AUDIT SCOTLAND

Disclosure Scotland

2015/16 Annual audit report to Disclosure Scotland and the Auditor General for Scotland

August 2016

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Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively (www.audit-scotland.gov.uk/about/).

Helen Russell, Senior Audit Manager, Audit Scotland is the appointed external auditor of Disclosure Scotland for the period 2011/12 to 2015/16.

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.

The information in it may be used by the Auditor General in support of her wider responsibilities, including reporting to the Scottish Parliament.

Contents

Key messages

Audit of financial statements	• Unqualified independent auditor's report on the 2015/16 financial statements. • All financial misstatements, presentation and disclosure issues identified during the audit process were corrected by management. • Working papers were of a good standard and officers provided good support.
Financial Position	• The accounts record an excess of income over expenditure of £2.7 million compared to budgeted net expenditure of £0.6 million. The excess was returned to the Scottish Government. • Management also closely monitor financial performance on a cash basis. During the year £11.7 million was returned to the Scottish Government. Financial management is strong and soundly based. • Over the next two years Disclosure Scotland is facing significant changes to the volume of business; a decrease of up to 90% of the basic disclosure market is estimated which will reduce projected income by £28 million per year. Management have recognised the challenges and are currently consulting with Scottish Ministers on a range of potential funding scenarios. Until the future funding position is formally agreed, there remains a risk to the ongoing financial sustainability of the organisation.
Governance & accountability	• There are sound and well-established governance arrangements in place and these were generally operating effectively subject to the issues raised in relation to the progress of the transformation programme. The Governance Statement refers to a number of key risks to the success of the transformation programme; namely the availability of personnel with the necessary skills, the impact on cost recovery as a consequence of reducing volumes and the need to ensure the continuing application of strong governance and risk management principles. • Systems of internal control operated effectively during 2015/16. We would like to acknowledge the effort invested by all staff involved in the bank and debtors' reconciliation processes. With the transfer of a range of finance functions in-house, we have taken assurance from the increased level of understanding that the staff now have of the overall process. • The current Chief Executive and Accountable Officer will leave the organisation during September 2016. There will be a short handover period with his replacement.

Best Value	• The new ICT managed service contract commenced 1 April 2015. A reduction of over £10 million in payments to the contractor was achieved. In addition, Disclosure Scotland has successfully managed the transfer of over 80 staff into the organisation and has taken in-house the validation process and the receiving and handling of payments. • Disclosure Scotland has faced significant difficulties in delivering on its transformation programme. An ongoing dispute is a focus of management time. In addition, the organisation has recently taken the decision to fundamentally change the approach to the transformation programme, halting a traditional procurement process and applying an agile process to deliver the IT required to support the PVG system and business transformation. The new approach to transformation is in line with the Scottish Government's digital strategy. • New leadership of the organisation is starting to have an impact. The organisation is more outward-looking and is engaging with users. It is also learning from other organisations and listening to relevant expertise.
Outlook	• The transformation programme should provide opportunities to reshape the business. Disclosure Scotland is however facing significant risks and uncertainty. These include: - being able to secure the appropriate skills to deliver an agile approach, and delivering to the tight timescales proposed - the uncertainty of the future funding model - the ongoing legal action. • These challenges all place significant demands on senior management time and capacity which may divert attention from the day to day business. • Given the significant risks involved in delivering the transformation programme we shall continue to monitor Disclosure Scotland's progress.

Introduction

1. This report is a summary of our findings arising from the 2015/16 audit of Disclosure Scotland.

2. The management of Disclosure Scotland 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
   - publishing with their financial statements 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 appendix II and appendix III.

6. Appendix IV is an action plan setting out our recommendations to address the high level risks we have 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 the Agency understands its risks and has arrangements in place to manage them. The Audit and Risk Committee should ensure that they are satisfied with proposed action 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.

9. 2015/16 is the final year of the current five year audit appointment. From 2016/17 the auditor of Disclosure Scotland will be Scott Moncrieff. In accordance with agreed protocols and International Standards on Auditing we shall be liaising with the incoming auditors as part of this transition.

Audit of the 2015/16 financial statements

Audit opinions

Financial Statements	• The financial statements of Disclosure Scotland for 2015/16 give a true and fair view of the state of the body's affairs and of its net expenditure for the year. • We confirm that the financial statements have been properly prepared in accordance with the 2015/16 FReM and the requirements of the Public Finance and Accountability (Scotland) Act 2000 and directions.
Regularity	• In all material respects, the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance.
Other prescribed matters	• The part of the Remuneration and Staff Report to be audited has been properly prepared in accordance with the Public Finance and Accountability (Scotland) Act 2000 and directions made thereunder by the Scottish Ministers. • The information given in the Performance and Accountability Reports is consistent with the financial statements.
Consolidation template	• The consolidation template has been audited to confirm that the figures are consistent with the audited financial statements.

Submission of financial statements for audit

10. We received the unaudited financial statements on 17 June 2016, in accordance with the agreed timetable. We also received a full set of working papers with the exception of the income reconciliations which were received on 1 July 2016. The working papers were of a good standard and staff provided good support to the audit team which enabled us to largely complete our on-site fieldwork on 1 July 2016.

Overview of the scope of the audit of the financial statements

11. 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 26 February 2016.

12. 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 2015/16 agreed fee for the audit was £40,000 and, as we did not carry out any work additional to our planned audit activity, the fee remains unchanged.

13. 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.

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

15. 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

16. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. 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. We revised our planning materiality for 2015/16 on receipt of the unaudited accounts to £0.453 million (1% of gross income).

18. We also set a lower level, known as performance materiality, when defining our audit procedures. This is determined to ensure that uncorrected and undetected audit differences do not exceed our materiality level. Performance materiality was set at £0.226 million (i.e. 50% of materiality). We report all misstatements greater than £5,000.

19. All financial misstatements, presentation and disclosure issues identified during the audit process were corrected by management. We therefore have no unadjusted misstatements to bring to your attention.

Significant findings from the audit

20. International Standard on Auditing 260 (ISA 260) requires us to communicate to you significant findings from the audit as detailed below:

- 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.

21. The following table details those issues or audit judgements that, in our view, require to be communicated to those charged with governance in accordance with ISA 260.

Table 1: Significant findings from the audit

Significant findings from the audit in accordance with ISA260

Income/Bank Reconciliation

22. From 1 April 2015 Disclosure Scotland became responsible for all income receipt, cash handling and debt processes, previously performed by the operational partner. We reported in our interim controls letter that no reconciliation had been undertaken which matched income to transactions for the 2015/16 financial year. I am pleased to record that full reconciliations for 2015/16 were completed and made available for audit review. While we were able to agree all of the entries to appropriate back-up, there remains at the year-end an un-reconciled balance of £0.2m. This balance is due to timing differences in sales which have not been matched to cash deposits at the year end and can be related to the timing of issuing invoices and receiving payment. While I am satisfied that the reconciliations have been properly prepared and reflect the underlying transactions, I have asked the Accountable Officer for assurances that there have been no material omissions from the reconciliations that will impact on the financial statements and that he will continue to review the reconciliation process in order to more fully identify the differences. In addition, we have raised concerns over the lack of desk procedures and instructions available for the reconciliation process. These are currently being finalised by staff.

Refer Action Plan No. 1

Protecting Vulnerable Groups (PVG) asset.

23. 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. 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. In 2015/16, a further write-off of the related PVG software was accelerated. While we consider this reasonable, we have requested assurances from the Accountable Officer that there are no reasons for the asset valuation to be amended.

For information only

Significant findings from the audit in accordance with ISA260

Contingent asset / liability.

24. The financial statements (at note 19) record an unquantified contingent asset / liability in relation to the award of a new contract for the care and maintenance of the PVG system to ATOS IT Services UK Ltd in May 2014 which did not take place as planned. Disclosure Scotland is currently in dispute with the supplier over the non-delivery of the contract. Officers are unable to quantify the amounts claimable or payable.

For information only

Future accounting and auditing developments

Code of Audit Practice

25. A new Code of Audit Practice applies to public sector audits for financial years starting on or after 1 April 2016. It replaces the Code issued in May 2011. The new Code outlines the objectives and principles to be followed by auditors.

26. The new Code increases the transparency of our work by making more audit outputs available on Audit Scotland's website. In addition to publishing all Annual Audit Reports, from 2016/17, Annual Audit Plans and other significant audit outputs will be put on the Audit Scotland website for all audited bodies. This is irrespective of whether the body meets in public or makes external audit reports publicly available.

Financial management and sustainability

2015/16 financial position

27. 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 2015/16	Budget (£000)	Actual Outturn (£000)	Under Spend (£000)
Cash Departmental Expenditure Limit (DEL)	(3,900)	(6,366)	2,466
Non-Cash	4,519	3,650	869
Total Revenue	**619**	**(2,716)**	**3,335**
Capital	200	170	30
Total	**819**	**(2,546)**	**3,365**

28. Gross operating costs during 2015/16 were £42.9 million and gross income of £45.6 million resulting in a net surplus of £2.7 million which was returned to the Scottish Consolidated Fund. This compares with a Scottish Government budget (as outlined in the Spring budget revision) of £0.8 million. The change in the financial outturn from 2014/15 when net cost of operations of £5.1 million was reported is due to increased income from disclosure fees (£2.3 million) and a decrease in operating costs (£11.8 million) offset by increased staff costs (£5.4 million).

29. Disclosure fee income was £45.6 million which was in line with forecast and the level of free checks undertaken was higher than expected.

30. Other operating costs record a decrease of £10.2 million in respect of payments to BT. This reflects the cessation of the PPP contract on 31 March 2015. The new contract which took effect on 1 April 2015 is for the care and maintenance of the PVG system and is based on both a fixed charge and a cost per transaction. In addition to these contract costs, payments to BT in 2015/16 also included:

- £2.8 million paid to BT for a hardware refresh which was agreed as part of the new maintenance contract
- £0.6 million towards achieving compliance with Payment Card Industry Data Security Standard (PCI DSS) banking requirements which is required to be achieved by September 2016. Action continues to be taken to meet this key date.

31. The Statement of Financial Position at 31 March 2016 shows net liabilities of £2.5 million compared to a net assets position of

£6.4 million in 2014/15. This negative position is largely attributable to the requirement to account for activities on an accruals basis, whilst recording funding from the Scottish Government on a cash basis.

32. The Statement of Changes in Taxpayers' Equity in the financial statements shows that Disclosure Scotland returned £11.7 million to the Scottish Government, compared to cash draw down of £1.8 million in 2014/15.

33. In the 2014/15 annual report and accounts, Disclosure Scotland referred to the award of a new care and maintenance contract to ATOS IT Services UK Ltd. The transfer of the service did not take place as planned and the existing service contract with BT was continued until 31 March 2015, with a new care and maintenance contract with BT commencing on 1 April 2015. Legal proceedings, initiated by Disclosure Scotland, are now underway in relation to the termination and we are satisfied that the disclosures made in note 19 in the financial statements are adequate in relation to this.

Financial Planning

34. As a result of policy changes by the UK Government in 2014, from January 2017, Disclosure Scotland will transfer the processing of all Basic disclosures in England and Wales to the Disclosure Barring Service. This transfer will result in a loss of up to 90% of the basic disclosure market and will have a considerable impact of the financial resources of the organisation.

35. As a consequence of this change, management are reviewing a range of scenarios for the future funding of the organisation as part of the overall transformation of the business (see paragraphs 80 – 100). Any change in the funding regime will, however, need the agreement of Scottish Ministers. Based on the current funding arrangements and future projections of activity, a shortfall of around £10.4 million in 2017/18 is anticipated. It is essential that timely funding decisions are taken to ensure the financial sustainability of Disclosure Scotland. Until the future funding model is formally agreed, it remains a significant risk to the ongoing financial sustainability of the organisation.

Refer action plan no 2

Financial management

36. 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
- audit and risk committee members provide a good level of challenge and question significant variances.

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

38. 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.

39. Based on our accumulated knowledge, our review of Senior Management Team meeting papers and through our attendance at the Audit and Risk Committee we conclude that Disclosure Scotland has strong financial management arrangements in place.

2016/17 budget

40. The 2016/17 Departmental Expenditure Limit from the Scottish Government is £0.9 million, with a further £1 million expected to cover the cost of free checks. This initial allocation consists of

- £0.3 million non-cash Resource DEL to cover depreciation costs and the statutory audit fee
- £2.5 million excess of income over expenditure to meet other costs
- £3.1 million to cover anticipated capital spend.

41. Management have forecast an operational year end surplus of £0.5 million and continue to manage the financial position going forwards.

Workforce Management

42. We have previously acknowledged that the deployment of agency staff is part of the workforce strategy to address resource requirements over a short-term planning horizon. This approach should ensure that the impact on permanent staff will be minimised when the delegation to produce English and Welsh basic disclosures ends whilst maintaining manageable levels of overtime to meet any surges in demand. The 2015/16 financial statements record that the costs of agency staff increased by 79% when compared to 2014/15.

43. Payments to contractors engaged by Disclosure Scotland increased by 27% in 2015/16, from £1.010 million in 2014/15 to £1.288 million (from £314,000 in 2013/14). 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.

44. As part of our 2015/16 audit work, we undertook a follow up review of the recommendations made in Audit Scotland's national report on *Scotland's Public Sector Workforce (November 2013).* The matters arising were reported to the Audit and Risk Committee in May 2016. The matters included:

- the content and format of the action plan should be reviewed and finalised
- succession planning for staff in key positions and/or leadership positions should be developed
- the plan focuses on the next 12 month period; the plan should include consideration of the medium to longer term
- no departmental plans have been developed, only the organisation wide plan.

45. We have been advised by management that a revised and updated workforce plan has been presented to the board which has taken account of the matters raised.

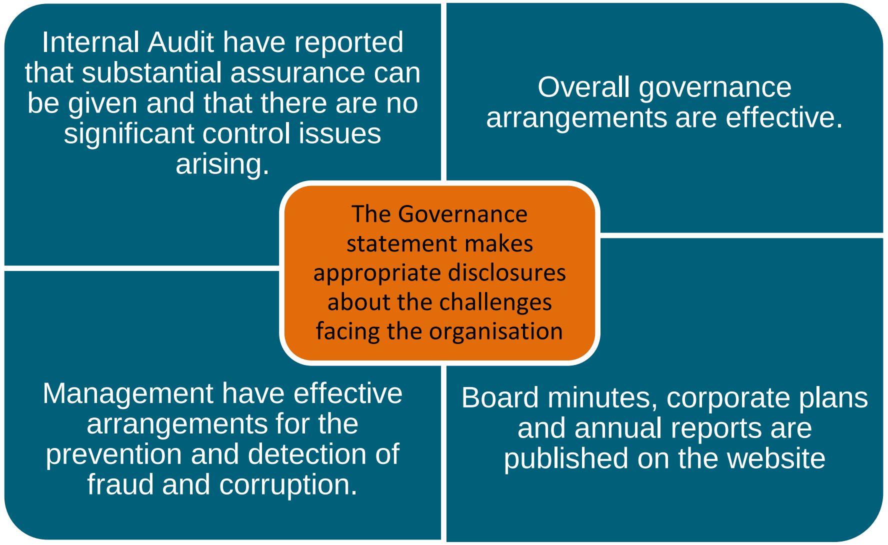
46. The transformation programme together with various other ongoing issues, has had an impact on the capacity of Disclosure Scotland staff, particularly senior management. We are also aware of the significant and varied problems and issues faced by the organisation over the last few years in relation to the operation of the PVG system. With only a limited number of people available to undertake key tasks the potential for overload is evident. This has been reported in the Governance Statement for both 2015/16 but also for the previous years. This will continue to be a significant challenge for the organisation as it delivers the transformation programme.

Refer action plan no 3

47. There have been a number of changes within the workforce. The previous Chief Executive and Accountable Officer retired in December 2015 and was replaced by David Wallace (previously Chief Executive of Student Awards Agency, Scotland); there was a short handover period. A new Director of Corporate Services was also appointed in summer 2015 following the resignation of the previous incumbent. In addition, over 80 staff transferred into the organisation under TUPE regulations following the in house transfer of validating the identity of applicants and the receiving and handling of payments.

48. In addition, one member of the board retired and two new members (one an independent adviser) were appointed to the ARC. As a consequence of the changes in executive and non-executive members, there has been a loss of knowledge during this period of change. We are also aware that the current Chief Executive is due to leave the organisation in September 2016. There will be a short handover period with the incoming Chief Executive.

Governance and transparency



Corporate governance

49. The corporate governance arrangements for Disclosure Scotland are set out in the agency's Framework Document. This was approved by ministers in 2015 and is revised at least every 3 years.

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

51. The Disclosure Scotland Board operates in an advisory capacity to support the Chief Executive in the setting the strategic direction of the organisation to ensure that it fulfils the objectives of Scottish Ministers; for monitoring performance; and for assessing the risk management and internal control arrangements. The Board meets monthly.

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

53. The 2015/16 ARC annual report refers to a number of challenges facing the organisation These matters have been reflected in the governance statement included within the annual report and accounts.

54. The ARC met five times during 2015/16. Two new members were appointed in October 2015 replacing 3 former members. Based on our attendance at the committee meetings, we are satisfied that the members provide an effective challenge to management.

55. Following discussions with non-executive members and based on our review of the transformation programme, we are aware that there have been occasions where non-executive members on the transformation programme board felt that their expertise and advice was not being taken forward by management. We are pleased to note that the recent change in leadership of the organisation is

changing this culture, and relevant expertise and advice is now being actively sought from board members.

56. 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.

57. 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 the issues raised have been adequately reflected within the governance statement.

58. We have reviewed the 2015/16 governance statement and consider that it has been fairly stated and reflects management's responsibilities and processes by which the assurances on the system on internal control are obtained.

59. We concluded that Disclosure Scotland has effective overarching and supporting governance arrangements which provide an appropriate framework for organisational decision making.

Transparency

60. The Annual Report 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.

61. A range of other information, for example corporate and business plans and governance structures are available for public review on the website.

62. Overall we concluded that Disclosure Scotland adequately complies with the principles of openness and transparency. Improvements have been made during 2015/16 with Board minutes now being published and it is anticipated that Audit and Risk Committee minutes will also be made available going forward.

Internal control

63. As part of our 2015/16 audit we reviewed and tested the operation of a number of key internal controls within Disclosure Scotland's main financial systems to establish whether they provide adequate assurance to support the preparation of the financial statements. We reviewed the key controls identified in the accounts receivable, banking, general ledger, accounts payable and payroll systems.

64. We reported our findings in May 2016 and noted that following the transfer of finance functions from BT to Disclosure Scotland on 1 April 2015, at the time of our audit review only one month’s income had been fully reconciled to the underlying transactions. The reconciliation of cash received to the underlying transactions is an essential element of the control process and provides

management with assurance over the completeness and accuracy of the income collection and debtors systems.

65. I am pleased to record that management responded positively to the issue raised and full reconciliations were provided for audit review in July 2016. I have however recommended that these processes and procedures become fully embedded and are undertaken on a regular basis. It is also essential that the underlying procedure notes are finalised and maintained. (this matter was also raised in our interim report)

Refer action plan no 1

66. We are now able to conclude that there are no material weaknesses in the accounting and internal control systems which we have identified that 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.

Internal audit

67. Internal audit provides the ARC and Accountable Officer with independent assurance on the overall risk management, internal control and corporate governance processes. We are required by international auditing standards to make an assessment of internal audit to determine the extent to which we can place reliance on its work.

68. As part of our risk assessment and planning process, our Scottish Government audit team assessed the Scottish Government Internal Audit Division, Disclosure Scotland's internal auditors, and concluded that they operate in accordance with the Public Sector Internal Audit Standards (PSIAS). This enabled us to place reliance on the work of internal audit, in terms of our wider code responsibilities.

69. We have also reviewed the annual report provided by the Scottish Government Internal Audit Division which was presented to the ARC in July 2016. They have provided substantial assurance and in their opinion Disclosure Scotland's controls are robust and well-managed.

70. 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.

71. 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 2015 to 31 March 2016. Exceptions were noted in relation to the controls in operation over payroll amendments, travel claim form authorisation and the checking of travel management and expense claims. 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

72. Disclosure Scotland is responsible for establishing arrangements to prevent and detect fraud and other irregularity. We reviewed these arrangements and have concluded that there are effective arrangements for the prevention and detection of fraud.

National Fraud Initiative in Scotland

73. Disclosure Scotland participates in the National Fraud Initiative (NFI) through the Scottish Government Payroll Division. The NFI uses electronic data analysis techniques to compare information held on individuals by different public sector bodies and different financial systems, to identify data matches that might indicate the existence of fraud or error.

74. The Scottish Government does not hold a separate record of data matches relating specifically to Disclosure Scotland and no data matches have been notified to management for follow up.

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

75. 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. We consider whether bodies have adequate arrangements in place and have concluded that appropriate arrangements exist within Disclosure Scotland.

76. There were no instances of fraud or corruption reported by Disclosure Scotland in 2015/16.

Best Value

Local performance audit work

Review of Transformation Programme

77. Accountable officers have a specific responsibility to ensure that arrangements have been made to secure best value. The Auditor General may require that auditors consider whether accountable officers have put in place appropriate arrangements to satisfy their duty of best value. Where no requirements are specified for auditors in a period they may, in conjunction with their audited bodies, agree to undertake local work in this area.

78. We reported in our 2015/16 Annual Audit Plan of our continuing interest in Disclosure Scotland's management of ICT contracts and the progress of its wider transformation programme. Therefore, as part of our 2015/16 audit work, we undertook a high level review of the management controls, progress and costs of the transformation programme.

79. In recognition of the need to replace the original BT partnership agreement on expiry, general technology advances and the need to review the entire functional design of the organisation, Disclosure Scotland embarked on a transformation programme in 2012/13 which continues to progress.

Background

80. Disclosure Scotland is facing a number of significant changes to demand for its services:

- basic disclosure checks for England and Wales will move from Disclosure Scotland to the Home Office's Disclosure and Barring Service on 1 January 2017
- retrospective checking of the existing regulated workforce is expected to be completed in 2017/18.

81. These two changes will result in a 68% reduction in activity in 2017/18 compared to 2014/15 and a reduction of income of around £28 million each year from 2017/18.

82. At the same time, Disclosure Scotland must renew its IT system. Disclosure Scotland's core technology platform is inefficient, expensive to maintain and poses a significant operational risk as the infrastructure and software are reaching obsolescence.

83. The transformation programme was designed to address these matters and has been taken forward by Disclosure Scotland in two phases:

- **Phase 1**: to replace the profit-sharing PPP contract with BT with a care and maintenance contract for the PVG system, and bring in-house a range of functions performed by BT.
- **Phase 2:** to develop a new rationalised, flexible IT system that meets the needs of the customer and provides a 'digital first' service. Significant investment in the core technology platform is required for Phase 2.

Phase 1 encountered difficulties

84. Disclosure Scotland awarded a new contract for the care and maintenance of the PVG system to ATOS IT Services UK Ltd in May 2014 to deliver Phase 1. 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 reviewed the evidence in support of this action in 2014/15 and were able to confirm that there was a sound basis for these business decisions. However, as noted previously, Disclosure Scotland is currently in legal dispute with ATOS.

85. Phase 1 was formally concluded in March 2015. While there were a number of issues identified with the transfer of the revised contract, these have largely now been addressed. In addition, savings in excess of £10m have been achieved when compared to the previous partnership agreement.

86. Management have had to work with BT to ensure the system software and hardware has remained fit for purpose. We have referred to the additional costs incurred at paragraph 30 above. Management have advised that the system is working effectively although the full compliance with PCI-DSS standards remains to be resolved.

Disclosure Scotland has significantly changed the approach for Phase 2

87. In recognition of the issues encountered in Phase 1, in November 2014 Disclosure Scotland decided to accelerate Phase 2 of the transformation programme.

88. Consultants were engaged to produce the Outline Business Case for Phase 2 (OBC1) which was presented to Scottish Ministers in June 2015. However, while the strategic case was accepted, OBC1 was referred back to Disclosure Scotland to identify a more affordable option. A revised business case was submitted and approved by Ministers in October 2015. The costs were substantially lower than the original version and were as a direct result of using market-insight to gather intelligence and to provide a reduced optimism bias and cost base. In accordance with HM Treasury guidance, optimism bias is included to allow for uncertainty in assumptions. Optimism bias tends to be higher at the start when less is certain about the programme requirements. Management consider that the revised OBC is more reflective of the current situation.

89. Following ministerial approval, Disclosure Scotland embarked on a procurement exercise to procure the new IT system. However due to concerns around the future programme, independent consultants were appointed and asked to review Disclosure Scotland's approach and make recommendations for the future.

90. The consultants concluded that the risk of overall programme failure was high and that as Disclosure Scotland could not clearly define its

requirements for a new IT system, it would likely end up with a system that did not meet its future needs. In addition, they commented that Disclosure Scotland's delivery and procurement approach were not detailed enough and there were key gaps in the capacity and capability of the transformation team.

91. As a consequence of this review and following advice from procurement and digital colleagues in Scottish Government, Disclosure Scotland decided to cancel the procurement exercise and the Invitation to Tender which had been issued in May 2016 was subsequently withdrawn.

Disclosure Scotland has faced the same challenges for a number of years

92. The challenges of achieving tight timescales and issues around staff capacity and capability have been flagged in a number of Gateway Reviews undertaken since May 2013. Similar matters were also discussed at the Senior Management Team (SMT) meetings and Transformation Programme Board (TP Board) meetings.

93. The drive to meet the timescales has had an impact on the decision making. For example, the original procurement strategy for OBC2 had to be revised as there was not enough time to deliver the original approach. The Delivery Strategy had recommended multiple procurements but due to time constraints, Disclosure Scotland considered that a single procurement with multiple lots was the only option. *(source: October and November Transformation Programme Board meeting minutes).*

Delivery of Phase 2 remains at risk

94. Following the independent review and advice from Scottish Government, Disclosure Scotland is now applying an 'Agile' approach to the delivery of the new IT system. Agile delivery is where prototypes are developed, procured, tested and changed in a staged approach. We consider that this decision to adopt an agile approach is in line with the Scottish Government Digital strategy. Senior management showed clear leadership in making the decision to change the approach. However, key risks remain particularly in relation to governance and scrutiny.

Refer action plan no 4

95. Disclosure Scotland's corporate risk register records significant risks in relation to the transformation programme. For example, risks have been identified around the time pressures of the procurement and delivery of the new IT platform and insufficient management capability and capacity to support present and forthcoming critical projects.

96. Demands on staff are significant and the application of agile will require a change of culture and governance for Disclosure Scotland. Disclosure Scotland has no experience of agile working and is being assisted by the Scottish Government's Digital Directorate which is providing some resource on a part-time and temporary basis. Management and officers appear to be committed to an agile approach at this early stage.

97. We have already referred to the difficulties of recruiting and retaining quality technical support and several recruitment

campaigns have failed to attract appropriate candidates. This is likely to remain a risk going forward. Disclosure Scotland is starting to address the problems of skill shortages in different ways. It is engaging with a number of public bodies (including Accountant in Bankruptcy, NHS Education for Scotland and Student Awards Agency for Scotland) which have experience of agile working to learn lessons and inform its agile approach. It is also training up its own staff in agile working.

Refer action plan no 5

98. The end of the BT contract in March 2018 remains an 'end date' for the Transformation Programme. Although Disclosure Scotland has suggested that there may be room to extend this slightly, the technical assessment of the current IT system highlighted that it is not forecast to last much past this date. There remains a real risk that the transformation programme is further delayed and the IT infrastructure cannot continue to support service delivery.

Refer action plan no 6

99. Given the on-going risks involved in delivering Phase 2 of the transformation programme and the uncertainty about its future funding, we plan to continue to monitor Disclosure Scotland's progress. While the change of approach to delivering the transformation programme is being embraced across the organisation as a positive move, it is still at an early stage. Disclosure Scotland continues to face significant risks in delivering the programme successfully in the time available.

Performance management

100. 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.

101. As recorded in the Performance Report, Disclosure Scotland received over 1.7 million applications in 2015/16. This represented an overall increase of 9% from the previous year. Within that there was a 13% increase in the number of basic disclosures to 1.4 million.

102. One of Disclosure Scotland's key organisational aims is to meet its public performance target (to produce 90% of all types of disclosure within 14 calendar days) and continuously improve the quality and efficiency of the service delivered. The Performance Report records that 99.8% of applications received were processed within 14 calendar days (2014/15: 92%); the average processing time was 4.7 days (2014/15: 5.8 days). This is a very good performance during a period of continuous change.

Performance audit reports

103. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2015/16, a number of reports were issued as outlined in Appendix III.

Appendix I: Significant audit risks

The table below sets out the audit risks we identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

Audit Risk	Assurance procedure	Results and conclusions
Risk of material misstatement		
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.	• We conducted detailed testing of journal entries. • We reviewed accounting estimates used to compile the financial statements. • We considered whether there were any significant transactions that are outside the normal course of business. • We reviewed internal audit opinion on the control environment. • There are a range of measures in place to prevent and detect fraud, including a Code of Conduct and whistleblowing and fraud policies.	• Detailed testing of journal entries was satisfactory. • There was no evidence of bias applied to the accounting estimates. • Analytical review of income and expenditure highlighted no unexplained issues. • Our review of working papers indicated that there were no significant transactions that were outside the normal course of business. All testing proved satisfactory. There were no issues arising from this review.

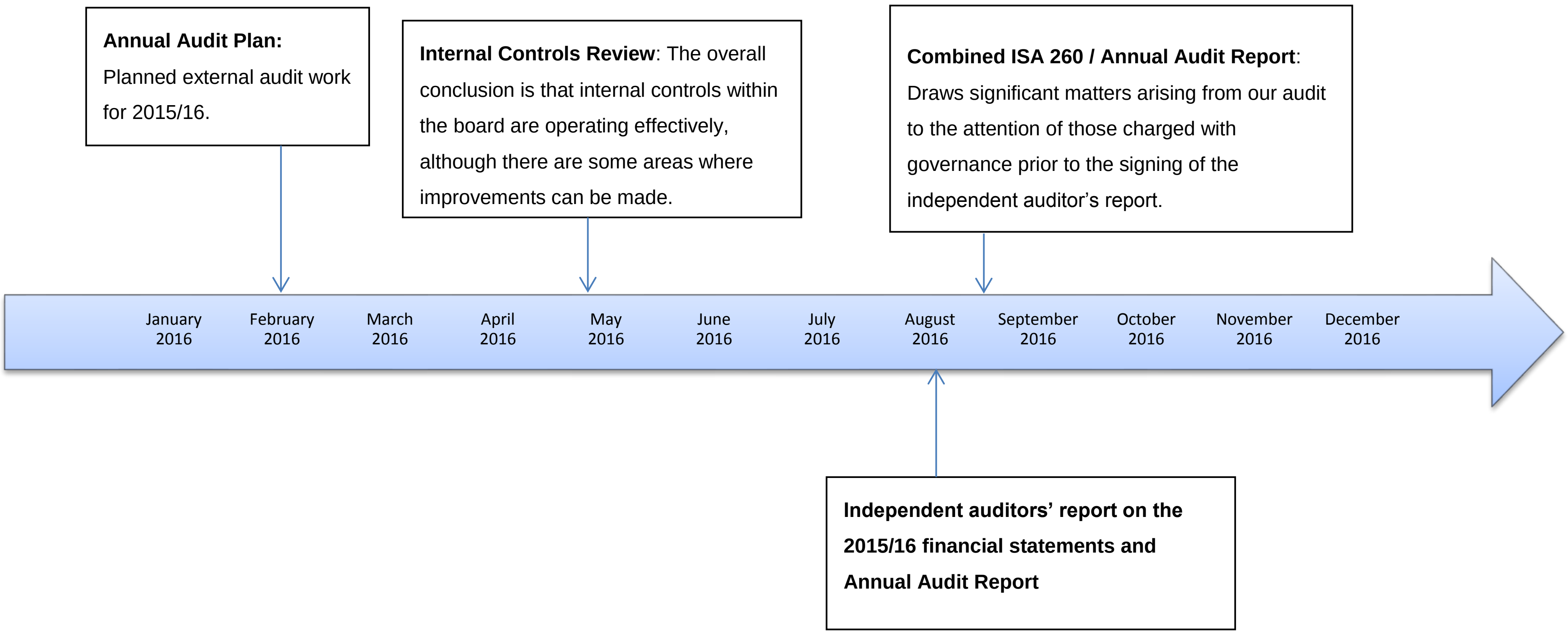
Audit Risk	Assurance procedure	Results and conclusions
Fraud: income recognition Income from external sources can present a risk of fraud. Disclosure Scotland receives a significant amount of its income from third parties. The extent and complexity of income means there is an inherent risk of fraud in 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. • Effective budgetary control by management. • There are a range of measures in place to prevent and detect fraud, including a Code of Conduct and whistleblowing and fraud policies.	• We raised some matters in relation to the bank reconciliations which we followed up at the year-end audit. Those concerns have been adequately addressed. • We undertook substantive testing of income and trade receivables. • We reviewed budgetary processes and fraud policies as part of our high level governance review and found no matters which required reporting to management. All testing proved satisfactory. There were no further issues arising from this review apart from the need to embed the bank reconciliation processes and finalise operating procedures.

Audit Risk	Assurance procedure	Results and conclusions
Income/Cash received There continues to be a difference between income received, cash recorded in the bank and trades receivables. Bank reconciliations have not been fully developed and there remain issues with the identification of balancing transactions. A fully reconciled bank balance is required as part of the ongoing management control of the operation. There is a risk that income may be misstated in the financial statements. There is a risk that the financial statements may be qualified if the balancing items have not been fully reviewed and identified.	• We reviewed the reconciliations prepared by the finance team and investigated the differences. • We reviewed the procedures.	• We reviewed the bank reconciliation process. • We raised some matters in relation to the bank reconciliations which we followed up at the year-end audit. Those concerns have been adequately addressed. We have also commented on the processes in this final report. • We undertook substantive testing of income and trade receivables. • Internal Audit have provided a substantial assurance on the follow up work in this area meaning 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 conclusions
FReM revision The 2015/16 FReM includes significant changes to the form and content of the annual report and accounts. There is a risk that Disclosure Scotland's 2015/16 draft financial statements do not reflect the revised FReM requirements.	• A paper has been prepared by the Director of Corporate Services outlining the scope of change was considered. This was circulated to senior management and the corporate governance team. • We reviewed compliance with the updated FREM as part of our year end audit.	We are satisfied that the Annual Report is in accordance with FReM requirements.
Protecting Vulnerable Groups (PVG) system The transformation programme includes the procurement of a replacement PVG system. In addition, the award in 2014 of the new care and maintenance contract did not progress as planned, resulting in a legal dispute. A new maintenance contract with BT commenced in April 2015. Disclosure Scotland also featured in the Audit Scotland national study where we reported our intention to 'consider the risks and challenges of replacing the BT service contract'.	• We undertook a review of the progress of the transformation programme. • Discussions were held with officers and non-executive members. • We reviewed the background information for example, minutes of transformation board meetings, business cases etc.	The outcome of this review is recorded in the main body of this report. (para 77 onwards) A number of risks have been identified as part of this work.

Audit Risk	Assurance procedure	Results and conclusions
Workforce There have been a number of changes within the workforce over the past year. There is a risk that there has been a loss of expertise within the organisation particularly at this time of change. In addition, the impact of the transformation programme may impact more generally on staff well-being and security.	• We considered the findings of the internal audit review of workforce planning. • We followed up on the recommendations made in the Audit Scotland national report.	• We raised a number of risks as part of our interim audit work. • We have been given assurance that the workforce plan has now been completed and approved.
Cyber attack Over the past year several public sector organisations have been victims of cyber-attacks and related activities. There is a risk that should Disclosure Scotland not respond to such attacks this could result in disruption to services and to financial penalties.	• We considered the findings of the internal audit follow up review on Information Governance. • We completed the cyber attack readiness questionnaire.	• Some weaknesses were reported in our interim management letter. Management provided appropriate responses and are taking action. We have been given assurances that they have now been addressed by management.

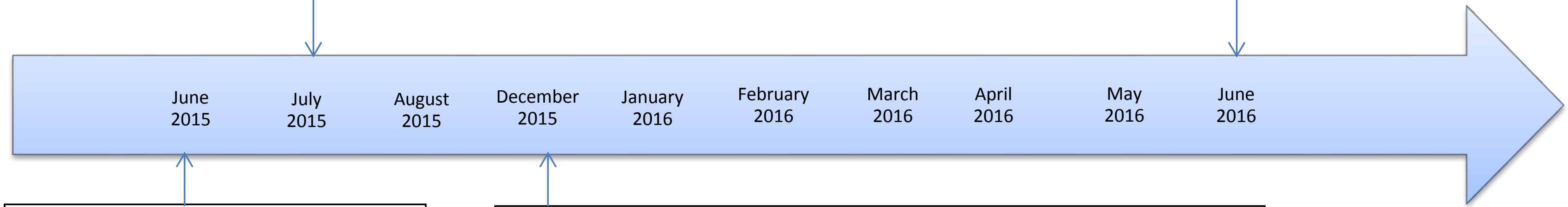
Appendix II: Summary of local audit reports 2015/16



Appendix III: Summary of Audit Scotland national reports 2015/16

Renewable energy – Impact report (published July 2015) - This report summarised the impact of the Audit Scotland report on Renewable energy originally published on 12 September 2013.

The National Fraud Initiative in Scotland: The National Fraud Initiative (NFI) makes a significant contribution to the security and transparency of public sector finances by confirming that services are provided to the correct people and by reducing fraud and error.



Managing ICT contracts in central government: an update (published June 2015) - This report reviewed the progress that the Scottish Government and central government bodies had made against the recommendations in our previous report on managing ICT contracts.

Implementing the Scotland Act 2012 – an update (published December 2015) - This report assessed how effectively Revenue Scotland implemented, and is collecting, the two devolved taxes introduced in April 2015. It also examined how the Scottish Government is working with HM Revenue and Customs to prepare to introduce the Scottish rate of income tax in April 2016, and looked at how the Scottish Government is developing its financial management and reporting.

Appendix IV: Action plan

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
1.	22/65	***Issue.*** Bank reconciliations matched to the underlying income transactions were not undertaken timeously. Procedures have not yet been fully updated. ***Risk.*** There is a risk that income is not fully recorded and that the financial statements are misstated. There is also a risk that the audit opinion on the financial statements is modified if these reconciliations remain incomplete. There is a risk that due to the absence of procedures and the continuing reliance on temporary staff in the reconciliation process that there is no assurance that the income received agrees to the services delivered. ***Recommendation.*** Reconciliations should be undertaken timeously. Procedures should be finalised for the preparation of the reconciliations and should become embedded in everyday practice.	Agreed. Reconciliation is being fine-tuned and we are automating manual interventions where we can. The procedures are nearing finalisation and we will continue to review as processes are updated.	Head of Finance Procedures finalised and signed-off by end Oct 2016.

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
2	35	***Issue.*** The reduction in basic disclosure applications being processed means that there will be a reduction in fee income. A future funding strategy has yet to be agreed. ***Risk.*** There is a risk that the current uncertainty over the future funding strategy impacts on future business requirements. ***Recommendation.*** Longer term financial planning should be addressed going forwards. The revised funding strategy should be agreed as soon as practicable in order to ensure the financial sustainability of the organisation going forwards.	Agreed. Progress has been made. We are working towards a proposal that will meet our requirements in regard to a balanced budget over the longer-term planning horizon.	Director of Corporate Services Completed by end Dec 16 (as part of the agreed Spending Review (SR) 16) being conducted by Scottish Government

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
3.	46	***Issue.*** Staff capacity has been adversely affected by the significant workload as a result of the pressures of the transformation programme and the ongoing legal dispute. Staff well-being may also be affected. ***Risk.*** There is a risk that staff absence and turnover increases and affects operational performance. There is also a risk that the progress of the transformation programme in particular is affected by the continuing and increasing pressure to address significant issues within a very tight timescale. ***Recommendation.*** Management should continue to review the timescales and milestones relating to the transformation programme to ensure they are realistic and are not placing undue pressure on staff to achieve.	Organisation-wide. Staff capacity and output requirements are subject to on-going monitoring across all Directorates and are given added focus at Senior Leader / Management Team and the Workforce Planning Group. We have also recruited a full-time HR professional advisor to ensure that interventions remain appropriate. The holistic situation is being managed proactively and is kept in view on our Corporate Risk Register. Programme The Programme has changed delivery direction and pursuing a more iterative approach i.e. Discovery/Alpha/Beta. The resourcing plan for the programme is currently being adjusted to reflect this revised approach and will continue to be refined through each iteration. Alternative resourcing models are being explored and in-particular greater core business involvement via internal Product Owners and Subject Matter Experts. We are also looking at options for flexible client-side support.	Across all Directorates On-going Programme Director Revised plan and delivery strategy will be available by end December 2016 and thereafter subject to on-going review.

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
4	94	***Issue.*** The adoption of an agile approach could also pose additional governance and scrutiny challenges. An agile approach is different to a traditional procurement and programme approach and changes to governance may be needed. ***Risk.*** There is a risk that governance and scrutiny challenge is affected by the move to agile working. ***Recommendation.*** Disclosure Scotland will have to consider how to ensure appropriate levels of governance and scrutiny over the transformation programme using the new agile approach.	Agreed. Programme Scope and Approach will be reviewed by Board on 31/08/2016. Revised Governance model is being developed and as part of this process we are consulting other Government Agencies to share experiences, e.g. NHS NES, AiB and CICA. The proposed Governance model will be presented to the Transformation Programme Board for consideration & agreement and thereafter taken to Board for approval.	Programme Director Approved Governance model in place by end October 2016

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
5.	97	***Issue.*** The usage and related cost of using contractors and consultants to provide the necessary expertise for its transformation programme continues to increase. Several recruitment campaigns have failed to attract appropriate candidates. ***Risk.*** The transformation programme is unable to progress due to the absence of skills and expertise. ***Recommendation.*** Management should continue to work with partners who have experience of agile working to learn lessons and inform its agile approach. Staff should be appropriately trained and developed as quickly as possible in order to progress the programme.	Agreed. The number of contractors working in the programme over the last 3 months has significantly reduced and as a result approximately £200k of savings have been delivered so far in 2016/17. Alternative resourcing models are presently being explored. The programme has made a significant investment in agile training. Our Business Change Manager has attended a week-long certified course, 'Scrum Master & Product Owner'. For August 2016 a one day agile overview for the DS programme team and senior managers are taking place. Additionally two staff will attend a NHS 'introduction to agile' course during the latter part of August 2016.	Programme Director Essential training activities to be completed by end December 2016

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
6.	98	***Issue.*** The current contract is due to end in March 2018. The current IT system has been fully written down in the financial statements as it has been assessed as largely obsolete and is unlikely to remain operational much longer. ***Risk.*** There is a risk that if the new IT project is further delayed, the current IT system will be unable to continue functioning effectively. ***Recommendation.*** Action should be taken to ensure that the IT system can continue to operate effectively should the expected end date require to be extended further.	Agreed. DS support staff will continue to work closely with BT to monitor system stability over the contract period. At the end of March 2016 we completed the agreed technology re-fresh programme with BT. Further changes to the PVG system are being tightly controlled and a major Service Release (SR13) is planned for early September 2016. This should ensure that current system defects are addressed.	Programme Director On-going and to be kept in view on ARC tracker