Care Inspectorate

External Audit Annual Report to the Accountable Officer and the Auditor General for Scotland

2016/17 Financial Year

28 September 2017

Contents

Summary of our audit plan:

Materiality has been updated based on the unaudited 2016/17 financial statements to £399,000 (1% of gross 2016/17 expenditure).

Performance materiality is £259,000 and we have reported to management everything identified over £3,990 (1% of materiality, which is how we calculated trivial).

Audit risks were: management override of controls; risk of fraud in revenue recognition; and completeness of operating expenditure (Public Sector Practice Note 10)

We have applied the smaller body exemption as set out in the Code of Audit Practice and have therefore focused on going concern, and financial sustainability.

We can confirm we are independent of the Care Inspectorate and our objectivity is not compromised in accordance with International standards on Auditing (UK & Ireland) and APB ethical standards for Auditors. No non-audit services have been provided to Care Inspectorate in 2016/17. Our audit fee as set out in the audit plan remains unchanged at £31,380.

Key Messages

We have issued an unqualified opinion on:

- True and fair view of the financial statements
- Regularity
- Other prescribed matters.

This report is a summary of our findings from our external audit work for the financial year ended March 2017. Our work has been undertaken in accordance with International Standards on Auditing (UK & Ireland) and the Code of Audit Practice (2016).

Our report is addressed to the Accountable Officer (in their role as Chief Executive and therefore charged with governance) and the Auditor General for Scotland. This report will be published on the Audit Scotland website at: www.audit-scotland.gov.uk

This report has been discussed and agreed with management and presented to the Audit Committee on 21 September 2017 alongside the final audited annual report and accounts. Our report and the final accounts will be considered at the Board on 28 September 2017.

We would like to thank management and staff for their co-operation and assistance throughout our audit work.

Our work included:

- An audit of the 2016/17 financial statements
- A review of the Performance Report and Accountability Report, including the Governance Statement and Remuneration Report
- Completion of an EU Funding data return and Role of the Board's return which were submitted to Audit Scotland to inform a future performance study
- Completion of the National Fraud Initiative (NFI) return and review of data matching progress

Overall an efficient audit process was achieved, with a very good draft annual report and accounts received in line with our agreed timetable. The accounts were supported by good working papers for audit purposes and our queries were answered quickly. The shared finance function between Care Inspectorate and Scottish Social Services Council (SSSC) who we are also the appointed external auditors for, meant that the two sets of accounts were consistent and good practices shared across the two organisations.

We set out in our audit plan that Care Inspectorate fell under the smaller body classification in the Code of Audit Practice and therefore the wider scope audit requirements do not apply. This has not changed.

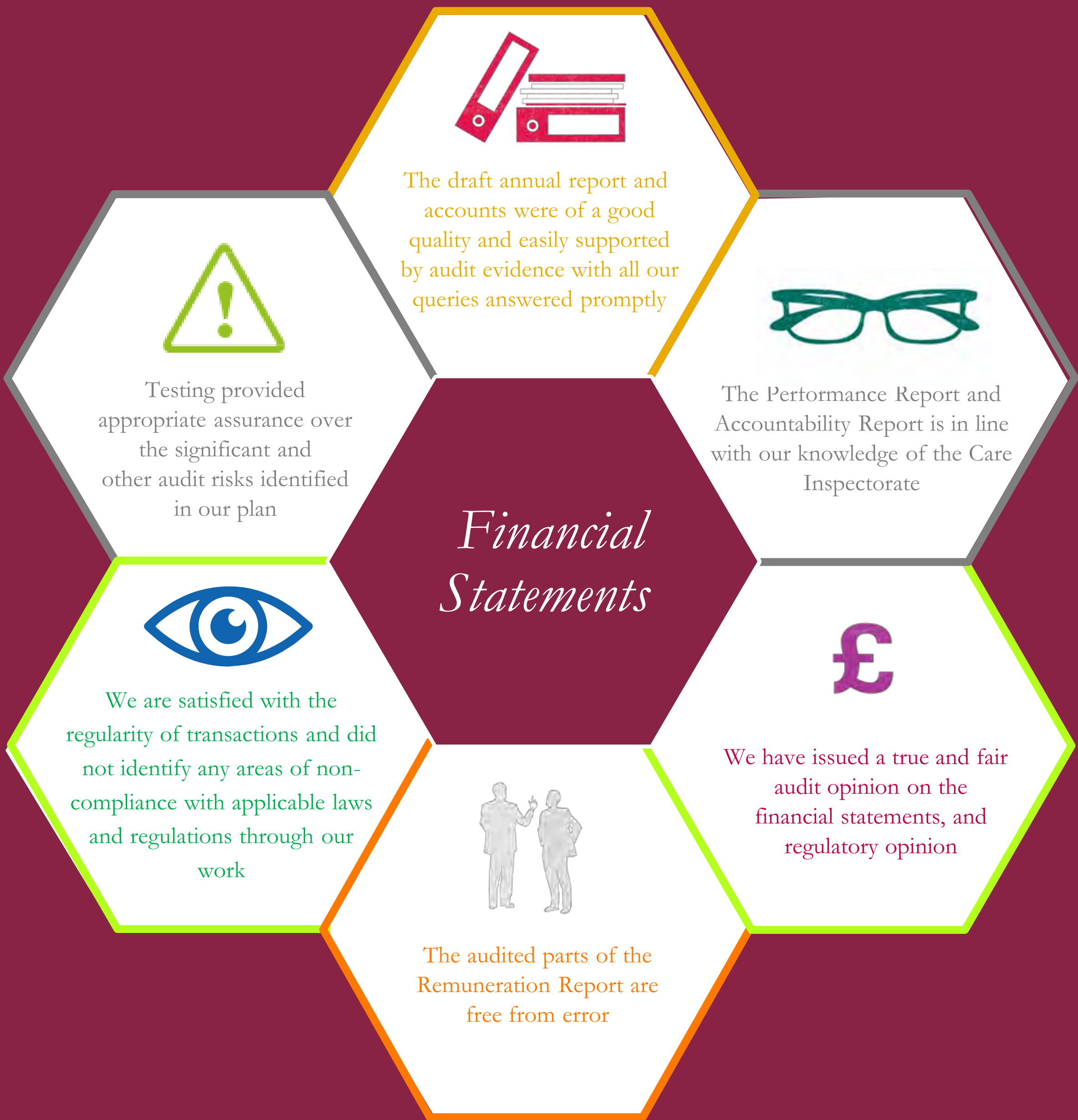
However, as set out in the Code of Audit Practice we have commented on Care Inspectorate's going concern arrangements and future financial sustainability; as well as certain aspects of Care Inspectorate's organisational arrangements.

A significant proportion of the Care Inspectorate costs are staff costs (circa 75%) and although staff restructuring has taken place, future options for this are potentially more limited. The approved budget for 2017/18 was a balanced budget. However, based on the indicative financial planning from 2018/19 onwards it is more difficult to achieve a balanced position and there are a number of variables (income and expenditure) which could have a significant impact on the Care Inspectorates medium term financial planning.

For and on behalf of Grant Thornton UK LLP

28 September 2017.

The Financial Statements Audit



Our audit plan was presented to the Audit Committee on 10 March 2017. We have not altered our planned audit approach as set out in the plan. However, we have updated our final materiality figures based on the unaudited 2016/17 annual report accounts. Our planned materiality was £385,880 which we subsequently updated to £399,000 taking 1% of unaudited gross expenditure.

Our audit work commenced on-site on 3 July 2017 following a planning visit we completed in December 2016. We received the draft annual report and accounts within the agreed audit timetable.

We believe we have built up good working relationships with Management and the finance team and this has ensured a good audit process.

The annual reports and accounts are prepared by Management during May/early June and our audit work takes place in July. However, the annual report and accounts are not signed until end of September. Therefore, there is scope to move this timetable to allow the audited accounts to be submitted to the Scottish Government earlier. **See Action Point 1.**

Appendix 1 shows there are no uncorrected adjustments affecting the primary statements.

We have made a number of recommended disclosure changes, which management have made to ensure compliance with the FReM and relevant accounting standards. None of these were considered material or significant in nature.

We have not found any potential audit adjustments above £3,990 (trivial) which we need to bring to your attention.

Internal Audit

As set out in our plan we have not placed formal reliance on the work of Internal Audit during 2016/17. Internal Audit is provided to Care Inspectorate by an outsourced provider, Scott Moncrieff. The overall input by internal audit is focused on key areas of control and is risk based. The plan is reflective of the risks facing Care Inspectorate and subject to detailed discussion at the Audit Committee before approval.

Internal Audit's annual opinion for 2016/17 was *"In our opinion Care Inspectorate has a framework of controls in place that provides reasonable assurance regarding the organisations governance framework, effective and efficient achievement of objectives and the management of key risks, and proper arrangements to promote value for money and deliver best value"*

The findings of internal audit do not disagree with our knowledge and understanding of Care Inspectorate as an organisation and its risk profile. Internal Audit provide assurances to management and the Audit Committee that their services are Public Sector Internal Audit Standards (PSIAS).

From attending the Audit Committee we have evidenced that the Committee take the findings of internal audit seriously and there is a good dialogue between internal audit, management and the Committee.

Internal Control Environment

During the year we have sought to understand Care Inspectorate's overall control environment as related to the Annual Report and Accounts. In particular we have:

- Considered procedures and controls around related parties, journal entries and other key entity level controls
- Performed walkthrough procedures on key controls and the identified risk areas in particular revenue, and expenditure.
- Understood the Care Inspectorate Controls in place in relation to SEAS the Scottish Government financial systems operated on their behalf.

No material weaknesses in the accounting and internal control systems were identified during the audit which could have an adverse impact on Care Inspectorate's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

In accordance with ISA 260, we are required to report to those charged with governance the main issues arising from our audit of the Annual Report and Accounts. This report discharges our obligations under ISA 260.

Our identified audit risks

Audit plan identified risk and work completed	Our conclusion
Management override of controls Under ISA (UK&I) 240 there is presumed risk that the risk of management over-ride of controls is present in all entities (fraud risk). **Work undertaken:** Completed a walkthrough of the controls and procedures in place around journal entries. Reviewed the key accounting estimates, judgements and decisions made by management. Tested journal entries with a focus on large and/or unusual values; posting sources; unexpected and unusual timing of journals, as identified using our IDEA data analysis software. Reviewed unusual and/or significant transactions.	**Key accounting estimates/judgements:** Given the nature of Care Inspectorate's activities, the key accounting estimate is the bad debt provision. We have reviewed debt outstanding at the year end for recoverability. We are satisfied that the bad debt provision is appropriate, and debt is recoverable. **Journal Entry Testing:** We made inquiries of those members of staff who can post and authorise journals related to inappropriate or unusual activity with no concerns noted. We confirmed completeness of journals during the year, and targeted large and/or unusual journals. We noted no issues from our testing. Care Inspectorate use the Scottish Government accounting system (SEAS). . We have obtained assurance over these arrangements through the letter provided by Audit Scotland over the SEAS system, in their role as external auditor for the Scottish Government. Through our substantive audit testing, we did not identify any significant or unusual transactions that are out with the normal course of business for Care Inspectorate.
The revenue cycle includes fraudulent transactions Under ISA 240 (UK&I) there is a presumed risk that revenue may be misstated due to the improper recognition of revenue. Having considered the factors set out in ISA (UK&I) 240 and the nature of the revenue streams at Care Inspectorate we determined the risk arising from revenue recognition could be rebutted relating to funding from the Scottish Government but not for the other income streams. **Work undertaken:** We completed a walkthrough of the controls and procedures in place around revenue. We reconciled the revenue per PMS to SEAS to gain assurance over the completeness and accuracy of income. We substantively tested a sample of other income. We tested cut-off of revenue. We reviewed the award letters for grant income, and substantively tested associated grant expenditure in line with the conditions of the grant.	Our walkthroughs did not identify any significant control deficiencies within the revenue processes. Our testing did not identify any issues over the completeness and accuracy of income. Our testing of cut-off confirmed income transactions were treated in the correct period. Our testing of grant income and expenditure confirmed that spending is in line with the conditions of the grant as set out in the award letters.

Audit plan identified risk and work completed	Our conclusion
Completeness of operating expenditure Operating expenses are understated or not recorded in the right period. This risk also relates to Practice Note 10 (revised) in respect of public sector entities which outlines that auditors should also consider the risk that misstatement may occur by the manipulation of expenditure recognition (Fraud risk). **Work undertaken:** Completed a walkthrough of the controls and procedures in place around purchase ordering, procurement and general payment and recording of expenditure. Gained comfort around the regularity of expenditure and the application of public funds in accordance with the FReM and the direction from Ministers. We substantively tested a sample of operating expenditure, and gained comfort around the regularity of expenditure transactions. We performed cut-off testing on pre-year and post-year expenditure transactions.	We did not identify any incorrect recording or classification of operating expenditure in the annual accounts based on our substantive audit testing. Our testing on cut off identified transactions sampled were treated in the correct period. Our testing confirmed expenditure recorded in the annual accounts was incurred in accordance with the purpose and nature of Care Inspectorate as an organisation and in accordance with relevant laws and regulations.

The narrative elements of your annual report and accounts

In accordance with our responsibilities we have reviewed your narrative aspects of the Annual Report and Accounts. We have considered the consistency of this narrative with our understanding of the Care Inspectorate and the financial information set out in the accounts and have set out our observations below.

Annual Report

• Overall the Annual Report is balanced and does reflect in detail the arrangements the Care Inspectorate has in place, including a very detailed performance summary section outlining performance against the respective strategic objectives. Going forward we recommend Management consider the level of detail presented as some of this information is easily available on the website so could be better linked and the Board members biographies at the back are not needed. **See Action Point 2.**
• The sustainability report is included in full within the annual report and accounts. Similar to the point above, this could be referenced with highlights included
• The report includes a financial analysis of Care Inspectorate's in-year performance.
• In line with best practice performance reports it includes an upfront statement by the Accountable Officer.

Accountability Report and Governance Statement

• All key required elements within the FReM are included within the Accountability Report and Governance Statement.
•Executive directors provide certificates of assurance to the Chief Executive/ Accountable Officer. This provides them with overall robust assurance to support the governance statement disclosures. This approach is in line with best practice and provides a clear paper trail behind the annual governance process.
•The risk and control framework is effectively summarised and covers the key risk areas. Care Inspectorate has a clearly articulated risk register used to underpin its wider governance arrangements.
•Each Care Inspectorate Committee as well as the Board undertake an annual review of effectiveness which is formally recorded and supports the governance process

Remuneration report

• The remuneration report has been completed in line with guidelines and the FReM
•We have also audited the financial information included in the remuneration report (marked up as audited information). We have no matters we wish to bring to your attention.

Judgements and estimates

We consider other aspects of your annual report and accounts, in particular key areas of judgement. We have summarised below our observations in these key areas:

Accounting Policies

- Accounting policies are in accordance with the Financial Reporting Manual (FReM) and we consider these to be appropriate to Care Inspectorate and have been applied consistently in practice.

Accounting estimates and judgements

- We have identified and gained comfort over the following key estimates and judgements:
  - The bad debt provision is appropriate, and we are satisfied that debt is recoverable.
  - We have reviewed the pension assumptions, in line with our pension benchmarks and consider these to be appropriate and in line with our expectations

Going Concern

- Care Inspectorate has an agreed budget for 2017/18 and continues to discuss future funding with the Scottish Government, and has in place a longer term financial strategy. Given the nature of the services delivered by Care Inspectorate which are set out in various legislation we have no reason to doubt that Care Inspectorate won't continue to operate beyond 12 months of the date of our opinion.

Timing of transactions and period in which they are recorded (Cut off assertion)

- Through our substantive audit testing we did not identify any concerns over timing of transaction or the period in which they were recorded.

Impact on the financial statements of any uncertainties

- No uncertainties have been identified which have an impact on the final annual report and accounts.

Wider commentary on Care Inspectorate arrangements

Overview of certain Care Inspectorate Arrangements

Risk management is well-developed and supported by detailed control environment documentation.

Planned capital commitments require to be funded through a small contingency of revenue grant-in-aid

Staff costs are 79% of Care Inspectorate's total budget and an element of further restructure is needed, alongside estates rationalisation to breakeven for 2017/18

A longer term financial strategy has been developed (2017/18 to 2022/23) which highlights financial challenges from 2018/19 onwards.

CIPFA completed an independent review of governance in 2016/17 and governance arrangements have been further strengthened

Grant in aid of £0.9 million has been carried forward as a general fund surplus into future years as relates to a specific project with grant conditions

Financial Position 2016/17

Total grants and grant-in-aid for 2016/17 was £22.896 million. £2.194 million of transitional funding was carried forward from 2015/16 in general reserves as agreed with the Scottish Government to contribute to budget saving projects including a voluntary early retirement scheme. This transitional funding was utilised during 2016/17 except for a small amount which is carried forward in the general reserve. Expenditure was broadly in line with budget during the year at £22 million

Future Financial Strategy

In June 2017 a draft financial strategy was presented to the Resources Committee. The strategy is a seven year financial plan which identifies a number of funding scenarios and certain initial propositions on how the funding gap can be reduced. This strategy will then shape wider thinking on how resources can be targeted in the future and aligned to the different corporate objectives.

Four financial strategy objectives have been developed:

- Achieve long-term financial security – The Care Inspectorate has a medium term target of holding reserves between 2.5% and 3.5% of gross expenditure
- To invest appropriately in key resources and capabilities. For example investment in staff development, digital systems and facilities
- To plan and control the financing of developments – operate within a financial planning and risk framework for reviewing strategic opportunities and projects. This includes the Care Inspectorate's contribution to strategic alliances and collaboration.
- To integrate and harmonise financial and other strategies. ensuring that the finance strategy is linked to delivery strategies (regulation and improvement) and resource strategies (workforce/digital/facilities)

The Board approved the budget for 2017/18 in March 2017 and at that time noted indicative budgets for 2018/19 and 2019/20. 61% of total income comes from Scottish Government Grant-in-aid, with fees charged to regulated care providers representing 33% of total income. The remainder is made up of recharges for shared services and seconded staff.

2017/18 Budget

The Budget was set assuming Grant-in-aid remaining on a cash basis the same as 2016/17. However, a number of cost pressures are anticipated including inflation and pay rewards. Therefore, in order to show a breakeven financial position savings are needing to be achieved from staff restructuring and a planned review of estates. Currently staff costs represent 79% of the Care Inspectorate Costs, limiting the Care Inspectorate's options for significant savings to be achieved.

Indicative budgets 2018/19 and 2019/20

The main assumptions in future budgets are:

- All staff not currently at the top of the salary scale will perform satisfactorily and receive incremental progression
- Pay award assumptions of circa 1%
- Rate of employers' pension contribution rate will remain at 17% for 2018/19 and 2019/20
- Indicative budgets provide provision for business rates, energy costs and contractual cost increases
- All other expenditure has been maintained at 2017/18 budget level adjusted for any one off grant related expenditure
- There is no investment factored in for digital/ICT development
- Grant-in-aid and fee rates are assumed to be maintained until end of March 2020

2018/19 shows a balanced budget as it is anticipated estates rationalisation will offset increasing costs. The 2019/20 budget shows a deficit of £0.502 million.

Following the assumptions, forecasting out to 2023/24 shows a deficit position first occurring in the 2019/20 financial year up to a deficit of £2.229 million by 2023/24.

The budget papers reflect a number of scenarios and sensitivities for example cash in aid staying same or increasing up or down to a maximum of 3%.

Early savings options considered include: enhanced workforce planning and looking at career pathways and what is needed at what grade; staff turnover at 9% gives some flexibility, simplification of pay and grading structures and efficiency targets through for example lean reviews.

Lastly, the paper reflects on the risks associated with the strategy including: potential impacts of BREXIT, income targets not being achieved, changes in governmental policy and future savings plans are underestimated.

Capital Planning

The Care Inspectorate does not receive any funding specifically for capital expenditure. Therefore capital spend is funded from Grant-in-aid intended for revenue purposes.

ICT equipment is typically replaced on a cyclical basis and this is the only planned commitment for 2017/18. Any possible property alterations or improvements which may need to be treated as capital expenditure are considered within a small contingency for unplanned capital works. Over this level Board and Sponsor Department approval are required.

Governance arrangements

During 2016/17 the Care Inspectorate undertook an independent external governance review, undertaken by CIPFA, with a view to obtaining the Excellence in Governance Charter Mark. Supporting this review was a corporate governance group who reviewed all of the Care Inspectorate supporting governance documentation. The CIPFA report states that the Care Inspectorate currently meets all the good governance standards and cites a number of areas of good practice. Lower risk recommendations for improvement were identified including around stakeholder engagement, and defining longer term outcomes. An action plan is in place which will be monitored during 2017/18.

Policy decisions are made at Public Board meetings. Regular performance reports are made to the Executive team and to Committee / Board. The Audit Committee review success (performance) measures annually.

The Care Inspectorate are at an early stage of a business transformation programme. A Programme Board (officers) has been constituted to oversee this programme and delivery of the Transformation and Directorate Plans. Independent advice supplied by Digital Transformation Scotland has been secured at Programme Board and Care Inspectorate Board levels.

A Board members model Code of Conduct is in place, supported by Board member induction and training. On an annual basis a report is prepared for the Resources committee setting out performance including an assessment of how the Care Inspectorate has achieved best value during the year.

Risk management

The Care Inspectorate has a well developed risk management framework. The risks are articulated well, supported by very detailed control environment narrative alongside specific actions to further mitigate the risks. Risks are routinely discussed and reviewed at the Audit Committee and also the Care Inspectorate Board.

Grant in aid- Carry forward

As reflected in the financial statements £0.9 million of grant-in-aid has been carried forward into 2017/18 and 18/19. This money is ring fenced for a specific project "Care about Physical Activity". We have confirmed this has been correctly treated within the general reserves in accordance with the Scottish Public Finance Manual and the FReM. Typically grant-in-aid money is not drawn down before need, but this is controlled by the Sponsor Department and not the Care Inspectorate and we have confirmed the conditions on this funding to the Scottish Government letter.

Senior Management

The Chief Executive of the Care Inspectorate is also the Chief Executive and Accountable officer for Education Scotland on an interim basis. Her time has been split since 1 July 2017.

The Executive Director of Corporate and Customer services will work with Education Scotland around their business functions on a part time basis for an initial period of three months beginning at the end of September 2017.

The Executive Director of Corporate and Customer Services will remain in his post in the Care Inspectorate, however, his responsibilities around shared business services with the Scottish Social Services Council (SSSC) will be taken up, for this period, by the Head of Finance and Corporate Governance.

Appendices

Audit adjustments

Over the course of the audit, we have identified the following misstatements that require adjustments:

Uncorrected misstatements

We did not identified any uncorrected misstatements during the course of our audit

Corrected misstatements

Below are our corrected misstatements, which are reflected in the final audited accounts.

	Comprehensive Income statement £000	Statement of Financial Position £000	Statement of changes in taxpayers equity £000
1) Expense incorrectly classified as a prepayment: Dr Trade Creditors Cr Prepayments		 51 (51)	

Disclosure misstatements

In accordance with auditing standards we are required to highlight significant disclosure misstatements to allow audit committees to evaluate the impact of these matters on the financial statements. During the course of our audit, we identified a number of disclosure enhancements, which management have reflected in the final accounts. There were no significant disclosure changes we wish to bring the Committee's attention to.

Follow up on prior year recommendations

We have undertaken a follow up of outstanding recommendations from prior years raised by the previous external auditors, Audit Scotland. The results of our work are outlined below:

Prior year finding	Action in 2016/17	
Issue: As reported in previous years a long term funding/efficiencies solution is required to manage the identified budget deficits in future years. **Risk:** without a longer term solution the Care Inspectorate may not be able to deliver the key objectives and outcomes set out in the corporate plan **Recommendation:** The Care Inspectorate should clarify future funding arrangements and continue to identify and implement efficiencies in order to reduce costs and have a balanced budget in-line with funding and anticipated income streams.	This has been completed. As set out in the agreed action, Management has prepared a long term financial strategy which was presented to the Resources Committee in June 2017 for discussion. This is set out in our wider arrangement commentary in the main body of this report.	Implemented

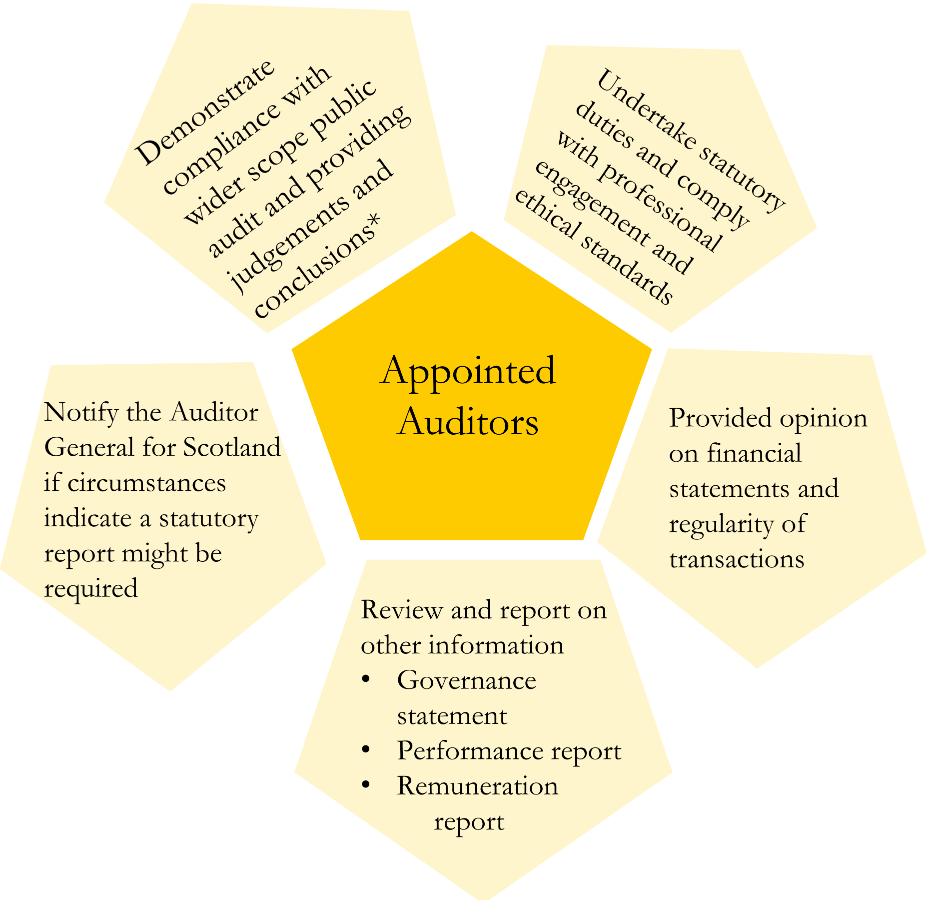
Action Plan for 2016/17

During the course of our 2016/17 audit work we have identified the following actions for management:

	Area	Issue & Risk	Priority	Recommendation and management response
1	**Year end accounts timetable**	As in previous years we undertook our external audit work over the first three weeks of July. The Accounts are not approved by the Board until October so there is either scope to move the audit process to later on, or for the Board to sign the accounts earlier. This would be a decision for Management and the Audit Committee to consider. Risk: A subsequent event happens post audit and before signing which could require substantial changes the accounts. The previous year accounts are still being considered 6 months into the new financial year, and resources directed to audit could be directed to future year budget setting	Low	Management and the Audit Committee should consider the audit timetable again, within the context of when the Board approve the accounts. **Responsible owner: Head of Finance and Corporate Governance** **Timetable for implementation: Dependent on Audit Committee view**
2	**Annual report**	The front end of the financial statements, the wider annual report commentary, is very lengthy and contains information which is already publically available on the Care Inspectorate and might not necessarily enhance the user of the accounts understanding of the work of the Care Inspectorate or the service outcomes.	Medium	Management should review the supporting annual report commentary, considering the use of diagrams and case studies. Management should review the NHS Performance Report publication produced by Audit Scotland, as still relevant to FReM requirements. This report provides good examples and narrative particularly on how to link to information that is already publically available. **Responsible owner: Strategic Communications Adviser** **Timetable for implementation: 30/6/18 or dependent on 1 above.**

Reminder of Responsibilities and audit fees

The Code of Audit Practice sets out responsibilities of the audited body (pages 10, 11 and 12) across: Corporate governance; financial statements and related reports; standards of conduct for prevention and detection of fraud and error; financial position; and value for money (as described in the Scottish Public Finance Manual). As appointed auditors our responsibilities are set out on page 13 of the Code and are summarised below.



An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. Weaknesses or risks are only those that have come to our attention during our normal audit work in accordance with ISAs and the Code and may not be all that exist.

Communication of the matters arising from our audit work does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

** Our audit of Care Inspectorate was undertaken under the smaller body exemption in the Code of Audit Practice. However, we have still considered the performance and accountability reports in the annual report and accounts; considered going concern and financial sustainability and included relevant commentary in this report to support Care Inspectorate's arrangements going forward.*