



**Scott-Moncrieff**  
business advisers and accountants

# Scottish Prison Service

Annual report on the 2017/18 audit  
to the Accountable Officer and the Auditor  
General for Scotland

**June 2018**

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# Summary

## Annual accounts

The Scottish Prison Service 'SPS', is scheduled to approve the annual accounts for 2017/18 on 27 June 2018 and the accounts will be submitted, together with this report, to the Scottish Government and Auditor General by 31 October 2018.

We intend to report that the financial statements of SPS for 2017/18 give a true and fair view of the state of SPS's affairs and of its net expenditure for the year. We also intend to provide an unqualified opinion on the regularity of transactions and other prescribed matters within our independent auditor's report.

We confirm that the financial statements have been properly prepared in accordance with the 2017/18 Financial Reporting Manual (FRm) and the requirements of the Public Finance and Accountability (Scotland) Act 2000 and Ministerial directions.

### SPS have a net 2017-18 underspend of £13.5 million (3.8%), components as follows:

- The Total DEL limit was underspent by £5.248 million (1.8%), resulting from repairs and maintenance not undertaken in the year and staff related provisions not being utilised;
- The Outside DEL limit was underspent by £0.795 million (1.1%), resulting from a change in the timing of settlement of a liability;
- The AME limit was underspent by £7.387 million (536.9%), resulting from greater than expected asset impairment reversals.

## Wider Scope

The Code of Audit Practice frames the wider scope in terms of four dimensions. We summarise below our conclusions on each dimension, which remain consistent with our evaluation in 2016/17.

<p style="text-align: center;"><b>Financial Management</b></p> <p>SPS has generally effective financial management and budget monitoring arrangements in place. The SPS has reported an underspend against both revenue and capital budgets in 2017/18 due mainly to delays in completing repairs and maintenance programmes.</p> <p>We note that the effectiveness of financial management arrangements within prisons has been given only limited assurance following internal audit reviews. SPS is in the process of reviewing the effectiveness of financial reporting structures for wider financial management within prisons as a result of these reviews.</p>	<p style="text-align: center;"><b>Financial Sustainability</b></p> <p>SPS has good arrangements for short-term annual financial planning and monitoring. However, with only 16% of SPS expenditure is on areas which are not committed in the short term, it is challenging to achieve further significant savings without more fundamental service re-design.</p> <p>Crucial to the effective delivery of sustainable financial performance is the effective use of the SPS estate. Appropriate investment in the estate is needed to ensure that it meets operational needs and repairs and maintenance expenditure does not consume a disproportionate share of resources.</p> <p>We note that SPS's two PFI/PPP prisons in Kilmarnock and Addiewell continue to consume an increasing share of total revenue expenditure, placing additional pressure on funding for the remaining estate.</p>
<p style="text-align: center;"><b>Governance &amp; Transparency</b></p> <p>Governance arrangements at SPS were found to be compliant with the requirements of the Scottish Public Finance Manual (SPFM) and generally operating satisfactorily.</p> <p>Weaknesses have been identified in procurement and contract management arrangements related to the national painting contract. This is subject to ongoing investigation by internal audit.</p>	<p style="text-align: center;"><b>Value for Money</b></p> <p>Overall SPS continued to demonstrate value for money in its operations and achieved the majority of its performance targets. A key challenge for the organisation in 2018/19 will be to implement its ambitious 'Prison Officer Professionalisation Programme' (POPP). Good progress has been made to date, but further work to develop the detailed financial model for this programme is required.</p>

Wider Scope

## Conclusion

This report concludes our audit for 2017/18. Our work has been performed in accordance with the Audit Scotland Code of Audit Practice, International Standards on Auditing (UK and Ireland) and Ethical Standards.

**Scott-Moncrieff**  
**June 2018**

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# Introduction

# Introduction

1. This report summarises our findings from the 2017/18 audit of SPS.
2. We outlined the scope of our audit in our external audit plan, which we presented to the RMAC on 9 March 2018. The core elements of our audit work in 2017/18 have been:
  - an interim audit of SPS's key financial systems and governance arrangements;
  - an audit of SPS's 2017/18 annual report and accounts, including a review of the Governance Statement;
  - a review of arrangements as they relate to the four dimensions of wider-scope public audit: governance and transparency, financial management, financial sustainability and value for money; and
  - consideration of arrangements for taking part in the National Fraud Initiative data-matching exercise.
3. SPS is responsible for preparing annual accounts that show a true and fair view, and for implementing appropriate internal control systems. The weaknesses and risks identified in this report 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 management from its responsibility to address the issues raised and to maintain an adequate system of control.
4. We discussed and agreed the content of this report with the Chief Executive and Head of Financial Policy & Services. We would like to thank all management and staff for their co-operation and assistance during our audit.
5. This report contains an action plan with specific recommendations, responsible officers and dates for implementation. Senior management should assess these recommendations and consider their wider implications before deciding appropriate actions. We give each recommendation a grading to help SPS assess

their significance and prioritise the actions required.

## Adding value through the audit

6. 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 the Advisory Board 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 the Advisory Board promote improved standards of governance, better management and decision making and more effective use of resources.
7. In 2017/18 we have supported SPS in the delivery of Corporate objectives by:
  - Providing data analytics support in the delivery of a contract investigation (with prior approval of Audit Scotland);
  - Undertaken a challenge role in the implementation of service redesign (with prior approval of Audit Scotland); and
  - Provided ad hoc support to the Risk Monitoring and Audit Committee in the delivery of their core function.
8. We welcome any comments you may have on the quality of our work and this report via: [www.surveymonkey.co.uk/r/S2SPZBX](http://www.surveymonkey.co.uk/r/S2SPZBX)
9. This report is addressed to the Advisory Board, Accountable Officer and the Auditor General for Scotland, and will be published on Audit Scotland's website. [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).

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# Annual accounts

# Annual accounts

## Introduction

10. SPS's annual financial statements are the principal means of accounting for the stewardship of its resources and its performance in the use of those resources. The respective responsibilities of SPS and the auditor in relation to the financial statements are outlined in Appendix 4.

## Overall conclusion

### Unqualified audit opinions

11. The annual accounts for the year ended 31 March 2018 are to be approved by SPS on 27 June 2018. We will report within our independent auditor's report:
  - an unqualified opinion on the financial statements;
  - an unqualified opinion on regularity; and
  - an unqualified opinion on other prescribed matters.
12. We are also satisfied that there are no matters which we are required to report to you by exception.

### Administrative processes were in place

13. We received draft financial statements and supporting papers of a good standard, in line with our agreed audit timetable. Our thanks go to management and staff for their assistance.
14. Arrangements are in place to enable the annual report and accounts to be submitted to the Scottish Government and Auditor General for Scotland prior to 31 October 2018.

### Our assessment of risks of material misstatement

15. The assessed risks of material misstatement described below are those that had the greatest effect on our audit strategy, the allocation of resources in the audit and directing the efforts of the audit team. Our materiality threshold was revised from our audit plan, as discussed at paragraph 35. We designed our audit procedures relating to these matters in the context of our audit of the annual report and accounts as a whole, and not to express an opinion on individual accounts or disclosures. We outline our four audit risks below.

## Audit Risks 1: Management Override

In any organisation, there exists a risk that management have the ability to process transactions or make adjustments to the financial records outside the normal financial control processes. Such issues could lead to a material misstatement in the financial statements. This is treated as a presumed risk area in accordance with ISA (UK) 240 – The auditor's responsibilities relating to fraud in an audit of financial statements.



16. We reviewed the accounting records for significant transactions outside the normal course of business and obtained evidence to ensure that these were valid and accounted for correctly.
17. We have no matters to report in relation to this risk.

## Audit Risks 2 : Fraudulent Revenue Recognition

Under ISA 240 - The auditor's responsibilities relating to fraud in an audit of financial statements there is a presumed risk of fraud in relation to revenue recognition. The presumption is that the SPS could adopt accounting policies or recognise income and expenditure transactions in such a way as to lead to a material misstatement in the reported financial position.



18. We conducted an analysis on SPS's revenue streams and reported no control weaknesses or deficiencies in our Interim Audit Report. We conducted substantive sample testing and identified no errors or matters to report.
19. We have no matters to report in relation to this risk.

## Audit Risks 3 : Fraudulent Expenditure Recognition

The FRC published Practice Note 10 which applies to the audit of financial statements for periods commencing after June 2016. The Practice Note recognises that most public sector bodies are net spending bodies and notes that there is an increased risk of material misstatement due to improper recognition of expenditure.



20. We conducted an analysis on SPS's revenue streams and reported no control weaknesses or deficiencies in our Interim Audit Report. We conducted substantive sample testing and identified no errors or matters to report.
21. We have no matters to report in relation to this risk.

## Audit Risk 4: Estates Valuation

As at March 2017, the SPS held property, plant and equipment with a carrying value of £1.072 billion (£1.143 billion March 2018).

The scale of the current estate, continuing developments to the women's estate and the on-going capital investment programme create complexities and potential risks to the valuation of the assets as recorded within the annual accounts.



22. SPS surplus land assets were re-valued by the District Valuer as at 31 March 2018. As stated in our audit plan, we conducted testing on the re-valuations in order to gain assurance over the accuracy and reasonableness of the estates valuations.
23. SPS specialised assets (the main establishment land and buildings) were not revalued during in the year. To ensure the valuation of these assets continue to reflect current market conditions, SPS applied indexation.
24. We have tested the indexation figure have identified a potential overstatement. This overstatement is not material and we therefore do not propose an adjustment to the financial

statements. We have identified an improvement to the basis of the calculation of this figure. [See appendix 1, action point 1.](#)

25. We performed depreciation testing to confirm that depreciation has been correctly calculated and incorporated within the annual accounts.
26. In 2016/17 we identified that 68% of fixed assets within the Fixed Asset Register were held at a nil closing value. This year this remains consistent with a rate of 65%. As part of our controls review, we did not identify any control deficiencies or weaknesses in SPS's asset verification procedures. This finding indicates the useful lives of assets applied by SPS's depreciation accounting policy may be understated.
27. In 2016/17 we recommended that SPS conduct a review of the depreciation accounting policy for asset lives to better match experience. We have been advised by management that an initial review of the policy has been undertaken and identified a requirement for some change to asset lives in the policy. Due to the volume of assets held at nil NBV, a longer term exercise will be necessary to confirm their status and the revised elements of the policy will be derived from this exercise. [See appendix 1, action point 2.](#)
28. We continue to monitor decisions announced by the Scottish Government and SPS regarding the closure of HMP & YOI Cornton Vale, in order to ensure the asset valuation remains appropriate. At the time of writing this report, HMP & YOI Cornton Vale remains in-use and has been valued as such. We have gained assurance that the carrying values of both establishments remain appropriate, as they were not revalued in 2017/18. Further consideration of the development of the estate is made at paragraphs 80-81.
29. We reviewed Advisory Board minutes and conducted a media review to ensure all matters that may impact estates valuations have been considered within the year end valuations by the District Valuer. We did not identify any unaccounted for events impacting on estates valuations as at 31 March 2018.
30. We will continue to monitor SPS's progress in terms of the capital investment programme. In 2017/18, SPS agreed plans for HMP Glasgow, however it appears the land will not be purchased until 2019. A new site has been purchased for the Women's Strategy in Inverclyde.

## An overview of the scope of our audit

31. We detailed the scope of our audit in our external audit plan.
32. Our plan explained that we follow a risk-based approach to audit planning that reflects our overall assessment of the relevant risks that apply to the Advisory Board. This ensures that our audit focuses on the areas of highest risk. Planning is a continuous process and our audit plan is subject to review during the course of the audit to take account of developments that arise.
33. At the planning stage we identified the significant risks that had the greatest effect on our audit. We

then designed audit procedures to mitigate these risks. We base our audit approach on performing a review of the key accounting systems in place, substantive tests and detailed analytical review.

34. Tailored audit procedures, including those designed to address significant risks, were completed by the audit fieldwork team and the results were reviewed by the audit manager and audit partner. In performing our work, we have applied the concept of materiality.

## Our application of materiality

35. Materiality is an expression of the relative significance of a matter in the context of the financial statements as a whole. A matter is material if its omission or misstatement would reasonably influence the decisions of an addressee of the auditor's report. The assessment of what is material is a matter of professional judgement over both the amount and the nature of the misstatement.
36. Our initial assessment of materiality for the annual report and accounts during our planning work was £4.964 million, being 1.5% of prior year SPS annual gross expenditure. Our assessment of materiality is set with reference to a range of benchmarks. On receipt of the draft 2017/18 accounts, we reassessed our materiality figure based on actual 2017/18 gross expenditure. We did not identify any control deficiencies during the course of our interim audit, and we were not aware of any significant issues that would warrant a lower threshold, so our threshold remained unchanged from the planning threshold. Our revised materiality is £4.655 million.
37. We set a performance materiality for each area of work which is based on a risk assessment for the area. We have performed audit procedures on all transactions, or groups of transactions, and balances that exceed our performance materiality. This means that we performed a greater level of testing on the areas deemed to be of significant risk of material misstatement. Our performance materiality and triviality thresholds were revised from our audit plan in line with the revised materiality figure stated above.

Area risk assessment	Weighting	Performance materiality
High	40%	£1.862 million
Medium	50%	£2.328 million
Low	60%	£2.793 million

38. We agreed to report any misstatements identified through our audit that fall into one of the following categories:

- All material corrected misstatements;
- Uncorrected misstatements over £93,000; and
- Misstatements below £93,000 we believe warrant reporting on qualitative grounds.

## Accounting and Internal Control systems

39. SPS has adequate systems in place to record, process, summarise and report financial and other relevant data. We have not identified any material weaknesses or governance issues in SPS's accounting and internal control systems during our audit.

## The Governance Statement in compliance with the Scottish Ministers' guidance

40. We are satisfied that the Governance Statement complies with the Scottish Ministers' guidance and that the content is not inconsistent with information gathered during the course of our normal audit work. We consider the coverage of the Governance Statement to be broadly in line with expectations.
41. The disclosures in the Governance Statement reflect internal audit's conclusion for 2017/18.

## Areas of the Remuneration and Staff Report subject to audit opinion

42. In compliance with the FReM, the Remuneration and Staff report is reviewed in its entirety for consistency with the financial statements and to ensure disclosures are in line with the auditors understanding of SPS.
43. The following areas of the Remuneration and Staff report are subject to audit opinion:
- Remuneration policy
  - Single total figures of remuneration and CETV pension figures for each director;
  - Payments to past directors;
  - Fair pay disclosures;
  - Exit packages; and
  - Analysis of staff costs and numbers.
- No issues were identified.

## Related Party Transactions

- 44. In compliance with ISA 550, we are required to perform audit procedures to identify, assess and respond to the risk of material misstatement arising from related party transactions. We conducted a review in order to identify any potential undisclosed related party transactions.
- 45. In order to verify the completeness of the board's declaration of interests, we conducted searches of all board members via Companies House.
- 46. We reviewed the Board and RMAC minutes for the 2017/18 period.
- 47. We did not identify any undisclosed interests.

## Regularity Opinion

- 48. We have planned and performed our audit recognising that non-compliance with statute or regulations may materially impact on the annual report and accounts. We did not identify any instances of irregular activity.

## Other matters and audit adjustments

- 49. We identified minor disclosure and presentational adjustments that were reflected in the final financial statements. The adjustments, taken individually and in aggregate, did not have any effect on SPS's outturn for the year.
- 50. SPS's inventories were material to the audit in 2017/18 (not material in 2016/17). We therefore

reviewed the items held as stock by SPS. We identified that locks and other materials used to repair parts of prisoner cells are held as stock.

- 51. We discussed the treatment of these items held as stock as potentially they should be accounted for as repairs and maintenance under IAS 2. However, through review of public sector interpretations of IAS2, specifically the FReM interpretation of IPSAS12. We are satisfied that SPS are accounting appropriately for these materials as inventories. We recommended that SPS update their accounting policy to state explicitly the items included in inventory, which has been reflected in the updated 2017/18 accounting policy.
- 52. No other matters were identified.

## Whole of Government Accounts

- 53. SPS is required to complete a Scottish Government consolidation pack that we are required to audit. This pack contains a section to detail information on the whole of government accounts (WGA), which are consolidated financial statements for the public sector in the UK.
- 54. We are not required to audit this section of the pack as SPS is below the de-minimus level of audit of £350 million of gross expenditure.
- 55. SPS are still required to submit an audited return to the Scottish Government. We have received the unaudited pack and expect to meet the Scottish Government submission deadline.

## Other qualitative aspects of accounting practices and financial reporting

- 56. We have considered the qualitative aspects of the financial reporting process, including items that have a significant impact on the relevance, reliability, comparability, understandability and materiality of the information provided by the financial statements. Our findings are summarised below:

Qualitative aspect considered	Audit conclusion
The appropriateness of the accounting policies used.	Further to the advised review of SPS's depreciation accounting policy at paragraph 4 and the update of the inventories accounting policy at paragraph 51, we consider the remaining accounting policies which are disclosed in the financial statements to be appropriate.

The timing of the transactions and the period in which they are recorded.	We did not identify any concerns over the timing of transactions or the period in which they were recognised.
The appropriateness of the accounting estimates and judgements used.	The accounting estimates and judgements used by management in preparing the financial statements are considered appropriate. The principal areas of estimates and judgements have been asset depreciation and provisions for injury benefits and prisoner claims. Where appropriate SPS utilised the work of independent experts or industry practice to support the estimates made.
The potential effect on the financial statements of any uncertainties, including significant risks and related disclosures that are required.	We have not identified any uncertainties, including any significant risk or required disclosures, which should be included in the financial statements.
The extent to which the financial statements have been affected by unusual transactions during the period and the extent that these transactions are separately disclosed.	From the testing performed, we identified no significant unusual transactions in the period.
Apparent misstatements in the annual report and accounts or material inconsistencies with the financial statements, particular in relation to Performance.	The annual report and accounts contain no material misstatements or inconsistencies with the financial statements.
Any significant financial statements disclosures to bring to your attention.	Apart from those already stated, there are no other significant financial statements disclosures that we consider should be brought to your attention. All the disclosures required by relevant legislation and applicable accounting standards have been made appropriately.
Disagreement over any accounting treatment or financial statements disclosure.	While some disclosure and presentational adjustments were made through the audit process, there was no disagreement during the course of the audit over any significant accounting treatment or disclosure.
Difficulties encountered in the audit.	There were no significant difficulties encountered during the audit.

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# Financial management

# Financial management

## Overall conclusion

**SPS has effective budget monitoring arrangement in place for financial management, however should consider the effectiveness of current financial governance structures.**

57. Overall, SPS has effective arrangements in place for the financial management of resources. Our conclusion is based on a review of SPS's financial performance, underlying financial position, financial reporting and considerations of financial capacity and capability at establishment level. Key elements of these areas are discussed in more detail below.

## SPS's financial performance in 2017/18

Expenditure	Actual Outturn £m	Revised Budget £m	Over/(Underspend) £m	Over/(Underspend) %
<b>DEL:</b>	276.772	282.056	(5.284)	(1.8%)
<b>Outside DEL:</b>	71.906	72.701	(0.795)	(1.1%)
<b>AME:</b>	(5.967)	1.400	(7.367)	(536.9%)
<b>Total:</b>	<b>342.711</b>	<b>356.157</b>	<b>(13.446)</b>	<b>(3.8%)</b>

## SPS has effective budget setting and monitoring arrangements

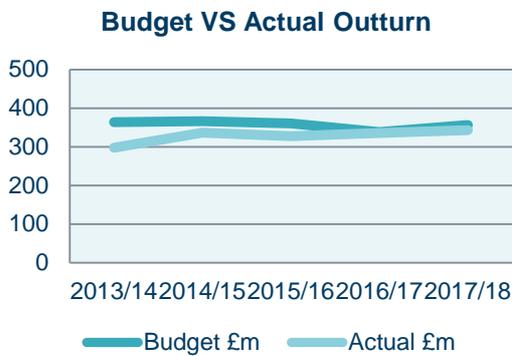
58. We have considered SPS's system of budgetary control and did not identify any significant deficiencies.
59. SPS is expected to manage its budget in accordance with its framework document and the Scottish Public Finance Manual. SPS budget setting and monitoring takes place at both a central and local prison level. Budgets are set based on the indicative funding allocation from the Scottish Government.
60. The central finance team create an annual budget, and issue budget packs to all 13 public establishments and HQ Directorates/Areas. The Finance Manager of each establishment sets an annual budget through Operations Directorate. The budget template provided identifies the main cost driver (staff costs) which is required to be analysed and efficiencies identified where possible.
61. In 2018/19 SPS will receive a flat budget against 2017/18's allocation. The budget planning process is discussed at the Executive Management Group. The process is directed by the CEO. The CEO instructed budgets to

be rolled forward for 2018/19 with directors to identify assessments on the impact of inflation, spending plans, and additional cost pressures/savings. This was to ensure that additional funding requests were only made in relation to corporate objectives. During the 2018/19 planning round, efficiencies were identified by Directors.

62. SPS have comprehensive financial regulations and policies in place, which are held within the shared network of SPS. These policies are subject to regular review and were last reviewed in 2016/17. Where variations in procedure are appropriate for an establishment, prison specific policies are constructed and held centrally.
63. The establishment Finance Managers complete monthly expenditure monitoring returns for Operations Directorate and Financial Policy & Services, which are reviewed and used to prepare the overall monthly performance report.
64. The Head of Financial Policy & Services prepares the monthly financial monitoring reports which are presented to the Risk Monitoring and Audit Committee (RMAC),

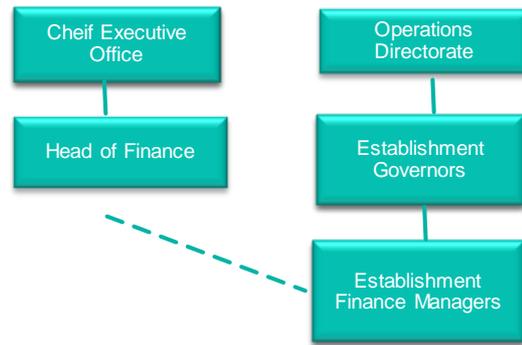
Executive Management Group and the Advisory Board.

- 65. The monitoring reports provide sufficient explanations for any significant variances to date and forecasted against budget.
- 66. We consider SPS's budgetary arrangements to be effective, this demonstrated by the graph below, which shows that SPS has improved delivery against budget over the past 5 years. SPS delivered underspends, mostly relating to the timing of maintenance expenditure against DEL and an underspend against AME primarily as a result of movement of indices between the spring SBR and preparation of the financial statement.



### SPS should consider the design of the financial management structure

- 67. The HQ finance team is led by the Head of Financial Policy & Services, who is accountable to the Chief Executive.
- 68. All 13 public establishments have a Finance Manager, who has a varied and split role between local financial responsibilities (e.g. warrant calculations), and providing the Head of Financial Policy & Services with various monthly monitoring returns.
- 69. The Establishment Finance Managers are directly accountable to the Prison Governors, who is accountable to the Operations Directorate. Work requirements of the Establishment Finance Manger role is split between 2 SPS directorates. This is demonstrated by the chart below.



- 70. In 2016/17 we raised the recommendation that SPS should review their accountability structure of the Establishment Finance Managers to the Operations Directorate to ensure it is effective. However we continue to perceive the above risk significant to future financial performance of the organisation. We recognise that this is being considered by management as part of a finance structure review as reported in our interim report and have not raised a further recommendation.

### Prevention and detection of fraud and irregularity

- 71. Our audit was planned to provide a reasonable expectation of detecting material misstatements in the financial statements resulting from fraud and irregularity. We found SPS's arrangements for the prevention and detection of fraud and other irregularities to be adequate.

### National fraud initiative

- 72. The National Fraud Initiative (NFI) is a counter-fraud exercise co-ordinated by Audit Scotland working together with a range of Scottish public bodies, external auditors and overseen by the Cabinet Office for the UK as a whole to identify fraud and error.
- 73. The most recent NFI exercise commenced in October 2016 and as part of our 2017-18 audit we monitored SPS's participation in NFI. We found the arrangements for participation in the NFI to be satisfactory at the time of reporting in February 2018.
- 74. The NFI uses data matching to compare a range of information held on bodies' systems

to identify potential fraud or error. Bodies investigate these data matches and record appropriate outcomes based on their investigations.

75. The current NFI exercise identified 1,115 matches for SPS, of which 112 were recommended for investigation. In February 2018, all recommended matches had been concluded upon with no frauds or errors identified.

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# Financial sustainability

# Financial Sustainability

## Overall Conclusion

**SPS has good arrangements for short-term annual financial planning and monitoring. However, with only 16% of SPS expenditure is on areas which are not committed in the short term it is challenging to achieve significant savings.**

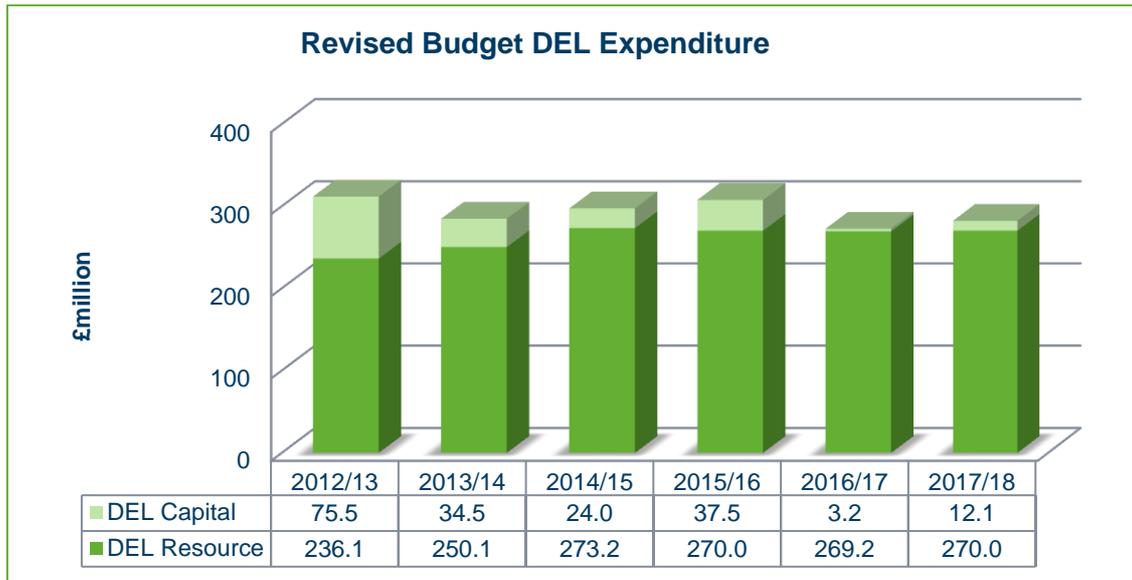
**Crucial to the effective delivery of sustainable financial performance is the effective use of the SPS estate. To manage financial performance appropriate investment in the estate is needed to ensure that repairs and maintenance do not consume a disproportionate share of resources.**

## Financial Planning

- 76.** Scottish Government cash funding comprises 98% of SPS's total income and funding, which is drawn down from the Scottish Consolidated Fund to meet cash requirements in year.
- 77.** The SPS Framework document is based on the Direction of Scottish Ministers and was constructed with the Cabinet Secretary for Justice. SPS operated in 2016/17 within the final year of the 2017-2020 Corporate Plan. The 3 year Corporate Plan is supported by the 2017/18 Annual Delivery Plan, which includes high level budget information.
- 78.** For resource expenditure, as previously stated detailed annual target budgeting takes place centrally, followed by detailed budgets being set at local establishment level. Local budgets are supported by cost driver analysis on staff costs, which is the most significant cost within

SPS. As shown by the table at the bottom of the page, SPS's resource allocation from the Scottish Government has not varied significantly in the past 3 years, signifying a stable funding environment.

- 79.** SPS has a 3 year Infrastructure Investment Plan, as agreed with the Scottish Government. This Plan highlights 4 major capital projects, for which construction and investment is underway for most, estimated capital investment is as follows:
- National Women's Facility - £58.5 million;
  - HMP Glasgow - £170 million; and
  - HMP Highland - £73.9 million
  - HMP Greenock - £75 million.
- 80.** Due to the age of the estate with facilities being built in some areas in the 19<sup>th</sup> Century, it is critical that suitable investment is made in the infrastructure of the organisation. We have noted that the developments at HMP Greenock and HMP Highland may be subject to delay and will consider the implications of this more fully within the 2018/19 audit of SPS. Land related to the development of HMP Highland has been purchased on 29 March 2018 and is held on at cost less irrecoverable VAT. We consider this to be reasonable at this time.

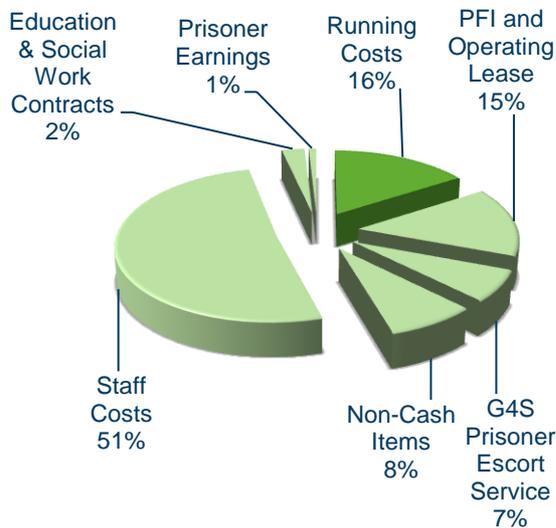


81. We also acknowledge that a high proportion (84% in 2017/18, 85% in 2016/17) of SPS's annual expenditure is largely committed with limited room for fluctuation in the medium and long term, as demonstrated in pale green segments by the chart below.

limited without significant alterations to the service delivery model.

83. Scottish Government has lifted the public sector pay cap for 2018/19. SPS have estimated that this creates a pay pressure on a recurring basis. Based on a flat budget settlement for 2018/19, this makes it increasingly difficult for SPS to deliver services at current levels.

### 2017/18 Gross Expenditure



84. As noted by the chart on the left summarising the proportion of Gross expenditure utilised by the PFI prisons is circa 15% on an annual basis. The contracts with the PFI provider allows for annual increases linked to inflation. Dependent on the nature of the expenditure, this is 2.5-4% per annum. If inflation remains at current levels, the proportion of expenditure on PFI could increase to 20% of SPS DEL Resource allocation (assuming 1% per annum increase), within the next 5 years. This would result in a requirement to save nearly £12m per annum on a recurring basis by 2022/23.

82. With only 16% of SPS's expenditure being in relation to non committed running costs, SPS's ability to make significant efficiency savings is

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# Governance & transparency

# Governance and Transparency

## Overall conclusion

Governance and transparency is concerned with the adequacy of governance, leadership and decision making, and transparent reporting of financial and performance information SPS has appropriate governance arrangements in place overall, but issues have been identified by Internal Audit. Weaknesses have been identified in procurement and contract management which have not yet been fully addressed.

85. Our audit work included reviewing corporate governance arrangements as they relate to the corporate governance framework in place, the information provided to the Board and committees and the risk management arrangements in place.

## SPS Governance Structure

86. The Chief Executive is SPS Accountable Officer, and is responsible for all matters delegated by the Director General for Learning and Justice, as set out in the SPS Framework Document.
87. The Chief Executive is a member of the Advisory Board, which is supported and advised by Executive Management Group and RMAC. The Advisory Board and RMAC are both chaired by a non-executive director.



88. SPS operates a 3 directorate model underneath the Chief Executive Office, which includes Operations, Strategy and Innovation and Corporate Services.

## Risk Management

89. In 2016/17, SPS adopted a framework to focus the alignment of the transformational vision, mission and values of SPS, whilst supporting the wider strategy for Justice in Scotland.

90. SPS's Risk Management Strategy sets basic compliance principles and approaches to risk management to be executed by responsible parties.

91. SPS defines risk appetite within the Risk Management Strategy. Risk appetite is split between strategic, operations, financial, legal/compliance and project risk. The board's currently approved the risk appetite is set out below:

- Strategic risk: medium appetite;
- Operational risk: low appetite;
- Financial risk: low appetite;
- Legal/Compliance risk: low appetite; and
- Project risk: medium appetite.

92. The risk management framework and corporate risk register is overseen by the SPS Corporate Change and Risk Manager, who reports to the Corporate Change Director.

93. We have no issues to report in relation to SPS's Risk Management Arrangements.

## Internal Audit

94. An effective internal audit service is an important element of SPS's governance arrangements. SPS operates in-house internal audit function (AAU).

95. In line with PSIAS, AAU were subject to independent review in 2017/18 to assess their compliance with the standards. The review was undertaken by Falkirk Council Internal Audit Department. Falkirk Council Internal Audit team reported the AAU was "broadly compliant" with PSIAS.

96. We note that internal audit reported an overall reasonable assurance opinion. However internal audit reported 29 areas of limited assurance and no assurance was given on 3 occasions, out of the 133 internal audit reviews conducted in year. Significant areas of limited assurance related to financial controls at 9 establishments, cash and banking and general procurement. Action plans have been developed for each area and progress will be reviewed in 2017/18.

**97.** During the May 2018 RMAC meeting the Head of Internal Audit reported within the annual report that there was slippage in the 2017/18 annual audit plan. During our review of internal audits annual report and annual plan, it was difficult to identify where slippage occurred and how the AAU performed in 2017/18 against the original annual plan. We noted that the CEO and RMAC were informed that there had been slippage in relation to the plan during the year. The Head of Internal Audit is due to consider the presentation of the annual report to better enable a clear understanding of the progress of internal audit.

**98.** During our audit we considered the work of internal audit wherever possible to avoid duplication of effort and make the most efficient use of SPS's audit resource.

### Painting contract

**99.** In the course of routine internal audit work, it was established that there had been significant overcharge against the National Painting Contract. An exercise was commissioned by the Chief Executive led by Internal Audit team and supported with data analysis provided by Scott-Moncrieff to establish the extent of the overcharge. The issues identified included control and policy compliance failure in the following areas:

- procurement;
- contract monitoring; and
- invoice payment review and authorisation processes.

The estimate of the nature and value of the overcharge is still being established based on legal advice informing the next steps that SPS will take.

**100.** Following the initial review of the National Painting contract, a contracts auditor has been recruited to the internal audit team to investigate the extent to which the issues identified apply to other contracts. At the time of this report, this work is ongoing.

**101.** In each of the last three years (2015/16 to 2017/18), Internal Audit identified limited assurance reviews of financial controls at the 13 publicly managed establishments. In 2017/18, an experienced Finance Manager has taken on a temporary role within Financial Policy & Services

to visit each of the prisons and provide more one to one financial training and support to the Finance Managers. Whilst we welcome this appointment, there is risk that SPS have ineffective financial accountability at local establishment level, which directly impacts on the robustness of overall financial control and management. This may have been a contributing factor which resulted in the ineffective operation of controls in relation to the painting contract. As noted in our 2016/17 annual report, SPS should consider if the current accountability structure of the Establishment Finance Managers to the Operations Directorate is effective. This should be considered in conjunction with other recommendations raised with regard to financial management.

### RMAC

**102.** During 2017/18 the RMAC were not quorate at two meetings. We have confirmed through our review of the RMAC minutes that no decisions were made at these meetings that would have breached SPS Policy. As a result we recommended that SPS revise the RMAC terms of reference to allow the numbers required to be quorate, to ensure future compliance and binding decisions in line with SPS's policy are able to be made. Since this change, all meetings have been quorate and this has been appropriately disclosed in the 2017/18 Governance Statement.

### Standards of conduct

**103.** In our opinion SPS's arrangements in relation to standards of conduct and the prevention and detection of bribery and corruption are adequate. Our conclusion has been informed by a review of the arrangements for adopting and reviewing standing orders, financial instructions and schemes of delegation and for complying with national and local codes of conduct.

### Impact of EU Withdrawal

**104.** Audit Scotland has identified EU withdrawal as an emerging significant risk facing public bodies across Scotland. Three streams of potential impact were identified:

- Workforce
- Funding
- Regulation

**105.** SPS has identified the most significant risk as the impact on workforce and has started to consider the potential impact.

## Cyber Security

**106.** In May 2017, a number of bodies across NHS Scotland were impacted by the Wannacry global ransomware attack. In response to this the Scottish Government launched 'A Cyber Resilience Strategy for Scotland: Public Sector Action Plan, 2017/18.

**107.** The action plan outlines a number of requirements that public bodies should be taking forward. This includes an action for public bodies to achieve a Cyber Essentials Plus certification by the end of October 2018.

**108.** SPS has presented regular updates to the RMAC and Board. The most recent update to the Board in May 2018 provided assurance that the Scottish Government deadline would be met and SPS outlined their action plan to achieve this. There were no significant risks to meeting the deadline highlighted as part of this report.

## General Data Protection Regulations

**109.** The General Data Protection Regulations (the Regulations) came into force in the UK on 25 May

2018. The Regulations replaces the Data Protection Act 1998 and as well as strengthening existing regulations the Act has brought in new legislative duties for the Board. The Regulations bring significant potential penalties for non-compliance therefore increasing the importance of compliance.

**110.** SPS used guidance issued by the Information Commissioner's Office to develop an action plan to ensure compliance with the new regulations.

**111.** Compliance with the Regulations is an ongoing process, which we will monitor as part of our annual audit procedures. We have not identified any significant risks to compliance with the Regulations at this stage.

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# Value for Money

# Value for money

## Overall Conclusion

**Value for money is concerned with the appropriate use of resources and ensuring continuous improvement of services delivered. Overall, SPS is generally doing well in meeting or exceeded its key performance indicators for the year. In 2018/19, SPS should prioritise developing a detailed financial model for the 'Prison Officer Professionalisation Programme' (POPP).**

## Prison Officer Professionalisation Programme (POPP)

**112.** SPS's vision 'Helping to build a safer Scotland – Unlocking Potential – Transforming Lives' requires a highly skilled, professional and qualified workforce to unlock potential and transform lives. SPS published 'The Value Proposition' in December 2016, which highlights the need for SPS to become a 'Citizen Recovery' service, which prisoner officers are the main driving force. SPS's 2017-2020 corporate plan has been built around this outcome focused vision.

**113.** In order to achieve this vision, SPS aim to change the operational model within prison walls, by expanding the role expectations of the Prisoner Officers and their First Line Managers. SPS are therefore re-designing the training and qualifications provided to the prison officer, to match the stretched role expectations.

**114.** POPP is currently being led by the Director of Corporate Change. The programme was initiated in June 2017 and the main planning and design stages have been completed.

**115.** There are a number of phases of the decision-making process currently and simultaneously underway:

- Preparation of the full business case including finalising the pay and grading

- approach all of which is in conjunction with the POA(S) and industry experts;
- preparation for concluding the engagement with Scottish Government Ministers and policy owners leading to an approval to proceed to the 'offer' stage;
- preparation for fully informed presentation of the 'offer' and dialogue with POA(S) membership;
- preparation for a ballot of POA(S) membership on whether to accept or reject the 'offer'; and
- preparation for positioning SPS and Ministers on the consequences of acceptance/rejection of the 'offer'.

**116.** The financial modelling aspects of the new operational model will require significant financial investment, but are anticipated to be cost neutral. However, this has not been fully developed and subject to detailed stress testing. The financial model will be built on efficiency savings. SPS have not fully developed the financial model for the implementation of POPP. **See appendix 1, action point 3.**

**117.** We will continue to review and monitor the progress of POPP, as part of the 2018/19 audit.

## Demonstration of value for money

**118.** SPS considers its approach to delivering savings as part of budget setting and monitoring arrangements as summarised under Financial Management.

**119.** Work has been undertaken to ensure best value in areas of spend which are not yet committed. Examples of this include:

- Tendering of the new prisoner escort contract; and
- Review of contracts for the provision of education services being consolidated to a single college (Fife College).

**120.** For each year of the 2017-20 Corporate Plan SPS develop an Annual Delivery Plan (ADP).

The ADP sets out the Essential Actions to be delivered during course of the year in order to deliver Strategic Outcomes. Progress is reported quarterly to the Executive Management Group with reporting on matters related to risk management, control and governance reported to RMAC.

**121.** The 2017-18 ADP contained 20 Essential Actions and good progress has been made. 15 have been delivered in full with two having been delivered in part and three assessed as being undelivered. The three areas which are not delivered are:

- Develop and/or revise policies, practices and guidance to meet SPS obligations contained within wider justice sector reform.
- Agree a strategic approach to Population Management and Estate Configuration.
- Develop an internal shared services model for finance.

## HM Inspectorate of Prisons for Scotland reviews

**122.** Four full inspections have been carried out by HM Inspectorate of Prisons for Scotland related to 2017/18. All were graded overall as either Satisfactory or Generally Acceptable. Environmental issues were noted at HMP Inverness, which further emphasises the need to ensure that the estate remains fit for purpose.

## Looking forward

**123.** Like all public sector organisations, SPS has a number of emerging challenges to continue to deliver services effectively. Key challenges include:

- Prison Officer Professionalisation is being introduced and represents a significant reform programme which will change the role of prison officers and how prisoners are looked after and rehabilitated;
- A smoking ban within the prison estate will be introduced in November 2018 representing a significant change to the lives of many prisoners and SPS staff. This represents a major project for the

SPS, with planning for implementing the ban well underway.

- There has been a shift in the makeup of the prison population in Scotland. The increased application of alternatives to imprisonment for those receiving shorter sentences is reducing the prisoner population. At the same time, there is a trend towards longer sentences for more serious offences which is increasing the prison population. The fastest growing age group of inmates are those over 50 with a reduction in the number of young offenders in custody. All of these factors change the operational demands on the prison service as overall prison populations increase and the care and rehabilitation requirements presents a significant challenge to SPS with different resources needed to effectively care for and rehabilitate inmates in the two groups. It is vital to engage effectively with partner groups including the NHS and social care providers to ensure that the needs of the inmate population are appropriately met.
- Many prisons within the prison service estate were built in the Victorian era to serve a very different prisoner population and imprisonment culture. Significant investment in the prison estate is now required to support a modern prison service. In particular, HMP Barlinnie is the key establishment for management of the overall prisoner population, but was built in 1882, is expensive to operate and maintain and is difficult to adapt to meet modern prisoner management standards.

The key challenges outlined above must be viewed in the context of financial austerity. Salary and estate management costs account for the significant majority of SPS expenditure and these costs are rising at above inflation levels whilst revenue funding is relatively flat, placing a continuing financial challenge to the Service. There is limited scope for the SPS to continue to deliver efficiency savings without more radical service re-design.

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## Appendices

# Appendix 1: Management action plan

Our action plan details the control weaknesses and opportunities for improvement that we have identified during our 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 audit of the annual report and accounts or of risks or weaknesses 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 SPS 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:

<b>Grade 5</b>	Very high risk exposure – major concerns requiring Board attention
<b>Grade 4</b>	High risk exposure – material observations requiring senior management attention
<b>Grade 3</b>	Moderate risk exposure – significant observations requiring management attention
<b>Grade 2</b>	Limited risk exposure – minor observations requiring management attention
<b>Grade 1</b>	Efficiency / housekeeping point

Action plan point	Issue & Recommendation	Management Comments
<b>1. Review of Indexation Calculation</b>	<p><b>Observation</b></p> <p>The District Valuer (DV) currently provides indexation rates for 5 areas of residential land (Glasgow, Edinburgh, Aberdeen, Dundee and Perth). To calculate indexation, SPS take an average of these indexation rates and apply the sum to opening values, to revalue their land and buildings which have not been revalued in the year.</p>	<p><b>Action owner:</b></p> <p>Head of Financial Policy &amp; Services</p>
<b>Rating</b>		<p><b>Due Date:</b></p> <p>31 March 2019</p>
<b>Grade 3</b>		<p><b>Agreed:</b></p> <p>Residential land indices will be requested and applied for each of the geographical areas.</p>
<b>Paragraph ref</b>	<p>We have identified that SPS hold land in the areas of Stirling, Falkirk and Greenock. SPS do not receive information from the DV for these areas, to enable them to calculate indexation more accurately.</p>	
<b>24</b>	<p><b>Recommendation</b></p> <p>We recommend that SPS obtain the appropriate indexation rates for all 8 geographical areas to which they own land and buildings, from the DV. SPS should calculate indexation by applying specific indices to the correct geographical location for each land and building asset, and not take the average of all indices.</p>	

Action plan point	Issue & Recommendation	Management Comments
<b>2. Review of Asset Useful Lives Accounting Policy</b>	<p>This recommendation was raised during our 2016/17 audit.</p> <p><b>Observation</b></p> <p>We identified that 65% (68% in 2016/17) of fixed assets within the Fixed Asset Register were held at a nil NBV. As part of our controls review, we did not identify any control deficiencies or weaknesses in SPS's asset verification procedures. This indicates the useful lives as per SPS's depreciation accounting policy could be understated.</p>	<p><b>Action owner:</b></p> <p>Head of Financial Policy &amp; Services</p>
<b>Rating</b>		<p><b>Due Date:</b></p> <p>31 March 2019</p>
<b>Grade 3</b>		<p>An internal review of the policy has been undertaken and identified a requirement for some change to asset lives in the policy. Due to the volume of assets held at nil NBV, a longer term exercise will be necessary to confirm their status and the revised elements of the policy will be derived from this exercise.</p>
<b>Paragraph ref</b>	<p><b>Recommendation</b></p> <p>We recommend SPS conduct a review of the depreciation accounting policy for reasonableness.</p>	
<b>27</b>		

Action plan point	Issue & Recommendation	Management Comments
<b>3. Financial Sustainability - POPP</b>	<p><b>Observation</b></p> <p>The financial modelling aspects of the new operational model will require significant financial investment, but are anticipated to be cost neutral. However, this has not been fully developed and subject to detailed stress testing. The financial model will be built on efficiency savings. SPS have not fully developed the financial model for the implementation of POPP.</p>	<p><b>Action owner:</b> Director of Corporate Change</p> <p><b>Due Date</b> 30 April 2019</p> <p>The Programme is currently modelling both the impact of efficiencies generated through a new operating model and the pay implications in the short, medium and longer terms. The financial case for the forward programme is currently being rigorously tested for affordability, financial sustainability as well as operational viability. The financial models will be subject to a further due diligence check by SM. The financial plans for the service will take into account the implementation of POPP. The authorisation route for the proposals, including appropriate advice and approvals through Scottish Government, have been planned and will be sought as part of the approval process over summer 2018. The risk as defined is already identified as part of the POPP Programme Risk Register and appropriate processes and measures to manage and mitigate the risk are identified as part of programme planning.</p>
<b>Rating</b>	<p><b>Recommendation</b></p> <p>SPS should consider the financial impact of POPP and in conjunction with developing their draft financial strategy, incorporate the financial implications on POPP.</p>	
<b>Grade 3</b>		
<b>Paragraph ref</b>		
<b>112-116</b>		

# Appendix 2: Respective responsibilities of the Board and the Auditor

## Responsibility for the preparation of the annual report and accounts

It is the responsibility of the Board and the Chief Executive, as Accountable Officer, to prepare financial statements in accordance with the Government Financial Reporting Manual (FRoM) issued by HM Treasury and the accounts directors issued by Scottish Ministers under section 19(4) of the Public Finance and Accountability (Scotland) Act 2000.

In preparing the annual report and accounts, the Board and the Chief Executive, as Accountable Officer are required to:

- apply on a consistent basis the accounting policies and standards approved by Scottish Ministers;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards as set out in the Financial Reporting Manual have not been followed where the effect of the departure is material;
- prepare the accounts on a going concern basis unless it is inappropriate to presume that the Board will continue to operate; and
- ensure the regularity of expenditure and income.

Board members are also responsible for

- keeping proper accounting records which are up to date; and
- taking reasonable steps for the prevention and detection of fraud and other irregularities.

## Auditor responsibilities

We audit the annual report and accounts and give an opinion on whether they:

- give a true and fair view in accordance with the Public Finance and Accountability (Scotland) Act 2000 and directions made thereunder by the Scottish Ministers of the state of the board's affairs as at 31 March 2018 and of its net expenditure for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2017-18 FRoM ;
- have been prepared in accordance with the requirements of the Public Finance and Accountability (Scotland) Act 2000 and directions made thereunder by the Scottish Ministers;
- in all material respects the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers;
- the auditable part of the Remuneration and Staff Report has been properly prepared in accordance with the 2017-18 FRoM and directions made thereunder by the Scottish Ministers; and
- the information given in the Performance Report for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the 2017-18 FRoM and directions made thereunder by the Scottish Ministers; and
- the information given in the Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the FRoM directions made thereunder by the Scottish Ministers.

We are also required to report by exception if, in our opinion

- adequate accounting records have not been kept; or
- the annual accounts and the part of the Remuneration and Staff Report to be audited are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit; or
- there has been a failure to achieve a prescribed financial objective.

### Wider scope of audit

The special accountabilities that attach to the conduct of public business, and the use of public money, mean that public sector audits must be planned and undertaken from a wider perspective than in the private sector. This means providing assurance, not only on the annual accounts, but providing audit judgements and conclusions on the appropriateness, effectiveness and impact of corporate governance and performance management arrangements and financial sustainability.

The Code frames a significant part of our wider scope responsibilities in terms of four audit dimensions. As part of our annual audit we will consider and report against these four dimensions: financial management; financial sustainability; governance and transparency; and value for money.

### Independence

We are required by International Standards on Auditing to communicate on a timely basis all facts and matters that may have a bearing on our independence. We can confirm that we have complied with the Financial Reporting Council's Ethical Standard. In our professional judgement the audit process has been independent and our objectivity has not been compromised. In particular, there have been no relationships between Scott-Moncrieff and the Board or senior management that may reasonably be thought to bear on our objectivity and independence.



**Scott-Moncrieff**  
business advisers and accountants

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