



Scott-Moncrieff
business advisers and accountants

Disclosure Scotland

Interim audit report

For the year ended 31 March 2018

April 2018

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Introduction

Introduction

1. Our 2017/18 external audit plan was approved by the Audit & Risk committee ('the ARC') in February 2018.

Scope of our interim audit

2. Auditors are required to carry out the audit of financial statements in accordance with International Standards on Auditing (UK) (ISAs UK). To comply with the requirements of the ISAs (UK) we consider the key accounting systems and internal financial controls, in order to determine whether these are adequate to prevent material misstatements in the financial statements.
3. Our approach includes documenting the processes and key internal financial controls within the key financial systems and performing walkthrough testing to confirm our understanding of those systems. We have also completed compliance testing over the key controls for processing disclosure fee income and expenditure transactions.

Reporting to those charged with governance

4. This report has been prepared to communicate the findings of our interim audit to the ARC.
5. Audited bodies are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls.
6. International Standards on Auditing (UK) (ISAs (UK)) require us to report promptly any material weaknesses in the design or operation of internal financial controls which have come to our attention.
7. A material weakness in internal control is a deficiency in design or operation which could adversely affect the entity'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.
8. Any weaknesses or risks identified are only those that have come to our attention during our normal audit work, and may not be all that exist. Communication in this report of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve

Disclosure Scotland of its responsibility to address the issues raised and to maintain an adequate system of control.

9. As required under the Code of Audit Practice, this report will be published on Audit Scotland's website: www.audit-scotland.gov.uk.

Adding value through the audit

10. All of our clients quite rightly demand of us a positive contribution to meeting their ever-changing business needs. Our aim is to add value to Disclosure Scotland through our external audit work by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way we aim to help Disclosure Scotland promote improved standards of governance, better management and decision making and more effective use of resources.
11. We always welcome feedback on the quality of our audit work and associated outputs. Please access the following link to provide comments: <https://www.surveymonkey.co.uk/r/S2SPZBX>
12. We would like to thank management and staff who have been involved in our work for their co-operation and assistance during our audit visits.

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Summary of findings

Summary of findings

Conclusion

13. Our audit work identified one minor observation in the design of controls over journal processing in the financial ledger. Our findings and corresponding recommendation in relation to this observation is detailed in the action plan at section three of this report. Overall, we consider Disclosure Scotland's systems to be well designed.

Review of Disclosure Scotland's key financial systems

14. To comply with the requirements of the ISAs (UK), we considered whether Disclosure Scotland's key accounting and internal financial controls are adequate to prevent material misstatements in the financial statements. During the interim audit we considered the systems and controls over:
- financial ledger and journals;
 - disclosure fee income and receivables;
 - payroll;
 - expenditure and payables;
 - cash and bank; and
 - related party transactions.
15. In accordance with our audit strategy, we completed compliance testing over disclosure fee income and expenditure transaction key controls.
16. We identified one minor observation in the course of the audit work noted above, in relation to journal entries. While processes are in place to review journals entries for errors, there is a possible deficiency in the design of controls to ensure the detection of fraudulent journal postings. Further detail in relation to this observation and a corresponding recommendation are noted within the action plan at section three of this report.
17. We did not identify any further issues during the course of our interim audit work.

Preparatory final accounts audit work

18. During our interim audit we undertook preparatory work for our final accounts audit. This included the following audit work:
- discussions with management;
 - review of Disclosure Scotland members' registers of interests; and
 - review of Board and ARC committee minutes.

Wider-scope public audit

19. We have applied our audit experience from the prior year, along with discussions at the planning and interim stages of this year's audit, to inform our understanding of Disclosure Scotland's arrangements as they relate to the four dimensions of wider-scope public audit: governance and transparency, financial management, financial sustainability and value for money.
20. Our work on the four dimensions of wider-scope public audit will be carried out during our final audit visit. We will conclude and report on Disclosure Scotland's arrangements within our 2017/18 audit report.

Internal audit

21. We are committed to avoiding duplication of audit effort and ensuring an efficient use of Disclosure Scotland's total audit resource. We consider the work of internal audit and our ability to place reliance on their work where possible. During our interim audit, in order to ensure no duplication of audit effort, we met with internal audit to discuss the areas subject to review and audit findings to date. Based on our evaluation, we do not expect to place reliance upon the work of internal audit in 2017/18. This is due to the work being performed not being directly aligned to our specific remit as external auditors. We will continue to evaluate this position in future years and will continue to use the work of internal audit to inform our risk assessment of the organisation.

Financial statements and the 2017/18 audit process

22. Audited central government agency financial statements must be submitted to the Scottish Government by mid-September 2018, and laid before Parliament by 31 December 2018. We will continue to liaise with management to agree respective expectations and timetables for our year-end audit. Our final audit visit is planned to commence in June 2018.

Year	2016/17	2017/18
Outstanding	0	0
Completion date not yet passed	2	1

External audit recommendations

23. As part of our interim audit, we have followed up on the recommendations we have raised in 2016/17, in order to present an up to date recommended action position to those charged with governance.
24. As noted in the table below, all 2016/17 recommendations past agreed completion dates have been implemented. Further detail of the 2016/17 audit recommendations are included in section four (prior year action plan) of this report.

Year	2016/17	2017/18
Total number of recommendations	6	1
Complete	4	0

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Action plan

Action Plan

Our action plan details the control weaknesses and opportunities for improvement that we have identified during our interim audit.

It should be noted that the weaknesses identified in this report are only those that have come to our attention during the course of our normal audit work. The audit cannot be expected to detect all errors, weaknesses or opportunities for improvements in management arrangements that may exist. The weaknesses or risks identified are only those which have come to our attention during our normal audit work, and may not be all that exist.

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

Action plan grading structure

To assist Disclosure Scotland in assessing the significance of the issues raised and prioritising the action required to address them, the recommendations have been rated. The rating structure is summarised as follows:

Grade 5	Very high risk exposure – major concerns requiring attention from those charged with governance
Grade 4	High risk exposure – material observations requiring senior management attention
Grade 3	Moderate risk exposure – significant observations requiring management attention
Grade 2	Limited risk exposure – minor observations requiring management attention
Grade 1	Efficiency / housekeeping point

Action plan point	Observation, Risk & Recommendation	Management Comments
1. Journals	<p>Observation</p> <p>Disclosure Scotland use a manual authorisation process whereby a journal request form should be completed before posting a journal, including sign-off by an appropriate officer.</p> <p>Once the journal is posted, it is entered onto a journals register spreadsheet. On a monthly basis, general ledger reports are reconciled to the journals register. However, this process does not extend to checking that a completed journal form is on file. This means that an individual posting a fraudulent journal could evade detection by entering their journal onto the spreadsheet.</p> <p>We acknowledge monthly budget monitoring procedures which would provide a degree of assurance over significant variances in income and expenditure; however fraudulent small and frequent journal amounts would not be identified from this process. We further recognise that a degree of collusion would be required in order to fraudulently remove funds from the organisation.</p> <p>Risk</p> <p>Despite budget monitoring procedures, there remains an increased risk that fraudulent and/or inappropriate journal postings can be processed in the financial ledger without detection, resulting in an elevated risk of fraudulent activity and management override of controls.</p> <p>Recommendation</p> <p>As part of the monthly journal reconciliation process, a sample of journals should be traced back to their journal forms, in order to evidence the nature and appropriateness of the journal.</p>	<p>We agree that this is an opportunity to improve controls.</p> <p>As part of the month end process a report of all transactions in the month is produced and sorted into transaction type and reconciliation for each type is produced to verify the figure. This includes a report identifying each journal.</p> <p>To provide additional assurance and mitigation of the risk materialising - as part of the month end process - the Financial Accountant or Head of Finance will review the journal reconciliation and ensure that each journal has been appropriately authorised and investigate any which are unexpected.</p> <p>Responsible officer: Head of Finance</p> <p>Implementation date: 30 April 2018</p>
Rating		
Grade 2		

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Prior year action plan

Follow up of 2016/17 prior year actions

1. Financial Sustainability	
Original Rating	Grade 3
Observation and Risk	We identified that the financial model does not account for the on-going legal litigation from 2014, relating to a failed IT contract. All litigation cases are subject to uncertainty. We recognise that communication with the Scottish Government regarding the case is ongoing.
Recommendation	We recommend that Disclosure Scotland perform scenario planning for the outcome of the litigation, which is due to appear in court in 2017-18, to ensure appropriate financial response plans are in place.
Original management response	Key stakeholders in the Scottish Government are aware of the financial position in regard to the litigation. We will ensure that this dialogue continues. Responsible officer and Target Date: Director of Corporate Services – N/A; Keep in view only
Management response update	The dispute has settled amicably, without admission of liability on the part of either party.
Completion date	16 October 2017

2. Governance: Framework Document	
Original Rating	Grade 2
Observation and Risk	Upon review of the Disclosure Scotland Framework Document, it was identified that this was last reviewed in 2015 and is therefore outdated to reflect terms of reference changes in 2016-17.
Recommendation	We acknowledge that the framework document is currently under review by the Accountable Officer of Disclosure Scotland, and advise this is completed within the 2017-18 financial year to ensure it reflects up to date Disclosure Scotland governance arrangements.
Original management response	Agreed. The Framework Document is currently under review and will be amended to reflect Disclosure Scotland's governance arrangements. Responsible officer and Target Date: Director of Corporate Services – End December 2017
Management response update	A review had been conducted and draft format prepared, however DS Board commissioned a review of the governing groups (DS Board, SLT and SMT). This impacts on the Framework Document therefore completion of the Framework review was postponed until the review of the governing groups was finalised. The review of

2. Governance: Framework Document

	governing groups is ongoing at the point of update.
Completion date	Completion rescheduled to 01 June 2018

3. Governance: Non Executive Members

Original Rating	Grade 3
Observation and Risk	Disclosure Scotland currently has three non-executive members. The ARC has an additional independent member, who has relevant financial experience and attends the ARC. This member is not however a member of the Disclosure Scotland Board. Currently there is limited non-executive financial experience on the Disclosure Scotland Board. There is therefore a risk that there is limited independent financial scrutiny and challenge at Board level.
Recommendation	There are currently two posts in advertisement for non-executive directors; therefore it should be a priority to ensure one of the new members has appropriate financial experience.
Original management response	A recruitment exercise is currently being undertaken to secure a nonexecutive board member with relevant financial experience. Pending successful outcomes / checks it is anticipated that the new board member will be appointed by September 2017. Responsible officer and Target Date: Director of Corporate Services – End December 2017
Management response update	DS has secured the services of a NEBM with financial expertise. His contract commenced on 18 December 2017.
Completion date	18 December 2017

4. Governance: Non Executive Members

Original Rating	Grade 3
Observation and Risk	It is recognised that the terms for two existing non-executive member may cease in the 2017-18 financial year.
Recommendation	Disclosure Scotland should therefore ensure appropriate transition arrangements are in place, to continue the required governance support and challenge provided by non-executive members.
Original management	Existing contracts for non-executive members end December 2017. The Chief Executive is to have a discussion with each member where an extension to their

4. Governance: Non Executive Members

response	contracts will be explored. Revised contracts will be issued / recruitment exercise undertaken. Responsible officer and Target Date: Director of Corporate Services – End November 2017
Management response update	A discussion has taken place between the 2 Non-Executives and CE. As a result the Non-Executives have agreed to an extension of their contracts. Revised contracts have been issued.
Completion date	22 November 2017

5. Value for Money: Strategic Performance Management

Original Rating	Grade 3
Observation and Risk	Disclosure Scotland do not have a formally documented Performance Management Framework, therefore it is not explicitly transparent how the 34 operational KPI's translate to the 17 success objectives set out in the 2016-17 ABP. There is therefore a risk that Disclosure Scotland's Board and stakeholders are unclear on the performance of Disclosure Scotland against its ABP.
Recommendation	We therefore recommend that Disclosure Scotland formally document their new 2018-2021 Performance Management Framework.
Original management response	Will review as part of the Corporate Planning and Reporting process. Responsible officer and Target Date: Director of Corporate Services – End June 2018
Management response update	The Performance Management Framework will be developed in tandem with Corporate Plan 2018-21. Agreed reduced number of Corporate KPIs will be reviewed as part of the 2018-19 Business Planning process to determine whether they remain relevant.
Completion date	30 June 2018

6. Value for Money: Strategic Performance Management

Original Rating	Grade 2
Observation and Risk	An annual performance report is presented to the Board detailing performance against the 17 success objectives set out in the ABP. There is therefore concern that Disclosure Scotland is not sufficiently measuring and reporting performance against

6. Value for Money: Strategic Performance Management

	<p>the ABP success objectives on a timely basis throughout the year. In order for the Board to sufficiently monitor Disclosure Scotland's progress against the ABP success objectives, it is recommended that Disclosure Scotland review current performance reporting arrangements.</p>
Recommendation	<p>In order for the Board to sufficiently monitor Disclosure Scotland's progress against the ABP success objectives on a timely basis, it is recommended that Disclosure Scotland review the frequency of current performance reporting arrangements.</p>
Original management response	<p>Reporting process and frequency will be reviewed to determine sufficiency. Any new agreed ways of working will be embedded as applicable.</p> <p>Responsible officer and Target Date: Director of Corporate Services – end December 2017</p>
Management response update	<p>A new monitoring template and process was developed and piloted during September 2017. Following feedback through the pilot, amendments were made to the process and a revised paper was issued to the DS Board and endorsed on 18/12/17. This revised format will continue and be improved.</p>
Completion date	<p>18 December 2017</p>



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