

Mental Welfare Commission
Annual Report to Commissioners and the Auditor General for
Scotland 2009/10



Contents

Section	Page
1. Executive Commentary	1
2. Introduction	3
3. Financial Statement and Audit Opinion	4
4. 2009/10 Performance	7
5. Governance and Control	9
6. Managing in a Period of Financial Uncertainty	11
Appendix A – Action Plan	14
Appendix B – Communications to Management	15

The principal objective of our audit procedures is to enable us to express our opinion, in line with the requirements of the Audit Scotland Code of Audit Practice, on the financial statements as a whole. Our audit opinion does not guarantee that the financial statements are free from misstatement. Our audit responsibilities, and their limitations are explained in our letter of appointment.

Any oral comments made in discussions with you relating to this report are not intended to have any greater significance than explanations of matters contained in the report. Any oral comments that we make do not constitute oral advice unless we confirm any such advice formally in writing.

The matters raised in this and other reports that will flow from the audit are only those which have come to our attention arising from or relevant to our audit that we believe need to be brought to your attention. They are not a comprehensive record of all the matters arising, and in particular we cannot be held responsible for reporting all risks at the SAS or all internal control weaknesses. This report has been prepared solely for your use and should not be quoted in whole or in part without our prior written consent. No responsibility to any third party is accepted as the report has not been prepared for, and is not intended for, any other purpose.

1. Executive Commentary

Introduction – Section 2

Our overall responsibility as external auditors of the Mental Welfare Commission (MWC) is to undertake our audit in accordance with the principles contained in the Audit Scotland Code of Audit Practice (“the Code”), revised and published in March 2007.

We have a dual reporting responsibility for the audit: to the Commissioners of MWC and to the Auditor General for Scotland.

Financial Statement and Audit Opinions – Section 3

The financial statements of MWC for the year ended 31 March 2010 have been prepared to comply with accounting requirements contained in the NHS Board Accounts Manual for Directors’ Report and Accounts of NHS Boards and for Scottish Financial Returns, and supplementary guidance, as issued by the Scottish Government Health Directorates (SGHD) and approved by the Scottish Ministers.

We are pleased to report that our **true and fair opinion** and **regularity opinion** on the financial statements for the year ended 31 March 2010 are **unqualified**.

We also provide a view as to whether those parts of the Remuneration Report subject to audit have been properly prepared. Our opinion on the relevant parts of the **Remuneration Report is unqualified**. It should be noted that our audit opinion does not extend to other parts of the Annual Report.

Basis of Preparation – International Financial Reporting Standards

Government bodies, including NHS Boards, have been required to adopt International Financial Reporting Standards (IFRS) from 2009/10 onwards. This included a restatement of 2008/09 comparatives. The objective is to bring the public sector into line with the private sector, and to introduce greater comparability and consistency across public sector accounting.

Accounting Issues

A number of accounting issues were discussed with management during the audit. The most significant of these are set out below:

- Assessment of going concern – net liability position; and
- Cost of capital

Financial Performance 2009/10 – Section 4

MWC is required to meet three targets each year as set by the Scottish Government Health Directorate (SGHD). All three of these were achieved in the year.

Governance and Performance 2009/10 – Section 5

We have reviewed MWC's overall governance arrangements including a review of Full Commission and key Committee structures and minutes, financial reporting to the Commission and risk management. We consider that appropriate arrangements and reporting were in place. We have reviewed MWC's overall systems of internal control including a review of IT general controls (ITGCs); and internal audit arrangements. Appropriate arrangements and reporting were noted.

Managing in Uncertain Times – Section 6

The UK economy went into recession in mid-2008 for the first time since 1991. Although the economy now appears to be showing signs of recovering from the recession, significant financial pressures remain and the future economic position is uncertain and difficult to predict. As a result of the current economic position, Audit Scotland has issued a number of reports on the matter. Key reporting themes from two of these reports: 'Scotland's Public Sector Finances' and 'Improving Public Sector Efficiencies' are included in the body of the report. Based on our experiences from elsewhere we agree with the matters raised by Audit Scotland and others.

To meet the significant challenges ahead we recommend that MWC looks at six key areas which our experience with other clients and in other sectors has shown may be relevant to addressing the challenges ahead: Honesty and awareness of the size of the challenge; Strong leadership; Need to engage with the whole organisation and external stakeholders; Realistic and detailed plans to resolve the situation; Rigorous implementation (programme management arrangements); and Financial control and discipline.

2. Introduction

Purpose of this report

The Annual Audit Report which follows is designed to set out the scope, nature and extent of our audit, and to summarise our opinion and conclusions on issues arising. Specifically, this will direct your attention to matters of significance that have arisen out of the 2009/10 audit process and to confirm what action is planned by management to address the more important matters identified for improvement.

Scope, nature and extent of our audit

Our overall responsibility as external auditors of the Mental Welfare Commission (MWC) is to undertake our audit in accordance with the principles contained in the Code of Audit Practice issued by Audit Scotland in March 2007. In this regard, the Code sets out the need for public sector audits to be planned and undertaken from a wider perspective than in the private sector involving not only assurance on the financial statements but also consideration of areas such as regularity, propriety, performance and the use of resources. It also sets out the need to recognise that the overall audit process is a co-ordinated approach involving the “appointed auditor”, the Auditor General for Scotland and other auditors such as Audit Scotland’s Health Performance and Public Reporting Group. Our audit has been planned and conducted to take account of these wider perspectives. Under the requirements of International Standard on Auditing (UK and Ireland) (‘ISA’) 260: “*Communication of audit matters to those charged with governance*”, we are required to communicate audit matters arising from the audit of financial statements to those charged with governance of an entity. This Annual Audit Report to Members, together with previous reports to the Audit Committee throughout the year, discharges the requirements of ISA 260.

Acknowledgment

We would like to formally extend our thanks to all MWC managers and staff for the assistance they have given us during the audit process.

PricewaterhouseCoopers LLP
Glasgow, 18 June 2010

3. Financial Statement and Audit Opinion

Audit opinion

Our audit opinion concerns both the true and fair statement of the MWC's financial results for the year ended 31 March 2010 and the regularity of its income and expenditure for the year.

We are pleased to report that our opinion on the true and fair view on the financial statements and on the regularity of income and expenditure is **unqualified**.

We also provide a view as to whether those parts of the Remuneration Report subject to audit have been properly prepared. Our opinion on the Remuneration Report is **unqualified**. Our audit opinion does not extend to any other part of the Directors' Report.

Audit Process

The financial statements and supporting schedules were presented to us for audit within the agreed timetable. The quality of working papers provided by management was of a high standard. Overall, an efficient audit process was achieved through an effective working relationship with your staff.

Basis of Preparation

The financial statements were prepared in accordance with the accounting requirements contained in the NHS Board Accounts Manual for Directors' Report and Accounts of NHS Boards and for Scottish Financial Returns, and supplementary guidance, as issued by the Scottish Government Health Directorates (SGHD) and approved by the Scottish Ministers.

Government bodies, including NHS Boards, have been required to adopt International Financial Reporting Standards (IFRS) from 2009/10 onwards. This included a restatement of 2008/09 comparatives. The objective is to bring the public sector into line with the private sector, and to introduce greater comparability and consistency across public sector accounting.

In order to prepare financial statements which are IFRS compliant, MWC has been required to change the format of its financial statements and include a considerable number of additional disclosures. Significant work has been undertaken (in consultation with the PricewaterhouseCoopers' technical support team) to achieve this objective.

Over the last 18 months this has required a significant time commitment by the Finance Manager and her team and it is to their credit that this first full audit under IFRS has been completed smoothly.

Approval

The Financial Statements were submitted to MWC's Audit Committee on 18 June 2010 and are to be approved and adopted at the Full Commission meeting on 28 June 2010.

Unadjusted misstatements

Under ISA 260 - "Communication of audit matters to those charged with governance", we are required to report to you all unadjusted misstatements which we have identified during the course of our audit, other than those which we deem to be of a trivial nature.

As a result of our work, we proposed a number of audit adjustments the majority of which have been processed by management in the finalised version of the 2009/10 financial statements. During our testing we also identified that MWC had overstated their holiday accrual by £2,000. This has not been amended by management on the grounds of materiality.

Accounting Issues

Going Concern

MWC's balance sheet discloses net liabilities of £641,437 at 31 March 2010 (2009: Restated IFRS net liabilities £134,952), meaning that it is technically insolvent. The primary reason for this position in 2009/10 is that the pension deficit has increased from £438,000 at the end of 2008/09 to £757,000 in 2009/10. MWC has a net current asset position (before the pension deficit) of £151,563.

Under the current accounting arrangements as set out in the Financial Reporting Manual (FReM), MWC must show liabilities on its balance sheet without drawing down the equivalent cash to fund them. However, as the liabilities fall due, the cash will be requested from the SGHD to meet the payments.

We are satisfied that the accounts have been correctly prepared on a going concern basis.

Cost of Capital

As a result of the significant net liabilities on the MWC's balance sheet as at 31 March 2010 it returned a negative cost of capital of £13,500 for the year. This was originally disclosed in the accounts by MWC as zero as it appeared counter intuitive to recognise a negative cost of capital within the accounts. However, section 11.5.14 in the FReM discusses negative cost of capital stating that:

"...Departments should debit (credit if negative) the operating cost statement and credit (debit if negative) the general fund with the aggregate of the non-cash charges..."

As a result, we are satisfied that MWC has recognised the negative cost of capital within their accounts effectively reducing its expenditure in year by £13,500.

Pension Reserve

At 31 March 2009, under UK GAAP, MWC disclosed a specific pension reserve on its balance sheet of £417,000. This pension reserve represented MWC's cumulative actuarial losses to date charged through the Statement of Recognised Gains and Losses (STRGL).

This additional pension reserve disclosure is not permitted under IFRS. Instead all retirement benefit costs find their way into the general fund via the Operating Cost Statement and the Statement of Changes in Taxpayers' Equity (SOCTE).

4. 2009/10 Performance

Financial Results 2009/10

2009/10 Outturn	£'000	£'000
Recurring income	4,000	
Recurring expenditure (before savings)	(4,000)	
Recurring savings	0	
Underlying recurring surplus / (deficit)		0
Non-recurring income	72	
Non-recurring expenditure (before savings)	(65)	
Non-recurring savings		
Non-recurring surplus/(deficit)		7
Financial surplus for the year		7
Underlying recurring surplus / deficit as a percentage of recurring income		0

Figures confirmed by Alison McCrae, Head of Corporate Services, 7 June 2010

At the start of the year the Scottish Government confirmed an allocation of £4 million for MWC for 2009/10 with an additional £72,000 of non-recurring income also provided. Subsequently, MWC requested a revenue to capital transfer of £22,000 from the Scottish Government to fund video conferencing and Intranet costs.

As part of its ongoing budget monitoring, and forecasting, MWC returned £36,000 of its non-recurring funding during the year.

At the year end, in relation to the Lothian Pension Fund, MWC incurred unforeseen pension costs of £35,000 arising from a change in the mortality assumptions used by the actuary.

MWC received an additional £35,000 funding to cover the additional pension costs less the negative cost of capital credit (discussed in Section 3) of £13,500.

At the end of the year MWC reported a small surplus of £7,000

Performance against Key Financial Targets

MWC is required to meet three targets each year as set by the Scottish Government Health Directorate (SGHD). MWC has achieved all three of its financial targets in the year, as follows:

	Limit set by SGHD £'000	Actual Outturn £'000	Variance (over)/under £'000
Revenue Resource Limit	4,035	4,028	7
Capital Resource Limit	22	22	Nil
Cash Requirement	3,649	3,642	7

Creditors – Creditors Payment Days

The Financial Statements at 31 March 2010 report a decrease in creditor payment days to 14 days, from 15 days in 2008/09. Government guidance issued in 2008/09 as a result of the economic downturn, states that suppliers should be paid within 10 days. While the payment days are falling they are still above the Government's target level.

5. Governance and Control

Overall Governance Arrangements

Governance at MWC is currently managed through the meetings of the Full Commission and six Standing Committees. Part time Commissioners are all members of the Full Commission but also carry out operational roles. MWC believes that this structure does not offer an appropriate framework for governance with the combination of Board and visiting functions being held by each commissioner.

MWC had recommended to the Scottish Executive a revised governance structure in 2006. This will now be facilitated through the Public Services Reform Act 2010. Full Commission made final recommendations to the Scottish Government in October 2009 and these have, in the main, been drafted into the Act. The intention is to have a Board with 6-8 members and to have a group of operational Visiting Commissioners. Recruitment for the new Chair will begin in June 2010 and a new Board in the autumn. The new Board will be operational from 1 April 2011.

The Board will be responsible for setting the strategic direction of MWC and monitor the work that is done. The structure and remit of the other MWC governance groups will be reviewed during 2010.

Service redesign and sustainability

Following consultation on the future of the Mental Welfare Commission and its governance structure, the Scottish Government, in a letter dated 20 October 2009, has proposed that MWC will be retained as an independent body with functions which are primarily about the protection of the rights of individuals who are subject to mental health legislation.

It is proposed that the current duties of MWC in respect of scrutiny and improvement will be more narrowly drawn to focus on legal and ethical practice only. General Service improvement will continue to be the responsibility of NHS QiS, SWIA and the Care Commission and the new successor bodies Health Improvement Scotland (HIS) and Social Care and Social Work Improvement Scotland (SCSWIS). It is proposed that MWC will be under a duty to communicate areas of concern with HIS and SCSWIS who, in turn, will have a duty to report to MWC on legal and ethical practices in the delivery of mental health services. MWC's budget allocation will be reduced for 2010-11 by 7.5% to £3,700,000. This is discussed in [Section 6](#).

The Public Services Reform Act 2010 received Royal assent in May 2010.

Systems of Internal Control

The results of our work on systems of internal control were communicated to the Audit Committee in our Interim Management Letter on 26 February 2010. The report contained 5 recommendations to improve controls, none of which was graded as higher risk. There were also no risks identified that could be considered business critical in nature. MWC has completed an action plan detailing those individuals responsible for implementing our recommendations and the timetable for completion. We will follow up this action plan during our 2010/11 audit process.

Statement on Internal Control

The Code of Audit Practice requires us to review and report on MWC's Statement on Internal Control. MWC has used the correct format for its Statement and has outlined the processes it has employed to identify and evaluate risks. In addition, key elements of the MWC's control framework have been highlighted. Based on our normal audit procedures, we do not disagree with the disclosures contained in the Statement.

Follow up of outstanding recommendations

We followed up the MWC's progress in implementing recommendations made in the prior year. Our Follow Up Report was considered at the Audit Committee meeting on 26 February 2010. At the time of reporting, of the 7 agreed actions, progress was as follows:

Status	Follow Up of Prior period Reports
Action Implemented	2
Action in Progress	3
Limited/Little Progress to Date	-
Not Yet Due	-
No Longer Applicable	2
Total	7

6. Managing in a Period of Financial Uncertainty

The UK economy went into recession in mid-2008 for the first time since 1991. By summer 2009, UK economic output had fallen for five consecutive quarters. Significant financial pressures remain and the future economic position is uncertain and difficult to predict.

In response to the recession the UK Government almost doubled its level of borrowing to £175 billion in 2009/10 to allow it to increase public spending to support the economy. This level of borrowing means that the UK Government will need to pay higher debt interest payments, which in turn reduces the amount left for spending on the public sector. The recent Westminster General Election has resulted in a change of Government and this has led to a change in the plans for repaying the national debt with the new coalition government planning to halve the debt by 2013/14. In order to achieve this ambitious target, significant reductions in public sector spending will be required. A recent paper by the Scottish Government Chief Economist predicts that public sector spending in Scotland may fall in real terms by 3% every year to 2014/15 and will take a total of 12 to 15 years to get back to 2009/10 levels.

Further details of this challenge may become clearer after the 22 June 2010 UK emergency budget, although the impact this will have on the NHS in Scotland may take some time to become apparent.

In April 2009, the UK Government also announced that Public Sector **capital budgets would fall**.

Taken together, these factors will have **serious consequences** for the Scottish budget. As a result of the current financial position, Audit Scotland has issued a number of reports on the matter. Key reporting themes from two of these reports are highlighted below.

Audit Scotland - Scotland's Public Finances: Preparing for the Future

In November 2009 Audit Scotland published their report: 'Scotland's Public Finances: Preparing for the Future'. This report highlighted the fact that the Scottish Government budget is likely to have peaked in 2009/10 for the foreseeable future. This means that individual public bodies will have **smaller budgets** in future years. It highlighted that in addition, **other public sector income is likely to be less than previously forecast**.

The report concluded that we are at a real **historical breakpoint** in public finances.

Audit Scotland - Improving Public Sector Efficiencies

Following on from the Scotland's Public Finances report, Audit Scotland published a further report in February 2010: 'Improving public sector efficiency'. It provided a position statement on the first year (2008/09) of the Efficient Government Programme (the Programme), which aims to deliver £1.6 billion efficiency savings over the three years to 2010/11. It also gave an update on how the Scottish Government and public bodies have addressed the recommendations made in a 2006 Audit Scotland report about the previous efficiency programme.

The report noted that Scottish public bodies had reported more efficiency savings than the Government's two per cent target. However, there were serious financial challenges ahead – the biggest since devolution – and making the required savings simply through efficiency will become increasingly difficult.

The report recommends that to deal with reduced future funding, public bodies need to consider fresh approaches to improving efficiency and productivity. They must take a more fundamental approach to identifying priorities, improving the productivity of public services, and to improving collaboration and joint working.

To support these high-level recommendations, Audit Scotland, the Northern Ireland Audit Office and the Wales Audit Office have drawn on their combined experience to develop a detailed good practice checklist. The checklist is intended to promote detailed review and reflection and, if necessary, a basis for improvement. ***We recommend that those responsible for leading efficiency and improvement work at MWC should formally assess themselves against each question raised in the combined Audit Scotland, the Northern Ireland Audit Office and the Wales Audit Office detailed good practice checklist.***

Action 1

Response by MWC

The 2010/11 budget was set against the backdrop of significant economic uncertainty. 2010/11 was within the current three year spending review period and the severity of the economic conditions has already impacted on the future resources of MWC. Despite previous predictions that the MWC would receive a baseline budget cut of 4%, it was confirmed just before year end that MWC would be expected to budget for a cut of 7.5%.

This is outlined on the following page.

Forecast Budget 2010/11

2010/11 Budget	£'000	£'000
Recurring income	3,700	
Recurring expenditure (before savings)	(3,700)	
Recurring savings	0	
Underlying recurring surplus / (deficit)		0
Non-recurring income	72	
Non-recurring expenditure (before savings)	(72)	
Non-recurring savings	0	
Non-recurring surplus/(deficit)		0
Financial surplus/(deficit) for the year		0
Underlying recurring surplus / deficit as a percentage of recurring income		0

Figures confirmed by Alison McRae, Head of Corporate Services, 7 June 2010

In order to respond to this reduction in funding MWC has identified where budget reductions can be made.

Salary Costs

The budget for the Chair and part time commissioners has been reduced by 7.5% in line with the baseline reduction. The staff budget has been increased by 1.5% in line with the agreed pay remit. To manage this increase in salary costs, the establishment for administrative posts has reduced by 1.6 whole time equivalents.

Communications Budget

The communications budget has been reduced from £180,000 to £106,300. As this budget supports all key themes within the communications strategy it will be the responsibility of MWC to prioritise areas of communications expenditure.

Good Practice and Performance Management Budgets

There will be no budget for these in 2010/11. This will provide £145,000 in savings but will compromise MWC's ability to hold good practice consultation events. MWC may be unable to carry out either the practitioner or staff survey both originally scheduled for January 2011.

Recruitment Budget

The recruitment budget has been increased by £6,000 to accommodate the recruitment of the Commission visitors. Part time commissioners were previously appointed through the public appointments process with adverts paid by the public appointments unit.

Appendix A – Action Plan

Recommendation and Risk Rating	Management Response, Responsible Officer and Implementation Date
<p>Action 1 We recommend that those responsible for leading efficiency and improvement work at MWC should formally assess themselves against each question raised in the combined Audit Scotland, the Northern Ireland Audit Office and the Wales Audit Office detailed good practice checklist.</p> <p>Risk Rating – Medium</p>	<p>Management Response Agreed</p> <p>Responsible Officer: Head of Corporate Services</p> <p>Implementation Date: April 2011</p>

Appendix B – Communications to Management

International Standards on Auditing (“ISA”) (UK&I) 260 – Reporting to those charged with Governance, requires that the External Auditor communicates certain matters to those charged with Governance. Those charged with Governance is taken to be the Members of the Audit Committee with responsibility discharged through the regular meetings of the Audit Committee during the year. Summarised below are the requirements set out within ISA 260 together with reference to the relevant communication with you during 2009/10 or comments as appropriate.

Communication Required under ISA 260	Reference/Comment
Engagement letters	Signed Engagements Letter with Audit Scotland at the start of our 5 year appointment and updated annually.
Independence	Audit Planning document report to 26 February 2010 Audit Committee and confirmed no member of audit team has any direct interest, financial or otherwise, in MWC.
Audit Approach and Scope	Audit Planning document (reported to Audit Committee 26 February 2010)
Accounting Policies/Practices with a Material Effect on the Financial Statements	Sections 3 of our Annual Report to Commission Members and the Auditor General for Scotland.
Potential Effects of Material Risks and Exposures	Audit Planning document (26 February 2010).
Audit Adjustments	Section 3 of our Annual Report to Commission Members and the Auditor General for Scotland.
Material Uncertainties relating to Going Concern	None identified.
Disagreement with Management about Matters that could be Significant to the Financial Statements	Not applicable.
Expected Modifications to the Auditor’s Report	No modifications identified. A true and fair opinion provided.
Letter of Representation	Signed by Management 28 June 2010.
Material Weaknesses in Internal Control	Internal Controls findings reported separately in our Interim Management Letter (26 February 2010), Section 5 of our Annual Report to Commission Members and the Auditor General for Scotland.
Fraud	Discussed fraud arrangements with the Audit Committee (26 February 2010) and Management throughout audit process.

Communication Required under ISA 260	Reference/Comment
Laws and Regulations	We have not identified any material braches of laws and regulations in the period which impact on the 2009/10Financial Statements.
Audit Materiality	Audit Planning document – presented to Audit Committee in 26 February 2010.
Fair Value Measurement and Disclosure	Included in representation letter, signed by Management dated 28 June 2010.
Related Parties	Other than those transactions disclosed in the financial statements we have not identified any further transactions requiring disclosure.

Formal Reporting to Management during 2009/10

During the year we have presented a number of formal reports to Management and the Audit Committee and produced certain outputs. Our principal outputs during 2009/10 are summarised below:

Formal Output	Timing
Letter outlining work undertaken in relation to our review of theSAS's 2008/09 shadow IFRS based financial statements	26 February 2010
Audit Plan	26 February 2010
Detailed Timetable for 2009/10 Financial Audit	26 February 2010
Interim Management Letter	26 February 2010
Annual Report to Board Members and the Auditor General for Scotland	18 June 2010
Audit Opinions 1. True and fair value on the financial statements ✓ 2. Regularity of income and expenditure ✓ 3. Remuneration Report (sections) ✓	} Unqualified } Audit } Opinions 28 June 2010

Freedom of Information Act (Scotland) 2002

In the event that, pursuant to a request which the institution has received under the Freedom of Information Act (Scotland) 2002 or the Environmental Information Regulations 2004 (as the same may be amended or re-enacted from time to time) or any subordinate legislation made thereunder (collectively, the "Legislation"), MWC is required to disclose any information contained in this report, it will notify PwC promptly and will consult with PwC prior to disclosing such report. MWC agrees to pay due regard to any representations which PwC may make in connection with such disclosure and to apply any relevant exemptions which may exist under the Legislation to such report. If, following consultation with PwC, MWC discloses any of this report or any part thereof, it shall ensure that any disclaimer which PwC has included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.

© 2010 PricewaterhouseCoopers LLP. All rights reserved. "PricewaterhouseCoopers" refers to the PricewaterhouseCoopers LLP (a limited liability partnership in the United Kingdom) or, as the context requires, other member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity. This report is protected under the copyright laws of the United Kingdom and other countries. Any other use or disclosure in whole or in part of this information without the express written permission of PricewaterhouseCoopers LLP is prohibited.