

Accountant in Bankruptcy

Report on the 2007/08 Audit

 AUDIT SCOTLAND

October 2008



Accountant in Bankruptcy

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Executive Summary

Introduction

In 2007/08 we looked at the key strategic and financial risks being faced by the Accountant in Bankruptcy (AIB). We audited the financial statements and we also reviewed aspects of performance management and governance. This report sets out our key findings.

Financial Position

AIB achieved a surplus of £0.23 million in 2007/08. This is the difference between net expenditure for the year of £6.895 million and the funding received from the Scottish Government of £6.918 million. The 2007/08 Spring Budget revision also saw a further £0.8 million voted to AIB. This increased vote funding was not utilised in the year.

AIB is currently projecting a £0.915 million underspend against budget in 2008/09. This projected underspend is attributed to lower net direct sequestration expenses in the year than were initially anticipated. AIB is also required to make 2% cash releasing efficiency savings as part of the 2008/09 budget settlement. We will continue to keep developments in this area under review.

Financial Statements

We have given an unqualified opinion on the financial statements of AIB for 2007/08. We have also concluded that in all material respects, the expenditure and receipts shown in the financial statements were incurred or applied in accordance with applicable enactments and relevant guidance, issued by Scottish Ministers.

Governance

Corporate Governance is concerned with the structures and process for decision making, accountability, control and behaviour at the upper levels of an organisation. Overall the corporate governance and control arrangements for AIB operated satisfactorily during the year, as reflected in the Statement on Internal Control.

We examined the key financial systems which underpin the organisation's control environment. We concluded that financial systems and procedures operated sufficiently well to enable us to place reliance on them.

Best Value

Audit Scotland is committed to extending the Best Value audit regime across the whole public sector and significant development work has taken place over the last year. Currently we are concentrating on the development of Use of Resources audit toolkits, focusing initially on Financial Management, Efficiency, and



Information Management. These toolkits are being piloted in a sample of NHS and central government clients during 2007/08 and 2008/09. Developed toolkits will also be made available to public bodies to consider for self assessment.

We will consider how AIB is addressing this developing area as part of our 2008/09 audit.

Performance

AIB fully achieved three out of eight of their main targets for 2007/08 and came very close to achieving the desired performance level to request Act and Warrant within 28 days of the circular to creditors. Agency performance against the targets was an improvement on 2006/07 for two of the targets, and equal performance for a further one target. AIB has reported that only three of the eight main targets had a lower achievement rate than the prior year.

AIB was unable to report performance against two of their main targets in time for inclusion in the Annual Report and Accounts. This delay in production was caused by the introduction of a new case management system within AIB, necessitating a change in the way the information to support the target is produced.

Looking forward

The final part of our report notes some key risk areas for AIB going forward. We highlighted a number of national issues which affect all public sector bodies including AIB, including the introduction of Scotland Performs; the impact of international financial reporting standards; and the review of data handling arrangement in public bodies across Scotland. We have also highlighted a number of issues specific to AIB including the introduction of Part 1 of Bankruptcy Reform and the Fee Review being undertaken.

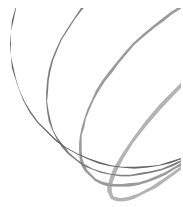
The assistance and co-operation given to us by Board members and staff during our audit is gratefully acknowledged.

Audit Scotland
October 2008



Introduction

1. This report summarises the findings from our 2007/08 audit of AIB. The scope of the audit was set out in our Audit Plan, which was presented to the Audit Committee on 8 April 2008. This plan set out our views on the key business risks facing the organisation and described the work we planned to carry out on financial statements, performance and governance.
2. We have issued a range of reports this year, and we briefly touch on the key issues we raised in these reports. Each report set out our detailed findings and recommendations and AIB's agreed response.
3. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officers and members of AIB during the course of our audit. This report will be submitted to the Auditor General for Scotland and will be published on our website, www.audit-scotland.gov.uk.



Financial Position

4. In this section we summarise key outcomes from our audit of AIB's financial statements for 2007/08, and comment on the key financial management and accounting issues faced. The financial statements are an essential means by which the organisation accounts for its stewardship of the resources available to it and its financial performance in the use of those resources.

Our responsibilities

5. We audit the financial statements and give an opinion on:
 - whether they give a true and fair view of the financial position of the AIB and its expenditure and income for the period in question;
 - whether they were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements;
 - the consistency of the information which comprises the sections, Our Role and Purpose, Our Vision, Aim and Values, Our Stakeholders, Management Commentary, Summary of AIB Performance and Statistical Information, and
 - the regularity of the expenditure and receipts.
6. We also review the statement on internal control by:
 - considering the adequacy of the process put in place by the accountable officer to obtain assurances on systems of internal control, and
 - assessing whether disclosures in the statement are consistent with our knowledge of AIB.

Overall conclusion

7. We have given an unqualified opinion on the financial statements of AIB for 2007/08.
8. Accounts were submitted for audit on 14 July 2008, supported by a comprehensive working paper package. The good standard of the supporting papers and the timely responses from AIB staff allowed us to conclude our audit within the agreed timetable and provide our opinion to the Audit Committee on 7 October 2008 as timetabled.
9. While year on year we are seeing an improvement in AIB's delivery of the financial statements, we would expect further improvements in the financial statements process in 2008/09 in order that the Agency is able to meet the Scottish Governments consolidation timetable.



Financial Position

Outturn 2007/08

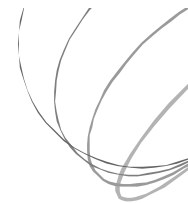
10. AIB achieved a surplus of £0.23 million in 2007/08. This is the difference between net expenditure for the year of £6.895 million and the funding received from the Scottish Government of £6.918 million. The 2007/08 Spring Budget revision also saw a further £0.8 million voted to AIB. This increased vote funding was not utilised in the year due to higher than budgeted income levels received by AIB.

2008/09 Budget

11. Scottish Ministers have agreed a resource budget for AIB of £6.9 million for 2008/09. The total resource budget has been allocated with £6.9 million for operating expenditure with no budgeted capital expenditure.
12. AIB is currently projecting a £0.915 million underspend in 2008/09. This projected underspend is attributed to lower net direct sequestration expenses in the year. The net direct sequestration expenses are calculated by offsetting the sequestration expenses against sequestration income and recoveries. AIB is predicting that while sequestration expenses will be close to the budgeted figure in 2008/09, sequestration income and recoveries will be substantially higher than budgeted. Specifically, recoveries to the public purse are now projected to be 17% higher than initially anticipated, and Debtor Application Fee income is projected to be 85% higher than initially anticipated.

Issues arising from the audit

13. As required by auditing standards we reported to the Audit Committee on 7 October 2008 the main issues arising from our audit of the financial statements. The main issues reported were;
 - Accounting Policies – AIB made changes to the level of accounting policy disclosure in the 2007/08 financial statements. There is now much greater disclosure than there has been in prior years leading to improved transparency.
 - Income Disclosure – AIB had in prior years not disclosed operating income by source. For 2007/08 AIB has broken down operating income by source in a note to the accounts. This improved disclosure of income allows for greater transparency and ensures compliance with the disclosure requirements of the Financial Reporting Manual.



Regularity Assertion

14. The Public Finance and Accountability (Scotland) Act 2000 imposes a responsibility on auditors that requires us to certify that, in all material respects, the expenditure and receipts shown in the accounts were incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers. We have been able to address the requirements of the regularity assertion through a range of procedures, including written assurances from the Accountable Officer as to his view on adherence to enactments and guidance. No significant issues were identified for disclosure.



Governance

Overview of arrangements

15. This section sets out our main findings arising from our review of AIB governance arrangements. This year we reviewed:
- key systems of internal control; and
 - internal audit.
16. We also discharged our responsibilities as they relate to prevention and detection of fraud and irregularity; standards of conduct; and the organisation's financial position. Our overall conclusion is that arrangements within AIB are sound and have operated through 2007/08.

Corporate Objectives

17. AIB are currently working through a five year business strategy covering the period 2006 – 2011. The strategy focuses on five main themes:
- Developing Policy – building the capability to develop policy relating to bankruptcy,
 - Modernising Services – delivering modern services that meet the needs of customers and stakeholders,
 - Supporting the Business – providing the foundations for an efficient and effective business
 - Managing the Business – developing the capabilities required to manage the business effectively, and
 - Investing for the Future – investing in AIB's people to build an organisation where the culture is one of empowerment, continuous improvement and learning and development.
18. Within each of the five themes AIB has defined objectives that require to be carried out. The Agency has also developed specific performance targets to be used to track progress towards achievement of the themes of the business strategy. We have provided more detailed commentary of AIB's performance against their main targets in 2007/08 in the Performance section of this report (see paragraphs 33–38).
19. The delivery of the business strategy will be challenging for AIB and this is an area we will keep under review during our appointment.



Systems of internal control

20. Key controls within systems should operate effectively and efficiently to accurately record financial transactions and prevent and detect fraud or error. This supports a robust internal control environment and the effective production of financial statements. In their annual report for 2007/08 internal audit stated that their work undertaken during the year did not identify any significant control weaknesses that were considered to be pervasive in their effect on the system of internal control.
21. As part of our audit we reviewed the high level controls in a number of AIB systems that impact on the financial statements. Our overall conclusion was that key controls were operating effectively.

Internal Audit

22. The establishment and operation of an effective internal audit function forms a key element of effective governance and stewardship. We therefore seek to rely on the work of internal audit wherever possible and as part of our risk assessment and planning process for the 2007/08 audit we assessed whether we could place reliance on AIB's internal audit function. We concluded that the internal audit service, provided by the Internal Audit Division of the Scottish Government Finance Directorate, operates in accordance with the Government Internal Audit Manual and therefore placed reliance on their work in number of areas during 2007/08, as set out in our annual audit plan.

Statement on Internal Control

23. The Statement on Internal Control provided by AIB's Accountable Officer reflected the main findings from both external and internal audit work. This recorded management's responsibility for maintaining a sound system of internal control and set out AIB's approach to this.

2006/07 Follow Up

24. As part of our 2007/08 audit we completed a review of AIB progress against 2006/07 audit action plans. We are pleased to report that at the time of our review, of the fifteen 2006/07 action points, eleven actions had been completed by the Agency. The remaining four actions are intended to be complete by the end of 2008. As part of our 2008/09 audit, we will review AIB progress against the four outstanding 2006/07 actions, as well as following up action plans issued in 2007/08.



Performance Management

25. Public audit is more wide-ranging than in the private sector and covers the examination of, and reporting on, performance and value for money issues. As part of our audit we are required to plan reviews of aspects of the arrangements to manage performance, as they relate to economy, efficiency and effectiveness in the use of resources.
26. Accountable officers also have a duty to ensure the resources of their organisation are used economically, efficiently and effectively. These arrangements were extended in April 2002 to include a duty to ensure 'best value' in the use of resources.

Best Value developments

27. The positive impact of the Best Value concept in local government led Scottish Ministers to introduce a non-statutory Best Value duty on all public sector accountable officers (i.e. across health and central government) in 2002. This was reinforced by refreshed Ministerial guidance in 2006, highlighting the importance that the Scottish Government places on Best Value as a means of supporting public service reform.
28. That position was again re-iterated in the Scottish Government's recent response to the Crerar scrutiny review which credited the Best Value regime as a key driver of modernisation and improvement in public services. Audit Scotland is committed to extending the Best Value audit regime across the whole public sector and significant development work has taken place over the last year.
29. The framework for our proposed Best Value audit approach was agreed by Audit Scotland's Corporate Management Team in September 2007. It is based on the key principles of flexibility and proportionality; alignment and integration with our existing activities; being delivered within our existing resources, and with an evolutionary implementation.
30. Using the Scottish Government's nine best value principles as the basis for our audit activity, we have identified five priority development areas (Use of Resources, Governance and Risk Management, Accountability, Review and Option Appraisal, and Joint Working) for our initial development work.



31. Currently we are concentrating on the development of Use of Resources audit toolkits, focusing initially on Financial Management, Efficiency, and Information Management. These toolkits are being piloted in a sample of NHS and central government clients during 2007/08 and 2008/09. Developed toolkits will also be made available to public bodies to consider for self assessment. We will consider further how AIB is addressing this developing area as part of our 2008/09 audit.

Efficiency

32. AIB's three year cumulative target under the Efficient Government Plan to 2007/08 was £1 million in cash releasing efficiency savings. AIB actually achieved £743,000 in cumulative cash releasing efficiency savings. The shortfall is explained by the Agency as being due to a move in focus in 2007/08 from achieving efficiency savings to delivering the implementation of bankruptcy reform.
33. AIB's target under the Efficient Government Plan, for 2008/09 has been set at 2%, as part of the budget settlement from the Scottish Government. This translates to £0.225 million in cash releasing savings required to be delivered by AIB during 2008/09. AIB have identified areas across the business where cash releasing efficiency savings can potentially be generated. These potential savings include bringing more services 'in-house', which has historically for AIB been a source of cash releasing efficiency savings. We will keep developments in this area under review during 2008/09.

Performance Management

34. AIB fully achieved three out of eight of their main targets for 2007/08. Agency performance against the targets was an improvement on 2006/07 for two of the eight targets, and equal performance for a further one target. AIB has reported that only three of the eight main targets had a lower achievement rate than the prior year.
35. AIB was unable to report performance against two of their main targets in time for inclusion in the Annual Report and Accounts. This delay in production was caused by the introduction of a new case management system within AIB, necessitating a change in the way the information to support the target is produced.



36. A breakdown of achievement against each performance measure is set out in tabular format below:

Performance Measure	Target	2006/07	2007/08
Reply to correspondence within 10 working days.	90%	94%	99%
Audit permanent trustee accounts within 4 weeks of receipt.	95%	99%	96%
Examine Sederunt books within 6 weeks of receipt.	95%	98%	87%
Pay invoices within 30-day credit period.	100%	98%	93.2%
Request Act and Warrant within 28 days of the circular to creditors.	100%	98%	99%
Interview debtors within 20 working days of case allocation	100%	100%	100%
Pay dividends to creditors in non-summary sequestrations	25%	34%	-
Pay dividends to creditors in summary sequestrations.	9%	8%	-

Source: 2007/08 AIB Annual Report and Accounts.

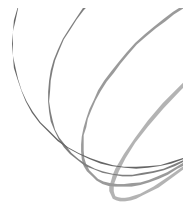
37. Of the three main targets where AIB recorded the target had been missed, the first relates to the target of examining Sederunt books within 6 weeks of receipt. AIB performance is lower than in the prior year because of IT issues that resulted from the introduction of MIDAS, AIB's new case management system. Functionality problems with MIDAS were not identified as being problematic immediately due to other priorities within AIB. MIDAS issues have now been resolved and the 2008/09 performance against this target is expected to improve on 2007/08 as a result.
38. The second target where performance has decreased and the target has not been reached is the requirement to pay invoices within a 30 day credit period. Officers have advised that payment performance target fell from that of 2006-07 due in part to the implementation of the Scottish Governments Purchase 2 Pay system, which required retrospective processing of purchase orders, the need to attach an audit trail and an increased number of queries. The backlog created at ordering stage caused a delay in the processing of purchase invoices. The performance for 2008/09 against this main target is expected to be significantly better.
39. AIB's target to request Act and Warrant within 28 days of the circular to creditors was set at 100%. AIB achieved a rate of 99% against this target, an improvement on 2006/07. Officers have advised that the introduction of MIDAS, the new case management system, has significantly improved AIB's ability to perform against this target, but MIDAS only becoming fully operational after the beginning of the year meant that 100% achievement of this target was extremely challenging.
40. We will continue to monitor the progress AIB is making in achieving their main targets as part of the 2008/09 audit.



Looking Forward

41. AIB faces a number of challenges in 2008/09, which include:

- **Fee Review** – AIB are currently in the final stages of preparation for submission to the Scottish Government of an extensive piece of work on AIB's fee regime. This submission may have implications on the way AIB is funded in the future and we will continue to monitor this developing area in 2008/09.
- **Bankruptcy Reform** – Part 1 of the Bankruptcy and Diligence etc. (Scotland) Act 2007, relating to personal insolvency legislation, came into full force on 1 April 2008 when bankruptcy reforms and changes to Protected Trust Deeds were implemented. Statutory Instruments to support the changes were successfully introduced including regulations for bankruptcy, Protected Trust Deeds and the Low Income Low Assets route into bankruptcy. These bankruptcy reforms could have a significant impact on the demand for AIB services. We will monitor the impact of bankruptcy reform on AIB's caseload as part of our 2008/09 audit.
- **International Financial Reporting Standards (IFRS)** – As part of the UK Budget 2007 the Chancellor announced that the timetable for IFRS implementation was to be extended by a year with central government accounts in Scotland to become IFRS compliant with effect from the 2009/10 financial year. The Scottish Government have notified central government bodies that they will be required to produce shadow IFRS based accounts for the financial year in 2008/09, including a restated balance sheet as at 1 April 2008. A detailed timetable and list of requirements has been issued by the Scottish Government. This process may require significant resource to complete and it will be important that the restatement is tackled early in 2008/09, with a plan in place to manage the transition.
- **Scotland Performs** – The Scottish Government is continuing to develop its approach to performance management based on a National Performance Framework and outcome agreements. The National Performance Framework is based on the outcome based 'Virginia-style' model of performance measurement and reporting. In support of this the Scottish Government has developed a new electronic tool and website to communicate to the public on Scotland's progress. This will include progress on overall delivery of the administration's purpose for Government, the five strategic objectives for Scotland and other aspects of the outcomes based National Performance Framework. We will consider how AIB is addressing this developing area as part of the 2008/09 audit.



- **Efficiency and future funding** – Budgets for 2008/09 and the immediate future will need to be managed within a tighter funding regime. This includes significantly less scope for the application of end of year flexibility for the Government with HM Treasury until the next Spending Review; no option to transfer funds from capital to revenue; and the impact of the introduction of International Financial Reporting Standards (IFRS), particularly on PFI, leases and infrastructure accounting. The challenge for AIB is to prioritise spending, identify efficiencies and review future commitments to ensure delivery of key targets and objectives.
- **Data handling** – The Scottish Government carried out a review of data handling arrangements in Scotland, in response to failures in UK government bodies' procedures and practices during 2007. The review considered current policies and procedures on data protection, consistency with government standards and local arrangements for implementation of procedures. An interim report published in April 2008 made some initial recommendations and a final report is expected soon. We will monitor AIB's response to the review and action taken as part of our 2008/09 audit.