesty's Prison Kilmarnock ("HMP Kilmarnock")

HMP Kilmarnock was opened in 1999 and is accounted for off-balance sheet. The discounted estimated capital value is £20 million and the operating service charge for the year was £10.3 million. The Service has elected to account for the PPP contract on a gross basis. To reflect the fact that the building will transfer to the Service, the financial statements include an asset of £20 million and a related long term liability of £9.2 million, the net of which is the value of the asset recognised in the first nine years of the 25 year PPP contract.

Addiewell

A PPP contract was signed in 2006-07 to build and run a new prison facility in Addiewell. The previous external auditors provided an initial opinion and concluded that the project, under the contract terms at the time, should be accounted for off-balance sheet. We have agreed with management to review the impact on the accounting treatment if there are any changes to the contract. The prison is expected to be operational during 2008-09. There is no financial statement impact in 2006-07.

Bishopbriggs

Management has recently finalised the initial project scope and received bids to build and run a third PPP contract for a new prison at Bishopbriggs. There are no financial statement implications for the year ended 31 March 2007 for this project, but we have made preliminary arrangements to liaise with management over the course of the project to assist in the accounting treatment. We will provide an initial opinion on the accounting treatment and update our opinion during the course of the project.

FRS 12 'provisions, contingent liabilities and contingent assets'

In accordance with FRS 12, management has provided for a number of future liabilities. Total provisions as at 31 March 2007 are £81 million (2006: £64 million), of which £73 million (2006: £58 million) relates to prisoner claims. The methodology used to estimate future liabilities in respect of prisoner claims was changed during 2006-07, resulting in an increase of £15 million. The related contingent liability, reflecting liabilities where management has assessed the certainty of payment at less than 50%, has been increased by £2 million to £29 million at 31 March 2007 (2006: £27 million).

Management has engaged third party experts, including lawyers, where appropriate, to assist in the estimation of all provisions. In addition, there is a comprehensive internal process to consider the completeness, existence and accuracy of provisions based on changes circumstances during the year.



In particular, management is following developments in all human rights cases to establish any impact on existing or future prisoner claims. We are satisfied that management has established reasonable processes in relation to this important area.

Tangible fixed assets

All specialised properties within prison establishments were revalued by an external valuer, resulting in a net increase in value of £80 million, at 31 March 2007. Management maintains detailed records of asset values at establishment level and performs detailed checking of the valuation results to ensure that the reasons behind all significant movements are understood and are consistent with expectations.

Corporate governance

Introduction

Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviour. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all bodies.

Through its chief executive, as accountable officer, the Service is responsible for establishing arrangements for ensuring the proper conduct of its affairs, including compliance with relevant guidance, the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. The *Code* requires auditors to review and report on the Service's corporate governance arrangements as they relate to:

- the Service's reviews of its systems of internal control, including its reporting arrangements;
- the prevention and detection of fraud and irregularity;
- standards of conduct and arrangements for the prevention and detection of corruption; and
- its financial position.

Systems of internal control

Statement on internal control ("SIC")

The SIC provides details of the internal control environment and risk management and control frameworks. No significant weaknesses have been included in the statement of internal control. Internal audit have provided an assurance statement to the accountable officer and concluded that *"our review of the corporate governance and control environment, management of risk and reliance placed on the work of other review bodies enables us, in forming our opinion, to offer a reasonable level of assurance"*. All financial and governance reviews undertaken by internal audit resulted in 'reasonable' or 'substantial' levels of assurances.

Management obtained evidence through its annual internal assurance programme to support the assessment of the operation of the system of internal control. Each responsible officer is required to submit signed statements of assurance to their line managers, ultimately resulting in each director providing a statement of assurance to the chief executive to assist in his preparation of the SIC. This process is formally reported to the risk monitoring and audit committee. No significant control weaknesses were reported through this process.

Governance arrangements and risk management

The Service has a strong risk management process. Strategic and operational risk registers have been established and are monitored on an ongoing basis throughout the organisation. Risks are prioritised according to impact and likelihood and allocated to specific directorates for monitoring and control. The board and risk monitoring and audit committee receive updates on risk management on a regular basis during the year. Risk management workshops are held twice a year and attended by board members and senior management. The Service is in the process of developing disaster recovery and business

continuity plans to mitigate the risk to operations in the event of a disaster impacting the information technology systems or general infrastructure.

Internal audit

Internal audit have completed work in accordance with the annual audit plan and concluded in their annual assurance report that *"we can offer an overall 'reasonable' level of assurance based on the work carried out in 2006-07."*, but 'limited' assurance was provided in relation to:

- prisoner complaints;
- cell sharing risk assessment; and
- clinical governance and health care standards.

Management share internal audit's opinion that matters arising from these reviews do not have a significant impact on the overall assessment of the internal control environment.

We relied on the findings of internal audit on a number of financial systems, but the rationale for sample sizes is not consistently documented in internal audit files. Internal audit should ensure that this is evidenced in future reviews to support the judgement of internal audit and allow us to continue to place reliance on their work.

Internal controls

Our testing of the design and operation of controls over significant risk points confirms that, subject to some minor weaknesses reported, controls are designed appropriately and operating effectively. We have reported some areas where the control environment could be enhanced and management has accepted these recommendations.

Prevention and detection of fraud and irregularity

There is a formal whistleblowing policy governing the procedures to be followed in the event of a fraud or suspected fraud. Where management are made aware of a suspected fraud, the internal fraud response group is convened to co-ordinate an investigation. Attendance at the fraud response group depends on the nature of the fraud but will usually include senior management from the finance department, human resources and internal audit. Significant frauds are reported to the risk monitoring and audit committee and an annual report on losses and investigations is presented to the committee in May each year.

Standards of conduct

All Service staff operate under the Civil Service Code and there is also an internal code of conduct which sets out minimal ethical and behavioural expectations. There is comprehensive collection of human resources policies and procedures providing additional guidance to staff, but these policies should be readily accessible to ensure staff have access to up to date information.

Management are currently reviewing arrangements for recording board members and senior managers' interests in the absence of a formal register of interests, which is regarded as best practice and assists in demonstrating consideration of independence in decision making and awarding contracts.

Financial position

The 2006-07 reportable spend, including capital and revenue, shows a net underspend against funding of £14 million. The main reasons for this are unutilised contingency in the capital programme (£2.3 million), the impact of revaluation on capital charges (£7.2 million), and non-staff costs (£4.9 million). Included in the reported spend is the net cost of £14.2 million resulting from the non-recurring increase in provisions (£16 million) and revaluation adjustment (£1.8 million).

The balance sheet at 31 March 2007 reports net current liabilities of £32.6 million (2006: £23.2 million) and long-term liabilities of £91.3 million (2006: £72.3 million) primarily due to the carrying value of provisions for liabilities and charges. Management have an understanding with the Scottish Executive that cash will be available in future years to fund cash payments.

The allocated budget for 2007-08 is £427 million, of which £97 million relates to capital expenditure and £330 million for revenue expenditure, for which detailed budgets have been prepared.

The cost per prisoner place is a key financial target. The actual average cost per prisoner place for 2006-07 was £30,989, within the £35,000 target and an increase of 2% compared to 2005-06.

Performance management

Overall arrangements

There are strong performance management arrangements in place. A number of key performance indicators, which are set annually by the Scottish Ministers, are included in the three year business plan. The management commentary reports that the Service has exceeded all indicators set by the Scottish Ministers, with the exception of the percentage of prisoners clear of in-prison drug use. Performance against key performance indicators is monitored on a monthly basis.

The Service has also established a series of formal contracts with public and private establishments. This provides a suitable framework of accountability for financial and operational performance.

Best Value

The Service was subject to an overview assessment of the arrangements to secure Best Value in 2005-06. Audit Scotland issued a report to the Service in September 2006, detailing the findings of their work. Seven out of the 10 areas included in the review were found to be 'well developed' to secure Best Value, with the remaining three areas regarded as 'under development' (responsiveness and consultation, sustainable development, and joint working). An overview paper was prepared in October 2006, summarising the findings and requesting directors to take action to improve Best Value in these three areas. Feedback from directors obtained in January 2007 indicates that progress has been made since this initial overview assessment. Action taken is the responsibility of and monitored by the executive management team.

Efficient government

Targets set by the Scottish Executive for 2005-06 and 2006-07 have been met or exceeded. In 2006-07 management reported cash releasing efficiency savings of £7.8 million (target £7 million), including staff cost savings, and time releasing efficiency savings of £0.9 million (target £0.9 million). The cumulative target for cash (£10 million) and time (£0.9 million) efficiency savings in 2007-08 is £10.9 million. Progress towards targets is reported to the executive management team during the year.

The internal audit department reviewed efficient government arrangements and concluded that overall the systems for identifying and tracking savings are appropriate and effective and offered 'substantial assurance' that progress towards the achievement of the required efficiencies is accurately calculated and reported.

Appendix – action plan

Priority rating for performance improvement observations raised		
<p>Grade one: Issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.</p>	<p>Grade two: Issues that have an important effect on internal controls, but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately, but the weakness remains in the system.</p>	<p>Grade three: Issues that would, if corrected, improve the internal control in general, but are not vital to the overall system. These are generally issues of best practice that we feel would be of benefit to you if introduced.</p>

No.	Issue and performance improvement observation	Management response	Officer and due date
1	<p>There is no formal register of interests in place at the Service, but certain compensating controls should ensure that senior management act appropriately. There is a risk that interests are not declared in a timely manner and taken into account during decision making.</p> <p>We understand that management are currently reviewing these arrangements. Formal registers of interests for all senior management and Board members is regarded as best practice and assists in demonstrating consideration of independence in decision making and awarding contracts.</p> <p><i>Grade two</i></p>	<p>Noted. This will be considered by the board.</p>	<p>Director of corporate services</p> <p>30 September 2007</p>
2	<p>We relied on the findings of internal audit on a number of financial systems. The rationale for sample sizes is not consistently documented in internal audit files.</p> <p>The rationale for sample sizes should be documented in internal audit files for all tests of operating effectiveness of controls.</p> <p><i>Grade two</i></p>	<p>Agreed.</p>	<p>Head of internal audit</p> <p>30 June 2007</p>

3	<p>The Service is in the process of developing disaster recovery and business continuity plans. We understand that a review of these arrangements is underway and recommend that this is completed to ensure continued operation in the event of a disaster impacting the information technology systems or general infrastructure.</p> <p><i>Grade two</i></p>	Noted. This will be considered by the board.	<p>Chief executive</p> <p>30 September 2007</p>
4	<p>Human resources policies and procedures are not readily accessible. There is a risk that staff are not appropriately aware of up to date policies and procedures, reducing the effectiveness of the guidance.</p> <p>Management should ensure all staff have ready access to the latest version of all policies and procedures.</p> <p><i>Grade three</i></p>	Agreed.	<p>Director of human resources</p> <p>31 October 2007</p>

