AUDIT SCOTLAND

Disclosure Scotland

Annual Audit Report 2014/15

Prepared for Disclosure Scotland and the Auditor General for Scotland

September 2015

Contents

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This report has been prepared for the use of Disclosure Scotland and no responsibility to any member or officer in their individual capacity or any third party is accepted.

This report will be published on our website after it has been considered by the Audit and Risk Committee and the financial statements have been laid before parliament. The information in this report may be used by Audit Scotland in any reporting to the Scottish Parliament.

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Key Messages

Audit of financial statements	• Unqualified independent auditor's report (audit certificate) on the 2014/15 financial statements. • Working papers were of a good standard and officers provided good support. However there was a delay of around 6 weeks from when we raised the matters arising and subsequent receipt of the updated financial statements. We acknowledge that much of the delay was caused by the need to seek advice from the Scottish Government. • With the exception of one misstatement which was not considered material, all other financial misstatements, presentation and disclosure issues identified during the audit process were corrected by management.
Financial management and sustainability	• The accounts are prepared on an accruals basis. The accounts record a net cost of operations of £5.129 million compared to the resource budget allocation of £9.975 million. The resultant underspend was returned to the Scottish Government. • Management also closely monitor financial performance on a cash basis. During the year £1.806 million was drawn down which was within the permitted cash limit.
Governance, transparency and performance	• There are sound governance arrangements in place. However the final version of the Internal Audit annual assurance report was only provided on 21 August 2015. • Systems of internal control operated effectively during 2014/15. We would like to acknowledge the effort invested by all staff into the income and debtors' reconciliation. We have taken assurance from the increased ownership of the amounts disclosed by Disclosure Scotland and also the level of understanding that staff now have of the overall process. • Disclosure Scotland has sound arrangements for recording and monitoring performance. • A record 1.6 million disclosure applications were received, of which 92% were processed within the target of 14 days, above the target of 90%. Average turnaround was 5.8 days.

Outlook	• The new ICT managed service contract commenced 1 April 2015. Disclosure Scotland have introduced a range of management and monitoring arrangements. • The validation process and the receiving and handling of payments have now been taken in-house (from 1 April 2015). A number of operational issues with the Oracle Financials ledger system are currently being addressed. • The original proposed outline business case to reflect the transformation is currently being reconsidered by management. • We have a continuing interest in Disclosure Scotland's management of ICT contracts and the progress of its transformation process in general. During 2015/16, we shall consider our audit approach to the issues and risks arising.

Introduction

1. This report is a summary of our findings from the 2014/15 audit of Disclosure Scotland.
2. The Chief Executive, as the Accountable Officer, is responsible for:
   - preparing financial statements which give a true and fair view, in accordance with the relevant financial reporting framework
   - ensuring the regularity of transactions, by putting in place systems of internal control
   - maintaining proper accounting records
   - preparing and publishing with the financial statements a management commentary, an annual governance statement and a remuneration report.
3. Our responsibility, as the external auditor, is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.
4. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements prepared by management with the oversight of those charged with governance. This does not relieve management of their responsibility for the preparation of financial statements.
5. A number of reports, both local and national, have been issued by Audit Scotland during the course of the year. These reports are summarised at appendices II and III respectively.
6. Appendix IV is an action plan setting out our recommendations to address the high level risks identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response". We recognise that not all risks can be eliminated or even minimised. What is important is that Disclosure Scotland understands the risks and has arrangements in place to manage these risks. Members should ensure that they are satisfied with the proposed actions and have a mechanism in place to assess progress and monitor outcomes.
7. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures. Consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.
8. The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged.

Audit of the 2014/15 financial statements

Audit opinions

Financial Statements	• The financial statements of Disclosure Scotland for 2014/15 give a true and fair view of the state of the body's affairs and of its net cost of operations for the year. • We confirm that the financial statements have been properly prepared in accordance with the 2014/15 FReM and the requirements of the Public Finance and Accountability (Scotland) Act 2000 and directions made thereunder.
Regularity	• In all material respects, the expenditure and income in the financial statements were incurred or applied in accordance with applicable enactments and guidance.
Other prescribed matters	• The part of the remuneration report to be audited has been properly prepared in accordance with the requirements of the Public Finance and Accountability (Scotland) Act 2000 and directions. • The information in the strategic and directors' report is consistent with the financial statements.

Submission of financial statements for audit

9. We received the unaudited financial statements in accordance with the agreed timetable. The working papers were of a good standard, the staff provided good support to the audit team and we completed our on-site fieldwork on 8 July 2015. However, we discuss the delay in receiving revised financial statements at paragraph 32 below.

Overview of the scope of the audit of the financial statements

10. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan, presented to the Audit and Risk Committee on 24 February 2015.

11. As part of the requirement to provide full and fair disclosure of matters relating to our independence, we can confirm that we have not undertaken any non-audit related services. The 2014/15 agreed fee for the audit was £40,000 and, as we did not carry out any work in addition to our planned audit activity, the fee remains unchanged.

12. The concept of audit risk is of central importance to our audit approach. During the planning stage of our audit we identified a number of key audit risks which had the greatest effect on the audit strategy, resources and effort. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance.

13. Appendix I sets out the significant audit risks identified at the planning stage and how we addressed each risk in arriving at our opinion on the financial statements.

14. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

Materiality

15. Materiality can be defined as the maximum amount by which auditors believe the financial statements could be misstated and still not be expected to affect the decisions of users of financial statements. In addition, a misstatement or omission, which would not normally be regarded as material by amount, may be important for other reasons (for example the failure to achieve a statutory requirement, or an item contrary to law).

16. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit procedures. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

17. We summarised our approach to materiality in our annual audit plan. Based on the draft financial statements, we concluded

that our original calculation remained appropriate (1% of income) and set materiality at £435,000.

18. We also set a lower level, known as performance materiality, when defining our audit procedures. This level depends on professional judgement and is informed by a number of factors including:

- extent of estimation and judgement within the financial statements
- nature and extent of prior year misstatements
- extent of audit testing coverage.

19. Performance materiality was set at £217,500 (i.e. 50% of materiality). We report all misstatements greater than £5,000.

Evaluation of misstatements

20. A number of monetary adjustments were identified within the unaudited financial statements submitted to audit. These were discussed and reviewed with officers who agreed to amend the unaudited financial statements. The most significant adjustments related to:

- Income (£1.455m) received in 2015/16 which should have been accrued into 2014/15.
- Expenditure (£1m) was paid in March 2015 which should have been treated as a prepayment.
- A number of year-end journal entries were incorrectly processed by officers which, following discussion, were reversed. The impact of this reversal led to an increase in the net cost of operations (£0.108m).

21. The overall effect of all adjustments made to the financial statements is to decrease the net cost of operations by £2.375 million. Net assets as recorded in the statement of financial position have increased by £2.375m.

22. While the total value of adjustments exceeded our overall performance materiality level of £217,500, these were due to infrequent year end transactions where it was agreed that the incorrect accounting treatment had been applied. We concluded that these did not indicate the existence of any systemic error within the financial statements.

23. These matters are discussed further below.

24. One misstatement identified during the audit has not been adjusted in the financial statements. If adjusted this would increase income and trade receivables by £109,000. We requested that all errors be corrected, although the final decision on this matter rests with those charged with governance taking into account advice from officers.

Significant findings (ISA260)

25. International Standard on Auditing 260 requires us to communicate to you significant findings from the audit:

- The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and disclosures.
- Significant difficulties encountered during the audit.
- Significant matters arising from the audit that were discussed, or subject to correspondence with management.
- Written representations requested by the auditor.
- Other matters which in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

26. During the course of the audit, we identified a number of significant issues which, in our view, requires to be communicated to you in accordance with ISA 260.

27. **Income.** Income (£1.455m) was received in April 2015 from the operational partner as recompense for not having provided a technical IT refresh during the course of the PPP contract which concluded in March 2015. Officers considered that the income related to 2015/16. We disagreed with this treatment and considered it related more appropriately to 2014/15. Following discussions with officers from Disclosure Scotland and the Scottish Government, the income was accrued into 2014/15. This entry resulted in an increase in income received for the year and therefore decreased the net cost of operations.

28. **Expenditure.** The 2014/15 financial statements included a payment of £1m which referred to the new maintenance contract. We disagreed with this treatment and considered the payment should be accounted for as a prepayment. Following discussions with officers from Disclosure Scotland and the Scottish Government, it was agreed that the expenditure should be treated as a payment made in advance. This resulted in a reduction of expenditure and an overall decrease in the net cost of operations.

29. **Accrued income\PPP expenditure**. We have reported previously that officers should gain a full understanding of the balances being held on their behalf by the operational partner as the PPP contract comes to an end. As part of our 2014/15 audit, we reviewed the validity of a number of year-end journals relating to accrued income and PPP expenditure which formed part of the contract settlement.

30. Our review identified a number of mis-postings which management agreed to amend, to more accurately reflect the evidence provided. This resulted in an increase in the net cost of operations by £108,000.

31. The Accountable Officer has provided assurances that there are no material amounts outstanding and any unresolved balances are also not material. Our audit testing has confirmed these assurances.

32. **Financial statements**. We have previously highlighted the importance of adherence to the financial statements plan. We advised the Audit and Risk Committee in July 2015 that we

were awaiting responses to number of significant accounting issues which had been raised with officers at a meeting held on 3 July and which were likely to require adjustment to the financial statements. Those revisions were agreed on 4 August and a full set of updated accounts was received on 17 August. We acknowledge that due to the significant nature of the matters being raised, the advice of the Scottish Government had to be sought and that this was a contributory factor to the update process.

33. In addition an updated annual report was received on 19 August and both the Internal Audit annual assurance opinion and the Audit and Risk Committee's statement of assurance to the Accountable Officer were not provided until 21 August. These delays have resulted in the late submission of the consolidation pack and have put serious pressure on the completion timetable for the audit. Management have advised that this was primarily as a result of factors outwith their direct control.

Refer Action Plan No. 1

34. **Income and trade receivables**. The PPP contract which operated throughout 2014/15, gave the operational partner responsibility for all income receipt, cash handling and debt processes. These are administered using the operational partner's financial systems. This has led to significant difficulties in preparing reconciliations to support the figures contained within the financial statements for Disclosure Scotland. This has been a particular problem for the reconciliation between banked monthly revenue and the movement on debtors and the transaction list which is used to record the income. A difference of £0.109m remains between these figures. We have reviewed this reconciliation together with the output of the work of the Oracle Financials consultant employed by Disclosure Scotland, and consider this difference to be acceptable. We have however, asked management for assurances that all income has been fully recognised in the 2014/15 financial statements in compliance with the PPP contract.

Refer Action Plan No. 2

35. **Protecting Vulnerable Groups (PVG) asset**. To accommodate changes arising from the PVG legislation, the Scottish Government commissioned the development of new software and hardware. The total cost of the assets transferred to Disclosure Scotland in February 2011 was £21.29m; as at 31 March 2015, just under 1 year of its useful life remains.

36. During 2014/15, Disclosure Scotland took the decision to accelerate the write off of the hardware associated with the PVG asset to reflect that the hardware was assessed to be technically obsolete. While we consider this reasonable and accept that the software continues to be reasonably stated, we have requested assurances from the Accountable Officer that there are no reasons for the asset valuation to be amended.

37. **Contingent asset / liability.** The financial statements (at note 20) record an unquantified contingent asset / liability: Disclosure Scotland is currently in discussions on the non-completion of an IT contract which Disclosure Scotland awarded in May 2014. We shall continue to review progress on this matter.

38. **Losses and special payments.** Note 15 in the financial statements (losses and special payments) records that Disclosure Scotland made a payment to a supplier of £1.1m which represented the first milestone payment of a contract which subsequently did not complete. We shall continue to monitor progress.

Outlook

Revisions to the Financial Reporting Manual (FReM)

39. The financial statements are prepared in accordance with the Government financial reporting manual (FReM). Two significant revisions will apply from 2015/16:

- Simplification and Streamlining Project – changes to the form and content of the annual report and accounts.
- Adoption of IFRS13 *Fair value measurement* for the first time – this also includes IAS 16 and IAS 38 adaptations.

40. **Restructuring of the annual report**: the 2015/16 FReM has been extensively re-written to require the annual report and accounts to include:

- A performance report which will give a fair, balanced and understandable analysis of performance and will include an overview section and a performance analysis section.
- An accountability report incorporating the following three main sections:
  - corporate governance report consisting of a directors' report, a statement of the Accountable Officer's responsibilities and a governance statement
  - remuneration and staff report which will cover a number of prescribed disclosures including remuneration policy, payments to directors, staff numbers and sickness absence rates
  - parliamentary and accountability report which will include information on the regularity of expenditure and the independent auditor's report.

41. Management should ensure a process is in place to review the revisions to the 2015/16 FReM, so that appropriate presentation and disclosures are made in the 2015/16 annual report and accounts.

Refer Action Plan No. 3

42. **International Financial Reporting Standards (IFRS) 13 Fair value measurement:** sets out the requirements for assets to

be valued at fair value and is applied in full by the FReM only to assets that are not held for their service potential (i.e. investment properties and assets held for sale) and operational assets which are surplus to requirements where there are no restrictions on disposal.

43. As Disclosure Scotland does not hold any assets of this nature this will not impact upon the 2015/16 financial statements.

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Financial management and sustainability

2014/15 financial position

44. Disclosure Scotland is largely self-funding from fee income received from disclosure checks. The Scottish Government provides additional funding for specific purposes. The organisation is therefore required to work within its resource budget set by the Scottish Government as detailed below:

Revised Resource Budget 2014/15	Budget (£000)	Actual Outturn (£000)	Under Spend (£000)
Cash Departmental Expenditure Limit (DEL)	4,422	530	3,892
Non-Cash	5,553	4,599	954
Total	**9,975**	**5,129**	**4,846**

45. Gross operating costs during 2014/15 were £50.116m with income of £44.987m giving a net cost of operations of £5.129m which was funded from the Scottish Consolidated Fund. The compares with a Scottish Government budget (as outlined in the Spring budget revision) of £9.975m. The resultant underspend of £4.846m was a result of underspends in staff costs, computer services and transition costs.

46. Disclosure fee income was £43.362m which was in line with forecast and the level of free checks undertaken was less than budgeted.

47. Other operating costs record an increase of £5.7m in respect of payments to the PPP partner which reflect the costs of the cessation of the PPP contract. The PPP contract was a profit sharing arrangement whereby the operational partner was responsible for the processing of disclosure applications and for the processing and recording of all supporting financial transactions. An exit plan was agreed in August 2014 together with the related financial processes. The financial statements recognise:

- £4.4m paid to BT in respect of the final settlement of cash and debtors, and
- £1m paid in respect of agreed exit costs.

Financial Management

48. As auditors we need to consider whether bodies have established adequate financial management arrangements. We do this by considering a number of factors, including whether:

- the officer responsible for finance has sufficient status to be able to deliver good financial management
- standing financial instructions and standing orders are comprehensive, current and promoted within the body
- reports monitoring performance against budgets are accurate and provided regularly to budget holders
- monitoring reports do not just contain financial data but are linked to information about performance
- members provide a good level of challenge and question budget holders on significant variances.

49. Senior management receive monthly budget monitoring reports. Regular budget reports are also provided to the Board for their information.

50. We continue to be aware of the demand-led nature of Disclosure Scotland's business and the importance of its management accounting and reporting arrangements to the financial management of the organisation. There remains an on-going need to monitor trends and developments as the pattern of business changes. This is particularly so with the demand for free-checks which can place budgetary pressures on the business.

51. Based on our accumulated knowledge and our review of relevant papers we conclude that Disclosure Scotland has appropriate financial management arrangements in place.

2014/15 financial position

52. The statement of Financial Position shows a net asset position of £6.442m at 31 March 2015 (£9.725m in 2013/14). This reduction of £3.283m reflects the depreciation of the PVG software and the depreciation and final write down of the PVG hardware (as discussed previously) of £4.599m and an increase in trade receivables and other current assets to incorporate the audit adjustments noted in paragraphs 27-30 above.

2015/16 and beyond

53. The 2015/16 Departmental Expenditure Limit from the Scottish Government is £6.8m, with a further £1m expected to cover the cost of free checks. This represents a decrease of £2.2m or 22% when compared to the 2014/15 final budget. As at June 2015, Disclosure Scotland continued to underspend against its current budget allocation. However, as a result of the audit adjustments detailed above, the 2015/16 budget is being reviewed. Demand is expected to continue to rise in 2015/16 by 2%.

54. The Scottish Government has agreed to provide the funding to support the budget pressure arising from consideration of the judgement delivered by the UK Supreme Court in June 2014. This refers to the disclosure of criminal record information for which there is now an agreed operational solution and which is due to be implemented in September 2015.

55. From January 2017, the provision of English and Welsh Basic Disclosure services will be provided by the Disclosure Barring Service: this will lead to a significant decrease in activity undertaken by Disclosure Scotland. This change will mean a significant change in the business model for Disclosure Scotland. The Transformation Programme is currently underway which is looking at the entire functional design of Disclosure Scotland. We are aware that the outline business case which recommended procuring a replacement to the PVG system has been referred back to Disclosure Scotland to identify a more affordable option.

56. The 2014/15 annual report and accounts refers to the award of a new care and maintenance contract to ATOS IT Services UK Ltd. The delivery and transfer of the service did not take place as planned and, to protect the business critical operations, the existing service contract with BT was continued. A new maintenance contract with BT commenced on 1 April 2015 for two years with an option to extend for a further year. We have reviewed the evidence in support of this action and can confirm that there was a sound basis for these business decisions.

57. From 1 April 2015 Disclosure Scotland has become responsible for all income receipt, cash handling and debt processes, previously performed by the operational partner. These processes will be undertaken on the financial ledger previously operated by the operational partner.

58. In our internal controls letter issued in May 2015, we noted some matters arising relating to the operation of the financial ledger. We are aware that there continues to be performance issues with the ledger and the Internal Audit report: Policies, Procedures and Accounting Controls over Income and Debtors also refers to similar matters. Management should continue to review the performance of the financial ledger and ensure all issues raised are suitably resolved.

Refer Action Plan No. 4/5

Workforce planning

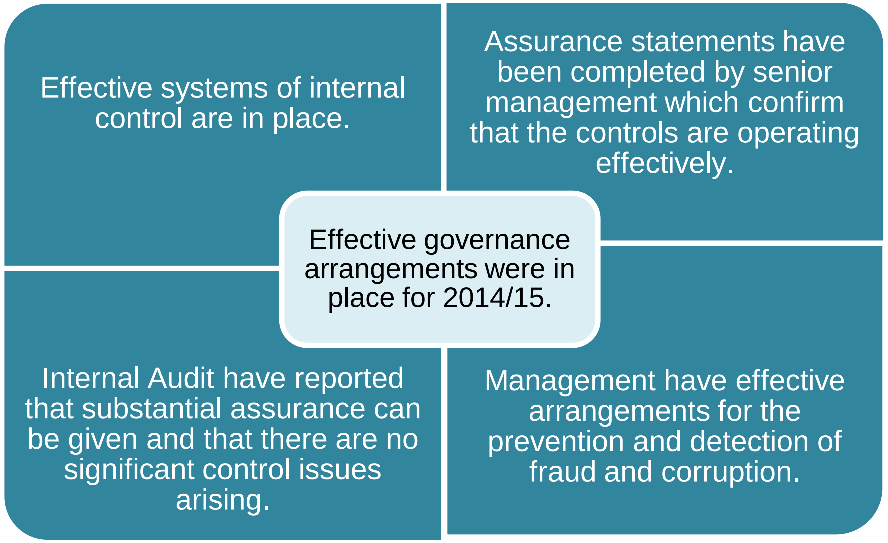
59. We are aware that an extensive programme of work has been undertaken on modelling the workforce to business demand and we have previously reported that agency costs and staff overtime continue to rise. As recorded in the financial statements, the costs of agency staff for 2014/15 increased by 26% when compared to 2013/14.

60. Management advise that they have robust models which provide a true reflection of disclosure application demand together with workforce requirements. We acknowledge that agency staff and/or overtime will continue to be required to address the fluctuating demand.

61. Payments to contractors engaged by Disclosure Scotland increased by 200% in 2014/15, from £314,000 in 2013/14 to £944,000. Due to market conditions and the lack of expertise within the Scottish Government and other Government

departments, contractors have been employed on critical aspects of the transformation programme. All employment decisions were subject to Scottish Government approval and the level of contractors' support continues to be closely monitored by management.

Governance, transparency and performance



Corporate governance

62. The Chief Executive, as Accountable Officer, is responsible for establishing arrangements for ensuring the proper conduct of the affairs of Disclosure Scotland and for monitoring the adequacy of these arrangements.

63. The Disclosure Scotland Board is responsible for: setting the strategic direction of the organisation to ensure that it fulfils the objectives of Scottish Minister; for monitoring performance; and for ensuring that statutory requirements for the use of public funds are complied with. The Board met six times in 2014/15.

64. The Board is supported by an Audit and Risk Committee which oversees Disclosure Scotland's arrangements for corporate governance. The Audit and Risk Committee prepares an annual report which provides the Chief Executive with assurance as to compliance and is used to inform the governance statement.

65. The Audit and Risk Committee met five times during 2014/15. Two new members were appointed in January 2015 and they continue to learn and develop their knowledge of the business. Based on our attendance at the committee meetings, we are satisfied that the members provide an effective challenge to management.

66. The governance statement included in the financial statements provides a description and assessment of the essential components of corporate governance and details of any significant risk-related matters arising during the period and is in accordance with Scottish Government guidance.

67. As part of the process for gaining assurance over the systems of internal control, the Accountable Officer requests confirmation of the operation of controls from the other Disclosure Scotland directors. We have reviewed these assurance statements and are satisfied that all issues raised have been reflected within the governance statement.

68. We consider that the 2014/15 governance statement has been fairly stated and reflects management's responsibilities and processes by which the assurances on the system on internal control are obtained.

Transparency

69. Disclosure Scotland's principal activity is to contribute to the protection of vulnerable groups in society by providing criminal history information to organisations and potential employers to assist them in making safer and more informed recruitment decisions.

70. The management commentary included within the financial statements provides a summary of the business strategy and future developments and information on the volume of applications processed together with performance against targets. Information is also provided on the operational activity throughout the year.

71. The report notes that the number of applications received increased by 12% to 1.579m. The main performance target is to process 90% of correctly completed applications within 14 days. Disclosure Scotland met this performance target, processing 92% within 14 days with an average turnaround of 5.8 days. This is an improvement from 2013/14 where 87% of applications were processed within 14 days with an average turnaround of 9.3 days.

72. A range of other information, for example corporate and business plans and governance structures are available for public review on the website. However management team, Board or Audit and Risk Committee minutes are not available for public review.

73. We have been advised that the Board have recently considered whether additional information should be provided on the web-site. It was concluded that, due to the sensitive nature of the discussions, it would be not be appropriate to make these publically available. We can conclude that Disclosure Scotland adequately complies with the principles of openness and transparency.

Accounting and Internal control systems

74. While auditors concentrate on significant systems and key controls in support of the opinion on the financial statements, their wider responsibilities require them to consider the financial systems and controls of audited bodies as a whole. However, the extent of this work should also be informed by their assessment of risk.

75. We reported in May 2015 that we were unable to form the view that the controls were operating effectively in relation to the income and debtors systems. As a consequence of action taken by management we are now able to conclude that there are no material weaknesses in the accounting and internal

control systems identified during the audit which could adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

76. We have also reviewed the annual report provided by the Scottish Government Internal Audit Division which was received on 21 August 2015. They have provided substantial assurance and in their opinion Disclosure Scotland's controls are robust and well-managed. We have expressed concern as to the delay in the submission of this audit opinion.

77. In the interests of an efficient audit approach, we also rely on assurances received from the auditor of the Scottish Government on the work performed on the shared systems that operate at Disclosure Scotland which are hosted by the Scottish Government. This approach ensures we are delivering an efficient co-ordinated audit that avoids unnecessary duplication and expense.

78. Two assurance reports covering payroll and financial services were provided by the auditor of the Scottish Government. The auditor was able to conclude that the controls tested, operated effectively throughout the period from 1 April 2014 to 31 March 2015. An exception was noted in relation to the controls in operation over payroll amendments and the travel booking process which did not operate effectively throughout the period. Our controls report also identified issues relating to the operation of the payroll at the Scottish Government. There is no material impact of these findings on the operation of these systems on Disclosure Scotland.

Arrangements for the prevention and detection of fraud

79. In our Annual Audit Plan we highlighted the responsibility audited bodies have for establishing arrangements to prevent and detect fraud and other irregularities. In our opinion the overall arrangements for the prevention of fraud are satisfactory, although it should be noted that no system can eliminate the risk of fraud entirely.

80. There were no instances of fraud or corruption reported by Disclosure Scotland in 2014/15.

Arrangements for maintaining standards of conduct and the prevention and detection of corruption

81. Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and have proper arrangements in place for implementing and monitoring compliance with standards and codes of conduct, standing orders and financial instructions. Auditors consider whether bodies have adequate arrangements in place. No issues have been identified by us for inclusion in this report.

National performance audit reports

Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2014/15, a number of reports were issued which may be of interest. These are outlined in Appendix III.

82. Disclosure Scotland should ensure that, where appropriate, these national reports are considered by management.

83. The Audit Scotland report 'Managing ICT Projects Follow up', was published in June 2015. This report considered what actions Disclosure Scotland had taken to improve how they manage ICT programmes. The report concluded that Disclosure Scotland had successfully managed the end of the recovery programme and moved the PVG system into business-as-usual.

Outlook

84. With the termination of the current PPP agreement and the creation of a new service contract with BT, Disclosure Scotland should continue their programme of self-evaluation and review of their management arrangements with a view to continuous improvement of performance.

85. Disclosure Scotland plan to undertake a lessons learned exercise from the termination and re-award of the maintenance contract which will encompass a revised approach to contract management being embedded within the organisation. This should ensure that Disclosure Scotland can take forward the outcomes as they move forward with their Transformation Programme.

86. Following on from the Audit Scotland report 'Managing ICT Projects: an update', together with the progress of the transformation programme and any potential budget impact, we shall consider our audit approach to these areas in 2015/16. We shall discuss with officers the issues and risks arising as part of our planning for the future audit of Disclosure Scotland.

Acknowledgements

87. We would like to express our thanks to the staff of Disclosure Scotland for their help and assistance during the course of this year's audit.

Appendix I – Audit risks

The table below sets out the audit risks, how we addressed each risk and our judgement in arriving at our opinion on the financial statements.

Audit Risk	Assurance procedure	Results and conclusion
Fraud: management override of controls There is a risk that management manipulate accounting records and prepare fraudulent or biased financial statements by overriding controls that otherwise appear to be operating effectively.	• Detailed testing of journal entries. • Reviewed accounting estimates for bias. • Evaluated significant transactions that are outside the normal course of business	• Our review of journal entries undertaken as part of interim and financial statements work identified significant transactions relating to the conclusion of the PPP contract. The outcome of this review resulted in a material restatement of the draft financial statements (*paragraphs 27-30 refers*). • No issues were identified in relation to the review of accounting estimates or significant transactions outside the normal course of business.

Audit Risk	Assurance procedure	Results and conclusion
Fraud: income recognition Income from external sources can present a risk of fraud. Disclosure Scotland receives a significant amount of its income from a third party. The extent and complexity of income means there is an inherent risk of fraud in accordance with ISA240.	• We evaluated the effectiveness of systems of internal control for income recognition and recording including the analytical review of income streams and testing controls. • Controls and substantive testing of income and trade receivables was undertaken. • Analytical review of disclosure income received was undertaken.	• All testing proved satisfactory. There were no issues arising from this review.

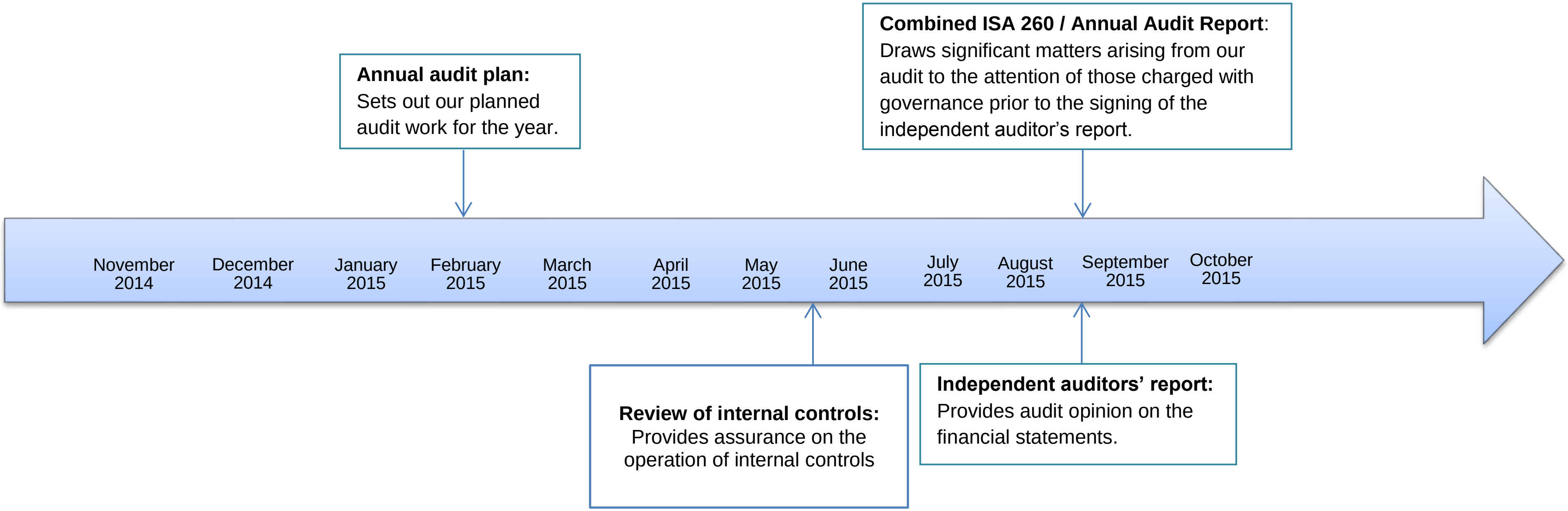
Audit Risk	Assurance procedure	Results and conclusion
PVG contract arrangements The current PPP contract has now been extended to 31 March 2015. There are some risks in relation to the extension of the contract including: • cost implications • the non-achievement of public performance targets • continuity of service may be adversely affected.	• Reviewed progress towards appointment of new contractor. • Monitored cost implications. • Reviewed arrangements for extending the current contract. • Monitored performance of system. • Provided an update on the issues raised in the national report Managing ICT Contracts (published August 2012). • Reviewed management plans.	• We have monitored progress of the appointment. We intend to review the arrangements in relation to the appointment of the new contractor as part of our 2015/16 work together with any cost implications. • Our review of the decisions surrounding the extending of the current contract and awarding the new contract established that there was sound reasoning applied. • We have reported on the performance of the system, in particular the financial ledger (paragraph 58 refers). • The follow up to Managing ICT Contracts was published in June 2015. • We continue to monitor management plans.

Audit Risk	Assurance procedure	Results and conclusion
Financial statements With the transfer of finance and other functions into Disclosure Scotland, there is a risk that officers are unable to adhere to the agreed financial statements completion timetable and/or are unable to provide all appropriate evidence. As a consequence, a qualified opinion may be given on the financial statements due to the absence of evidence. The audit is delayed due to the absence of management review.	• A financial statements production plan was prepared which included time built in for management review. • Unaudited accounts were received in accordance with this timetable.	• Timetable agreed with officers. • Ongoing discussion was held with officers to monitor progress of financial statements completion. • As referred to in paragraph 32 above, a number of significant accounting issues were raised with officers on 3 July, which were later amended. A full set of updated accounts was received on 17 August. We acknowledged that due to the significant nature of the matters being raised, the advice of the Scottish Government had to be sought and that this was a contributory factor to the update process. A final revised annual report was received on 21 August. • These delays have resulted in the late submission of the consolidation pack and have put serious pressure on the completion timetable for the audit. • There was no impact on the accounts preparation process as a result of the finance processes transferring in-house.

Audit Risk	Assurance procedure	Results and conclusion
Income and trade receivables A difference continues to exist between the monthly cash-based figures of monies banked and the movement on debtors when compared to the transaction list totals for the month. There is a risk that income and debtors may be mis-stated in the financial statements.	• Reviewed reconciliations. • Reviewed any remaining balance.	• We reviewed the reconciliations and the underlying financial transactions during our interim and financial statements audit. • We were unable to review and rely on the work undertaken by Internal Audit due to the timing of completion of this work and we extended our audit testing as necessary. On conclusion of this work, Internal Audit provided reasonable assurance meaning that some improvements were required and that none of the matters identified were of a significant nature. • Internal Audit have provided a substantial assurance level overall and that there are no materially significant issues. • Overall, we are satisfied that income has been fairly stated.

Audit Risk	Assurance procedure	Results and conclusion
Accrued income Accrued income is largely represented by the movement in debt outstanding in excess of 90 days together with the settlement of credit balances and miscellaneous income. An element of this is payable to Disclosure Scotland. There is a risk that the financial statements do not accurately record the value of accrued income due from the operational partner.	• Reviewed operational partner debt write-off. • Reviewed monthly reconciliations. • Reviewed year-end balance.	• We reviewed the year-end balances, which includes the movement in debts outstanding and raised some matters which were discussed with officers. Officers agreed to amend a number of balances. • Due to the termination of the PPP contract on 31 March 2015, accrued income relating to the PPP contract should cease as under the new contract arrangements, Disclosure Scotland will become responsible for all debt raised. • We have been able to take assurance from the increased level of understanding that staff now have of the overall process

Appendix II – Summary of local audit reports 2014/15

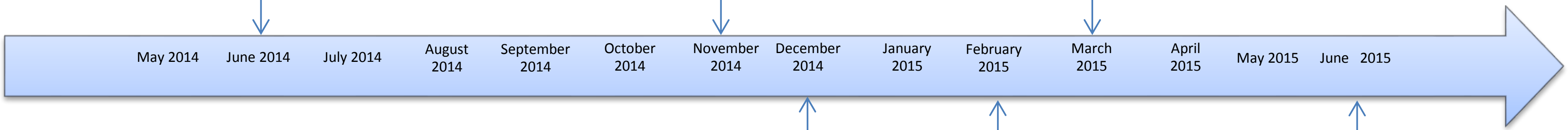


Appendix III – Summary of national reports 2014/15

Scotland's public finances - a follow-up audit: Progress in meeting the challenges. Provides a high-level update on the financial position and on how public bodies are meeting the challenges of reduced public spending.

Community planning: Turning ambition into action. Provides a national update on community planning in Scotland since March 2013. The report assesses progress locally and nationally and identifies opportunities for further improvement.

Update on developing financial reporting. Reviews the principles of public financial management and provides an update on the actions the Scottish Government is taking to further develop financial reporting.



Preparations for the implementation of the Scotland Act 2012. Reports progress in preparing for the Land and Buildings Transaction Tax (replacing the current stamp duty arrangements), Scottish Landfill Tax and other financial powers for the Scottish Government from 1 April 2015.

Superfast broadband for Scotland: a progress report. Assesses whether the Scottish Government and HIE have clear plans and arrangements in place to build their superfast broadband network in Scotland.

Managing ICT contracts in central government: an update. The Scottish Government and central government bodies continue to encounter difficulties in managing ICT programmes, though progress is being made to overcome these issues.

Appendix IV– Action plan

No.	Paragraph	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
1.	33	**Financial statements** There has been slippage in the agreed financial statements preparation timetable. These delays have resulted in the late submission of the consolidation pack to the Scottish Government and also meant that the annual audit report clearance process has been put under extreme pressure. **Risk:** There is a risk that a qualified opinion is given on the financial statements due to insufficient evidence being available to support figures within the financial statements and annual report. **Recommendation:** A timetable should be agreed which is realistic and achievable.	The copy of the Accounts was submitted to AS on 26 June 2015, prior to the commencement of their audit as planned. The Annual Report part of the Annual Report and Accounts was submitted in draft to AS on 3 July 2015 as planned. The time taken to complete a few major outstanding matters, which had a significant impact across Government, delayed the accounts final completion. DS will review the options, with all stakeholders, to mitigate the timings within the plan for 2015-16 to complete and finalise the 2015-16 Annual Report and Accounts.	Director of Corporate Services	End February 2016

No.	Paragraph	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
2	34	**Income reconciliation** At the year end, differences continued to exist within the reconciliation between the income and trades receivable balances due to timing differences. We acknowledge that this should no longer be an issue as the systems have been brought in-house. **Risk.** There is a risk that the financial statements are materially mis-stated. **Recommendation.** As the new income processes bed in, management should ensure that appropriate control is exercised over the systems and that the accuracy of the systems is monitored.	Having brought all collection systems in-house the reconciliation process will be reviewed to enable better use of the inherited financial ledger to inform the reconciliation process.	Head of Finance	End November 2015

No.	Paragraph	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
3	41	**Revision to FReM** The 2015/16 FReM has been extensively re-written and includes significant changes to the form and content of the annual report and accounts. **Risk:** Disclosure Scotland's 2015/16 financial statements do not reflect the revised FReM requirements. **Recommendation:** Management should review the revised requirements to identify the impact upon their 2015/16 financial statements, and discuss these with their external auditors as required.	The requirements of the FReM will be reviewed and the required changes will be discussed with SG Finance. This will ensure that the changes made by DS reflect those required by the Scottish Public Finance Manual and the FReM.	Director of Corporate Services	End February 2016

No.	Paragraph	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
4	57,58	**Transfer of functions** From the 1 April 2015, Disclosure Scotland will be responsible for the processing of all income, banking and debtor functions. Disclosure Scotland will need to further develop processes and procedures to addresses the weaknesses which have been reported with the income and debtors under the PPP contract. **Risk.** The financial statements are materially mis-stated. **Recommendation.** Management should undertake a full review of the procedures in operation to ensure any weaknesses are addressed.	DS will undertake a full review as recommended.	Head of Finance / Finance Operations Manager.	End March 2016

No.	Paragraph	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
5	58	**Financial ledger** Both we and Internal Audit have raised a number of matters arising in relation to the efficient operation of the Oracle financial ledger which Disclosure Scotland took responsibility for on 1 April 2015. **Risk.** That a qualified opinion is provided due to unreliability in the operation of the finance ledger. **Recommendation.** Management should continue to assess the ledger's suitability and ensure adherence to and achievement of the agreed action plan.	Acceptance criteria for the Oracle work has been agreed with BT. The overall completion of the project is wholly dependent upon BT delivering as planned. We shall work with BT to ensure achievement of the agreed action plan.	Head of Finance	End February 2016