



INFRASTRUCTURE, GOVERNMENT &
HEALTHCARE

Scottish Prison Service

Annual audit report to the
Scottish Prison Service and the
Auditor General for Scotland
2007-08

24 June 2008

AUDIT

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This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ('the Code'). This report is for the benefit of only the Scottish Prison Service and is made available to Audit Scotland (together the beneficiaries), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives section of this report.

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Executive summary

This report summarises our work for 2007-08 and our findings in relation to our audit of the financial statements, corporate governance and performance management arrangements.

Financial statements

Following approval on 11 June 2008 we issued an audit report expressing an unqualified opinion on the financial statements of SPS for the year ended 31 March 2008 and on the regularity of transactions reflected in those financial statements.

One adjustment to the draft financial statements was made as a result of the audit process, reducing net operating costs and increasing net assets by £1.5 million.

Corporate governance

We considered corporate governance arrangements as they relate to systems of internal control, the prevention and detection of fraud and irregularity, standards of conduct and arrangements for the prevention and detection of corruption, and its financial position.

- The statement on internal control does not disclose any significant weaknesses in the systems of internal control, but does highlight the continuing increase in prisoner numbers as a risk.
- There is a formal process to record, distribute and monitor action in response to key guidance and circulars.
- SPS underspent against revenue and capital allocations by £12 million.
- The Scottish Government has set SPS cumulative efficiency savings targets for the next three financial years of £8.6 million, £17.1 million and £25.6 million.

Performance management

There are strong performance management arrangements in place and performance against performance indicators is monitored on a monthly basis. SPS has also established a series of internal performance contracts with establishments, providing a suitable framework of accountability for financial and operational performance.

- SPS achieved all 11 key performance indicators set by the Scottish Ministers.
- Management reported cash releasing efficiency savings of £1.6 million and time releasing efficiency savings of £0.9 million (target £0.9 million) for 2007-08. The cash savings of £1.6 million for 2007-08 brings the cumulative savings to £9.4 million against a target of £10 million.

Introduction

Audit framework

This year was the second of our five-year appointment by the Auditor General for Scotland as external auditors of the Scottish Prison Service (“SPS”). This report to SPS and Auditor General provides our opinion and conclusions and highlights significant issues arising from our work.

In accordance with Audit Scotland’s Code of Audit Practice (“the *Code*”) the scope of the audit was to:

- provide an opinion on SPS’s financial statements and the regularity of your transactions;
- review and report on:
 - your corporate governance arrangements as they relate to: your review of systems of internal control; the prevention and detection of fraud and irregularity; standards of conduct, and prevention and detection of corruption; and your financial position
 - SPS’s arrangements to achieve Best Value
 - other aspects of your arrangements to manage performance, as they relate to economy, efficiency and effectiveness in the use of resources.

We outlined the framework under which we operate, under appointment by Audit Scotland, in the audit plan discussed with SPS’s risk management and audit committee.

Background

SPS is an executive agency of the Scottish Government whose function is to provide secure custodial services and enhance opportunities for people sent to prison. SPS spends around £280 million per annum operating 14 establishments in Scotland. One prison is currently managed through a public private partnership in Kilmarnock with another one coming into operation in December 2008 in Addiewell.

The current design capacity of Scotland’s prisons is around 6,600 – around 1,100 less than the number of prisoners. Prisoner numbers have increased by 466 over the 2007-08 year to 7,704 at 31 March 2008. Increasing prisoner numbers remains the most significant challenge for SPS and may remain so for some time to come, with an expected increase of almost 20% by 2016-17¹. Action taken to mitigate the increasing numbers of prisoners includes the current construction of new houseblocks at HMP Edinburgh and HM Young Offenders Institution Polmont, which will provide 253 places, and the public private partnership contract at HMP Addiewell, which will provide 700 places when it opens in December 2008. Planned new prisons at Bishopriggs and in the north east of Scotland may provide a further 1,200 places by the end of 2013, subject to planning permission.

We considered the processes and arrangements in these areas in focusing our audit effort.

¹ Managing increasing prisoner numbers in Scotland (Audit Scotland, May 2008)



Responsibilities of SPS and its auditors

External auditors do not act as a substitute for SPS's own responsibilities for putting in place proper arrangements to account for its stewardship of resources made available to it and its financial performance in the use of those resources, to ensure the proper conduct of its affairs, including compliance with relevant guidance, the legality of activities and transactions, and for monitoring the effectiveness of those arrangements and, through accountable officers, to make arrangements to secure Best Value.

We have structured the report around the headings financial statements audit, governance arrangements and performance management arrangements.

Acknowledgement

We wish to record our appreciation of the continued co-operation and assistance extended to us by your staff.

Financial statements audit

- We issued unqualified opinions on the financial statements.
- Provisions were reduced by £1.5 million as a result of the audit process.

Audit opinion

Following approval on 11 June 2008 we issued an audit report expressing an unqualified opinion on the financial statements of SPS for the year ended 31 March 2008 and on the regularity of transactions reflected in those financial statements.

Public Private Partnerships

HMP Addiewell

This contract was signed in 2006-07 to build and run a new 700 prisoner place facility in Addiewell. The project is on schedule with the building nearing completion and staff being recruited and trained. It is expected to be completed in 2008 with the initial transfer of prisoners in December 2008 and to be running at full capacity by March 2009.

HMP Bishopriggs

Low Moss prison was closed in June 2007 because the buildings were declared unfit for purpose. SPS had planned to construct a new prison, HMP Bishopriggs, with a 700 prisoner capacity on this site and a bordering piece of land which it had acquired. The initiative was in the tendering process for a public private partnership at the time of the change in administration at the Scottish Government. The new administration policy of new prisons being operated by the public sector was announced in August 2007 and SPS were instructed to terminate the tendering process and to constitute a new competition to design and build a prison to be operated in the public sector by SPS. The nature of the tendering process was such that the risk lay with the party submitting the tender and as a result, SPS did not incur any loss by withdrawing.

SPS did incur staff relocation costs of £0.5 million associated with closing down the old prison. SPS has planning permission to build a 700 place prison on this site and placed an advertisement in April 2008 inviting the private sector to submit tenders for the design and build of the new prison with a closing date in June 2008. This new prison will be known as HMP Bishopriggs prison.

Administration of prisoner claims

As a result of SPS being required to pay the legal fees of the claimants, which can amount to between £150 and £3,000 per claim, it set up an administration scheme during November 2007. This scheme allows prisoners to submit claims to SPS directly where they have not raised court action. The objective of the scheme is to reduce legal costs and increase the rate at which claims are settled. Between November 2007 and March 2008, approximately 3,000 claims had been received via the administrative scheme, of which approximately 670 claims had been settled.



Managed service contracts

Services contracted out to the private sector include prisoner escorting, healthcare and the running of an entire prison. Currently, only the Kilmarnock prison is operated by the private sector with a second opening in December 2008 in Addiewell. Another major service provided by the private sector is the prisoner escort and court custody contract. The cost of this service is based on activity levels achieved.

Provisions for injury benefits

In accordance with accounting standards provisions, including provisions for staff and prisoner claims, are recognised in the balance sheet when the prison service has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected, risk adjusted, future cash flows using the discount rate prescribed by HM Treasury.

The draft financial statements included a provision for £6.3 million, which was reduced by £1.5 million through the audit process following further consideration of the assumptions used in calculation of the provision. The provision for injury benefits of £4.8 million reflected in the final 2007-08 financial statements relates to claims received during the period 2000-01 to 2007-08. In 2007-08 and earlier periods, payments in respect of injury benefits were charged to the operating cost statement when paid. As SPS has a liability for future payments to employees injured in the period and earlier periods, a provision for future payments has been recorded.

Corporate governance

- The statement on internal control does not disclose any significant weaknesses in the systems of internal control, but does highlight the continuing increase in prisoner numbers as a risk.
- There is a formal process to record, distribute and monitor action in response to key guidance and circulars.
- SPS underspent against revenue and capital allocations by £12 million.
- The Scottish Government has set SPS cumulative efficiency savings targets for the next three financial years of £8.6 million, £17.1 million and £25.6 million.

Introduction

Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviour. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all bodies.

The chief executive, as accountable officer, is responsible for establishing arrangements for ensuring the proper conduct of its affairs, including compliance with relevant guidance, the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. The *Code* requires auditors to review and report on corporate governance arrangements as they relate to:

- SPS' reviews of its systems of internal control, including its reporting arrangements;
- the prevention and detection of fraud and irregularity;
- standards of conduct and arrangements for the prevention and detection of corruption; and
- its financial position.

Corporate governance framework

The risk management and audit committee is established as a sub-committee of the board. The role of this committee is to support the chief executive as accountable officer to ensure that corporate governance arrangements are effective and appropriate. The chairman of the committee is required to report to the board on a six monthly basis on corporate governance arrangements and the internal control environment. The committee's terms of reference are updated and minuted at regular meetings and include its role, effectiveness and membership profile.

The board consists of seven executive directors, including the chief executive, and three non-executive directors. The chief executive retired on the 6 April 2007 and his replacement took up post later that month.

The Ethical Standards in Public Life etc. (Scotland) Act 2000 required public sector organisations to implement a code of conduct for board members, outlining their responsibilities. In line with the model code, SPS' code contains rules of conduct on:

- general conduct;
- registrations of interests;
- declaration of interests; and
- lobbying and access to members of public bodies.

We considered the corporate governance arrangements and concluded that, the corporate governance framework has been designed and implemented appropriately.

Statement on internal control ("SIC")

The accountable officer is responsible for maintaining and reporting on the system on internal control. The statement provides details of the internal control environment, risk management and control frameworks. The system of internal control is an ongoing process to identify and evaluate the probability and impact of risks that may prevent SPS from achieving its policies, aims and objectives. Controls are designed to manage risks efficiently, effectively and economically which results in risks being reduced to a reasonable level rather than entirely eliminated. The effectiveness of the system of internal control can therefore only provide reasonable, and not absolute, assurance. The accountable officer relies on the following support in achieving an effective system of internal control:

- the board meets on a monthly basis where the strategic direction of SPS will be considered with reference to plans;
- the executive directors meet on a weekly basis to discuss operational issues;
- clear lines of responsibility and accountability are maintained;
- each director is required to report to the board on key systems and controls for which they are responsible;
- the chairman of the risk monitoring and audit committee is required to report to the board at the end of each six months about corporate governance and the control environment;
- the work performed by internal audit in assessing the effectiveness of the system of internal control and providing recommendations for improvements.
- reports from the external auditors on the progress of implementing recommendations.

The statement on internal control does not include any significant weaknesses, but does highlight the continued increase in prisoner numbers throughout the year from 7,238 on 1 April 2007 to 7,704 at 31 March 2008. The chief executive reports in the SIC that "*the risk is carefully and closely managed and I have not found a failure in control. However, Scottish Ministers face significant potential risks from the need to continue to balance the competing legislative requirements of accepting all those sent by the courts alongside health and safety and European Convention of Human Rights requirements, whilst regularly accommodating around 15% more people than the prisons were designed to hold.*"

Risk management

Risk management is the responsibility of the board who devote substantial time to the identification and management of risks at all levels. The key elements of SPS' risk management strategy are:

- assessment and review of major risks on a monthly basis;

- having corporate risk as a standing item on the board's agenda at monthly meetings;
- regular workshops involving 'horizon scanning' in an attempt to identify risks;
- discussion of potential risks at the weekly executive directors meeting;
- the maintenance of a risk register which rates risks according to probability and potential impact; and
- the responsibility for identified risks is allocated at director level who are required to report back to the board.

Internal audit

Our planned audit approach seeks, wherever possible, to place reliance on the work completed by internal audit to minimise duplication of effort and ensure maximum benefit from the combined audit resource. To support this, in accordance with International Standard on Auditing 610, we have therefore again undertaken a formal evaluation of SPS's internal audit function. Our evaluation incorporates consideration of both the organisational and operational aspects of the internal audit function, including the scope of internal audit work, the independence of the internal audit function, arrangements to secure due professional care and quality of work performed and reporting mechanisms. As in 2006-07, we have concluded that we are able to place formal reliance upon the findings of internal audit.

The permanent position of head of internal audit remains vacant, but the senior internal auditor appointed to fill this position on a temporary basis in October 2007 continues in his acting role. SPS has extended its contract with Scott-Moncrieff chartered accountants for the 2008-09 year which includes an extension of existing services at SPS' discretion.

We have been liaising with management to agree the areas in the 2008-09 internal audit plan where we intend to place reliance and assisting in identifying areas that could be seen as important to the overall system of control established by SPS. There may be a risk over delivery of the 2008-09 plan if alternative arrangements are not fully operational in a timely manner, but management are confident that the assurance plan will be met for 2008-09.

Internal audit have completed work in accordance with the annual audit plan and concluded in their annual assurance report that "*we can offer an overall 'reasonable'² level of assurance based on the work carried out in 2007-08.*", and 'limited'³ assurance was provided in relation to:

- cell sharing risk;
- cell certification;
- home detention curfew;
- multi agency public protection arrangements; and
- security standards.

² Systems of internal control that are satisfactory in part, but contain a number of weaknesses that are likely to undermine the achievement of systems objectives and leave them vulnerable to material error/ abuse or threatening risk.

³ A basically sound system of internal control, but a few weaknesses that may place achievement of some systems objectives at risk.

Internal audit delivered the annual assurance plan in full and the head of internal audit's opinion to the accountable officer at the audit committee on 23 May 2008. We placed reliance on internal audit's work in the following areas:

- trade creditors;
- staff costs;
- budgetary control and financial reporting;
- controls risk self assessment;
- performance management; and
- efficient government.

Internal controls

Our work on organisation-wide controls has included the review of relevant policies and procedures and consideration of the adequacy and appropriateness of the content. In addition, we reviewed evidence of processes such as risk monitoring and financial reporting, to confirm these processes are operating as intended. The majority of policies and procedures are available to all SPS staff on the intranet. This ensures that relevant personnel have access to the current version of key documents at all times.

We identified some minor areas for enhancement of IT controls and recognised progress by management in developing disaster recovery and business continuity plans. Management accepted our recommendations.

Prevention and detection of fraud and irregularity

Fraud policy

There is a formal whistle blowing policy governing the procedures to be followed in the event of suspecting or detecting fraud. Where management are made aware of a suspected fraud, the internal fraud response group is convened to co-ordinate an investigation. The composition of the fraud response group depends on the nature of the fraud, but will usually be chaired by the director of finance and attended by the head of finance, the head of internal audit and any other relevant officers. The fraud response group is responsible for undertaking preliminary investigations, reporting to the risk monitoring and audit committee, board and chief executive and proceeding with a follow up investigation if required.

Regularity

In accordance with our responsibilities within the Code, we provide an opinion on SPS's financial statements and, as required by relevant authorities, the regularity of transactions.

In order to gain assurance over the regularity of income and expenditure we have updated our understanding over the processes in place to receive Scottish Government circulars, register, allocate and distribute responsibility for action points and monitor and follow up these action points. Testing of the register and monitoring process identified that these processes are designed, implemented and operating effectively.

Financial position

SPS has underspent against its capital and revenue allocations during the year as shown below.

£ million	Revenue allocation	Revenue spend	Outturn	Capital allocation	Capital spend	Outturn
2007-08	300	294	6	59	53	6

The total reportable spend for 2007-08, including capital and revenue, is £347 million which is a net underspend of £12 million when compared with funding for the year of £359 million. Delays in the estates development programme were the primary reasons for slippage in the capital spend. The underspend is fully committed in future years as part of SPS' estates strategy. A reversal of a previous impairment of fixed assets is a significant part of the revenue underspend. The original budget for 2007-08 was £427 million, of which £97 million was allocated for capital expenditure and £330 million for revenue expenditure. This budget was amended during the year based on discussions between SPS and the Scottish Government to reflect the changes in operational plans for HMP Bishopriggs and funding not required in the current year for HMP Addiewell.

The balance sheet at 31 March 2008 reports net current liabilities of £30.2 million (2007: £32.6 million) and long-term liabilities of £86.8 million (2007: £91.3 million) primarily due to the carrying value of provisions for liabilities and charges. Management has an agreement with the Scottish Government that cash will be available in future years to fund cash payments.

The cost per prisoner place is a key financial target. The actual average cost per prisoner place for 2007-08 was £32,358, within the £36,000 target and an increase of 4% compared to 2006-07.

Financial plans

All public bodies are required to meet the Scottish Government's efficiency targets. The Scottish Government has set SPS cumulative efficiency savings targets for the next three financial years of £8.6 million, £17.1 million and £25.6 million. SPS anticipate working with its trade union partners to identify potential ways of achieving these targets. The allocated budget for 2008-09 is £441 million, of which £110 million relates to capital expenditure and £331 million for revenue expenditure, for which detailed budgets have been prepared.

In response to the continued increase in prisoner numbers, which is expected to continue for the foreseeable future, and the new Scottish Government's policy of new prisons being operated by the public sector, SPS has had to adapt its planned capital projects up to 2010-11. These plans need to meet the demand for the growth in estimated prisoner numbers in addition to allowing for the capital commitment for prisons to be built and operated by SPS. These projects include:

- a new 700 cell prison at Bishopriggs, which is expected to be started in 2009-10 and completed in 2011-12 with an estimated construction cost of £100 million;
- a 116 place house block at HMP Edinburgh, which is due to open early 2009 at a cost of £13.4 million; and
- a 137- place houseblock at HM Young Offenders Institution Polmont, which is due to open in Autumn 2009 at a cost of £16.2 million.

Performance management

- SPS achieved all 11 key performance indicators set by the Scottish Ministers.
- Strong performance management arrangements include regular monitoring of key performance indicators and existence of formal contracts with establishments to provide a framework of accountability for performance.
- For 2007-08 management reported cash releasing efficiency savings of £1.6 million and time releasing efficiency savings of £0.9 million (target £0.9 million). The cash savings of £1.6 million for 2007-08 brings the cumulative savings to £9.4 million against a target of £10 million.

Performance management

The board is responsible for meeting key performance indicators which are monitored against targets set by the Ministers and detailed in the 2007-08 delivery plan. These key performance indicators include, annual average cost per prisoner place, percentage of available prisoner places with access to night sanitation and serious assaults on staff and prisoners. For 2007-8, all of the 11 key performance indicators were reported as having achieved target.

There is an internal automated network that provides management with data such as offender records. During 2007-08 SPS was awarded the accreditation required to access the secure criminal justice extranet network. From 2008-09 access to this network will allow SPS to share information electronically with criminal justice partners.

There are strong performance management arrangements in place, which includes the monitoring of key performance indicators on a monthly basis and the establishment of a series of formal contracts with public and private establishments that provides a suitable framework of accountability for financial and operational performance.

Audit Scotland performance studies

Audit Scotland undertakes a programme of studies on financial management, governance and performance on behalf of the Auditor General. This programme covers topics of national importance, including:

- managing increasing prisoner numbers in Scotland;
- dealing with offending by young people: performance update; and
- value for money in public sector corporate services.

The chief executive receives reports and distributes them to relevant senior management. Where appropriate, an internal action plan is prepared, based on Audit Scotland's summary and national conclusions, to address local weaknesses.

Managing increasing prisoner numbers in Scotland

Audit Scotland's report, issued in May 2008, highlighted key issues around increasing prisoner numbers and the extent of overcrowding in Scottish prisons. The report identified a number of recommendations for the Scottish Government to action in relation to improving the accuracy of prisoner number projections, identify action to be taken to accommodate future prisoner numbers, monitor the availability and unit costs of across community justice authorities, and establish the relative effectiveness of prison and community sentences on reducing re-offending.

In addition, the report recommended that SPS should:

- assess the potential risks of legal challenges associated with prisoners: sharing cells; spending long periods locked in their cells; and sharing accommodation with other categories of prisoner;
- collect and report information to provide a clearer picture of the availability and delivery of prisoner activities;
- consider further analysis of the cost of service delivery in each prison, including the costs associated with admitting, transferring and releasing prisoners, in order to identify scope for potential efficiencies.

This is actively being considered by directors, who are being asked to consider the impact on specific areas of SPS' activities.

Best Value

Senior management continue to consider whether SPS can demonstrate continuing improvement and contribution to the characteristics of Best Value. Since Audit Scotland's baseline review of arrangements to secure Best Value in 2005-06 management has continued to assess SPS' arrangements against the nine characteristics of Best Value. This is demonstrated through formal consideration by directors based on the arrangements in place within each directorate. Specific actions have been identified, which will be fully implemented in 2008-09, to ensure that arrangements are developed and enhanced, where required, in line with best practice.

2008-09 onwards

Audit Scotland has been committed to extending the Best Value audit regime across the whole public sector for some time now, with significant amounts of development work having taken place during the last year. Using the Scottish Government's nine best value principles as the basis for audit activity, Audit Scotland has selected five areas as priority development areas (use of resources, governance and risk management, accountability, review and option appraisal, and joint working). Audit Scotland is currently developing a series of toolkits that auditors will be required to use from 2008-09. Completion of these toolkits will require a detailed examination of arrangements in specific areas.

The focus of this work in 2008-09 will be on the use of resources, including efficiency, information management, procurement, asset management, performance management and people management. It is anticipated that national reports may be prepared by Audit Scotland and it is therefore important that SPS ensures that appropriate focus and resources are available to develop arrangements to secure Best Value.



Efficient government

Internal audit reviewed arrangements and systems in place to track and report achievement of efficiency targets and found there to be clear evidence to support the achievement of efficiencies while maintaining quality of service. Internal audit concluded that, based on their work, “*substantial assurance*” could be provided over these systems.

For 2007-08 management reported cash releasing efficiency savings of £1.6 million and time releasing efficiency savings of £0.9 million (target £0.9 million). The cash savings of £1.6 million for 2007-08 brings the cumulative savings to £9.4 million against a target of £10 million. This small shortfall is due to attempts at maintaining service levels while managing higher than expected levels of prisoners.

