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# Scottish Prison Service

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

Year ended 31 March 2011

30 June 2011

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**About this report**

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 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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This report summarises our work for 2010-11 and our findings in relation to our audit of the financial statements, corporate governance and performance management arrangements.

#### **Financial statements**

Following chief executive approval in June 2011, we issued an audit report expressing an unqualified opinion on the financial statements for the year ended 31 March 2011 and on the regularity of transactions reflected in those statements.

The 2010-11 reportable spend, including capital and revenue, shows a net underspend of £7.2 million against the departmental expenditure limit. This has been achieved through an underspend on capital expenditure of £5.1 million, an underspend on operations of £3.0 million and an overspend on impairments and provisions of £0.8 million. The actual cost per prisoner place for 2010-11, as defined, was £32,146 (within the target of £36,750 and represents an increase of 1.4% compared to 2009-10).

Total provisions as at 31 March 2011 are £32.6 million (2010 : £26.9 million), of which £18.9 million (2010 : £16.1 million) relate to prisoner claims.

Net Assets at 31 March 2011 are £792 million (2010: £710 million). The main reason for the movement in net assets is the significant capital additions in year £139 million (2010: £88 million). Land and buildings revalued at 31 March 2011 resulted in a reduction in asset value of £26 million (2010: £94 million)

#### **Governance and accountability**

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 annual internal assurance programme supports the assessment of the operation of the system of internal control. Responsible officers provide a statement of assurance to the chief executive to assist in his preparation of the statement.

Our testing of the design and operations of controls over entity level controls and significant risk points in key financial processes confirms that, controls are designed appropriately and operating effectively.

#### **Performance**

Scottish Prison Service (“SPS”) continues to have strong performance management arrangements in place, and performance is measured on a monthly basis against key performance indicators. A number of key performance indicators have been set by Ministers, with the primary financial measure being average annual cost per prisoner place.

SPS have reported savings of £32.6 million for 2010-11 against a target of £25.6 million under Scottish Government efficiency targets. Budgeted savings have been attained due to the SPS operating at an average of 7,816 prisoners during the year 216 prisoners higher than the budgeted figure thus creating a notional saving of £7.1 million. During the course of the budgeting cycle SPS effectively had £25.5 million cut from its original budget which amount to the remaining savings in year.

SPS have been set an efficiency target of £5 million for 2011-12, which management notes will be challenging to achieve due to the anticipated rise in prisoner numbers.



## Executive summary

# Headlines

Our audit work is undertaken in accordance with Audit Scotland's Code of Audit Practice ("the Code"). This specifies a number of objectives for our audit.

This report summarises our work for the year ended 31 March 2011.

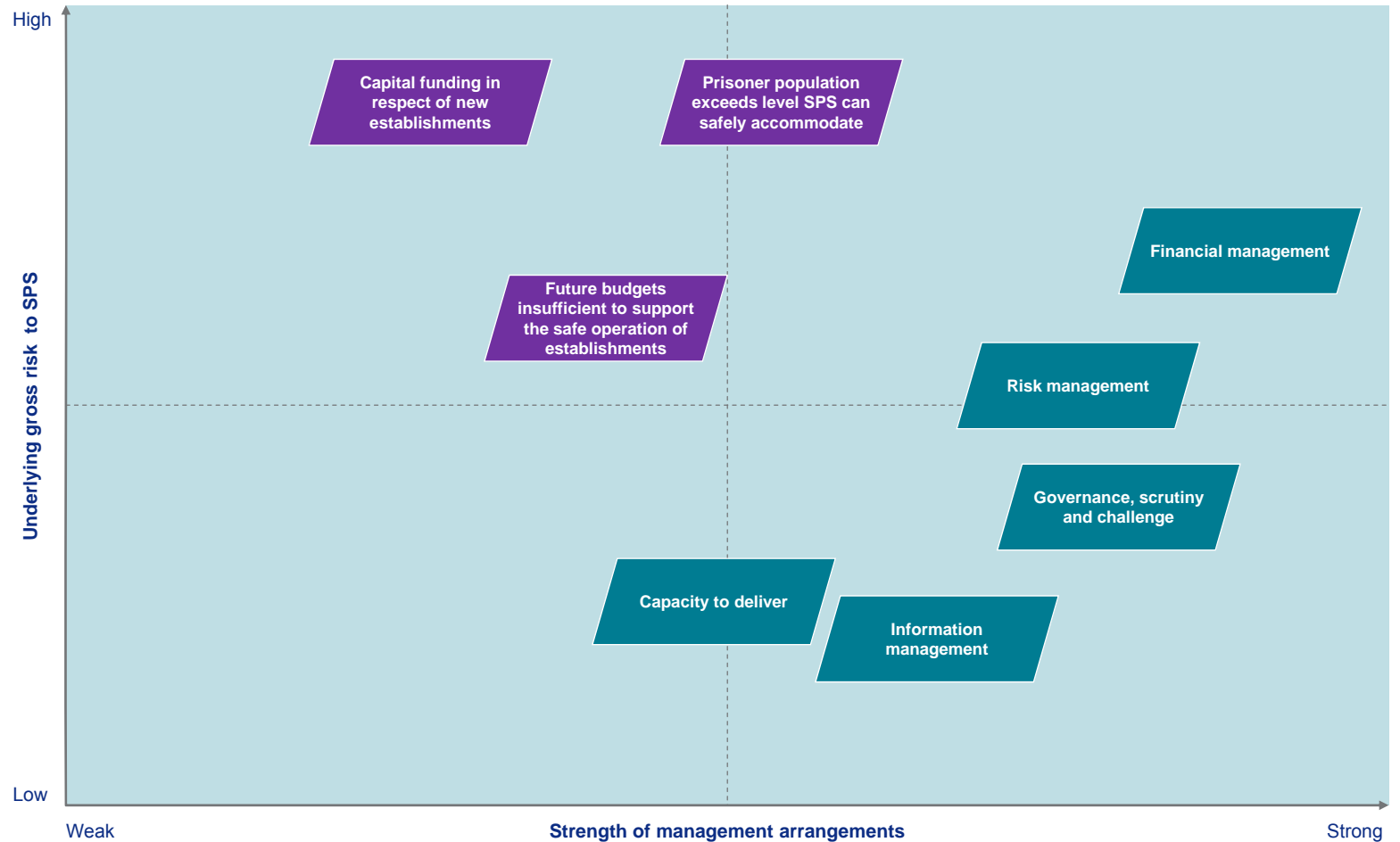
We wish to record our appreciation of the continued co-operation and assistance extended to us by Scottish Prison Service staff during the course of our work.

Recommendations in appendix one include a number of suggestions for improvement, none of which are considered to be 'high' risk.

Priorities and risks	
Management has made significant progress to enhance arrangements around the funding of current major capital projects through gaining assurances from the Scottish Government that the funding shortfall for 2011-12 will be met. Some risks continue to exist around project completion, but internal processes reduce the likelihood and potential impact on the SPS.	Page 4
We continue to report significant risks in respect of resource availability for prison capacity. In our view, the risk that resources are not available to complete and staff projects such as HMP Low Moss continues to present ongoing challenges to operational sustainability.	Page 5
Financial statements	
We have issued unqualified audit opinions on the 2010-11 financial statements and the regularity of transactions reflected in those financial statements.	-
A number of technical accounting matters were considered during the audit process; management provided good quality analysis and no adjustments were required.	Page 6
Use of resources	
SPS met its financial targets recording an under spend against the spring budget of £7.2 million.	Page 7
We assessed management's response to Audit Scotland's national report on procurement. Management has taken reasonable action to mitigate risks and improve processes at a local level.	Page 9
Governance	
There have been no significant changes and the statement on internal control continues to confirm the existence of a comprehensive framework of internal control.	Page 10
Internal audit completed their plan and did not report any significant risk recommendations.	Page 10
Arrangements to prevent and detect fraud are embedded in internal controls, including processes to comply with requirements in respect of the National Fraud Initiative.	Page 10
Recommendations	
We have noted a number of areas where SPS may be able to improve its operating effectiveness and efficiency. These recommendations are low priority areas and do not merit a formal action plan. Management may wish to consider these going forward.	Page 12

Competing risks and pressures continue to present new and recurring challenges. Overall, the impact of sector priorities present a high risk.

The diagram summarises the potential underlying risks to achievement of strategic objectives, compared to the strength of management arrangements to mitigate these risks. The following pages summarise the areas where we believe that significant risks are present, together with how management arrangements are likely to mitigate or eliminate these risks to a greater or lesser extent.



Arrangements in respect of the estate development programme are likely to mitigate the impact of significant risks.

Management's approach to the risk of prisoner population exceeding safe capacity is unlikely, in its current form, to address recurring risks to sustainability.

<b>Future SPS budget insufficient to support the safe operation of prisons</b>	<p>To reduce the risk, management strive to ensure that SPS is operating as effectively and efficiently as possible. Performance contracts are agreed with each prison and these are aligned to the SPS delivery plan.</p> <p>Management note that following the May 2011 election, budget setting for the 2012-13 to 2014-15 period will need to be monitored to ensure that budgets are sufficient to operate safely.</p>	<p>In our view, risk reduction measures in place are sufficiently robust to mitigate risks around future funding for the Service.</p>
	<ul style="list-style-type: none"> <li>■ In our view significant risks exist, but actions have been identified which are designed to address the problem .</li> </ul>	
<b>Prisoner population exceeds level that SPS can safely accommodate</b>	<p>To mitigate this risk, management agree budgets for each prison which are aligned to service agreements, thus ensuring each establishment has sufficient resources to operate effectively.</p> <p>The maximum capacity of each prison is also defined in 2010-11 performance contracts.</p> <p>SPS requires agreement with ministers for appropriate measures to take in the event that prisoner numbers exceed a safe and legal operating level.</p>	<p>Risk reduction measures in place are sufficient to understand the prison capacity at which SPS can safely operate however clarity needs to be reached with ministers, in a timely manner, as to how SPS can continue to operate safely at all times.</p>
	<ul style="list-style-type: none"> <li>■ In our view significant risks exist, but actions have been identified which are designed to address the problem.</li> </ul>	
<b>Estates development programme fails to provide sufficient capacity to accommodate the prisoner population</b>	<p>Management monitors all current developments in approved capital programmes to ensure that they are completed on schedule.</p> <p>SPS aims to extend the current capital programmes to ensure that the prison estate is 100% fit for purpose and provides sufficient capacity to accommodate the projected prison population of 10,000 by 2019-20.</p>	<p>Controls in place to mitigate the risk of slippage on major capital programmes are sufficient to monitor current projects.</p> <p>Discussion with ministers will progress in 2011-12 to ensure that the estate is fit for purpose.</p>
	<ul style="list-style-type: none"> <li>■ In our view risks exist but actions have been identified to address these risks.</li> </ul>	

Management anticipated risks around non-current asset valuation and provisions; no audit adjustments were required and matters were concluded in a timely manner.

Areas of HIGH audit risk			
Area	Value (£'000)		KPMG comment
	2010	2011	
Non-current assets valuation	763,320	850,602	<p>During the year the SPS made improvements to Buildings, and purchased Plant and Equipment, Fixtures and Fittings, Computer Equipment and Software at a cost of £139,299k, (2009-10 £87,902k).</p> <p>Land and Buildings were either revalued or indexed at 31 March 2011 which resulted in a reduction in the asset value of £25,626k.</p> <ul style="list-style-type: none"> <li>■ No adjustment to the financial statements was necessary.</li> <li>■ Financial statement disclosures in this respect are complete and accurate.</li> </ul>
Provisions – prisoner claims	16,114	18,885	<p>In line with prior years, management has engaged legal advisers from the Scottish Government Legal Directorate “SGLD” to help assess claims and estimate the level of provisions required. We have sought confirmation from the SGLD for the amounts provided by SPS in relation to prisoner claims. SGLD confirmed that amounts provided at the 31 March 2011 were the best possible estimates at the current time for relevant costs. Management continue to monitor the potential financial impact of claims.</p> <ul style="list-style-type: none"> <li>■ No adjustment to the financial statements was necessary.</li> <li>■ Financial statement disclosures in this respect are complete and accurate.</li> </ul>

Systems and controls
<p>Preparation of the financial statements</p> <ul style="list-style-type: none"> <li>■ Draft financial statements and supporting documentation were provided between 3 May and 23 May, which was in line with the agreed timetable.</li> <li>■ The schedules and supporting documentation were prepared to a high standard and submitted for audit both in electronic and paper format.</li> </ul>
<p>Control environment</p> <ul style="list-style-type: none"> <li>■ Overall, management’s approach to preparing the financial statements is efficient. Management worked consistently to the audit timetable which built in time for internal review before schedules were submitted for audit.</li> </ul>

**SPS has recorded an under spend of £7.2 million against spring budget figures.**

**SPS has surpassed efficiency savings target of £25.6m in 2010-11. These savings have been reviewed by internal audit.**

### **Financial position**

The SPS budget was finalised in Spring 2011 and budgeted total expenditure of £456.4 million, split between operating expenditure £317.0 million and capital expenditure £139.4 million.

SPS recorded an under spend against this budget of £7.2 million. This breaks down into an under spend on operating expenditure of £3.0 million relating primarily to the release of provisions in the year and a £5 million under spend on capital which relates to slippage on significant capital projects due to the bad weather experienced before Christmas.

### **Net operating cost**

The SPS has reported a Net Cost for the Financial Year of £310,024k (2009-10 £279,875k). This represents an increase of 10.8% over the comparative figures for 2009-10 which included a significant release of provisions which reduced the net operating cost in 2009-10. Of this increase, staff costs increased by 1.5% and other costs by 4.3%. The reduction in running costs primarily relates to impairment charges following the valuation and indexation of land and buildings at 31 March 2011.

Whilst the number of prisoners, held in custody increased from 7,758 on 1 April 2010 to 8,034 on 31 March 2011 the average number of prisoners, held in custody during 2010-11, fell to 7,853 from 7,967 in 2009-10. The numbers exceeded 8,000 on 17 occasions throughout the year peaking at 8,059 on 24th May 2010 (figures exclude Home Detention Curfew).

### **Efficiency savings**

The Scottish Government set SPS efficiency savings targets of £25.6 million for 2010-11. SPS has reported savings achieved of £32.6 million in the year surpassing the target by £7 million (27%).

The government's spending plans for 2010-11 were based on an average custodial prisoner population of 7,600 during the year. £7.1 million of the reported saving is recorded because the average custodial prisoner population was 7,816 and SPS incurs savings for each prisoner above the 7,600 budgeted threshold.

The remaining £25.5 million in savings arises from SPS budget reductions made during the funding cycle by the Scottish Government Justice department.

Internal audit have reviewed savings reported by SPS in the year and has concluded "SPS has delivered savings in the year of £32.6 million against the total target of £25.6 million and that this has been achieved without a diminution in service."

All savings reported have been verified by internal audit to ensure they concur with the Scottish Government's efficiency savings unit's definitions of legitimate reportable savings.



### **Financial plans 2011-12 and beyond**

The Scottish Government has been allocated a resource and capital budget which will reduce by 6.8% and 38.4% respectively in real terms by 2014-15.

On the 9 February 2011, the Scottish Parliament approved the Budget Bill 2011-12 in which, SPS was allocated a draft Departmental Expenditure Limit of £365.5 million comprising of £318.0 for resource and £47.5 million for capital. This budget recognised a shortfall in capital funding on major projects of £22 million which the Scottish Government has since agreed to fund.

The resource budget has reduced by £15.1 million with £10 million of this reduction being attributable to the planned transfer of the responsibility for prisoner health care to Health with effect from November 1, 2011. The remaining savings when taken into consideration with general inflation, increase in VAT and pay inflation total required savings of £12 million for 2011-12. SPS will also be required to cover start up costs for Low Moss of £13 million.

To meet these savings the budget setting process for 2011-12, which was confirmed to the SPS Board in February has identified £9.4 million savings.

### **Key risks**

Achievement of the financial plan will be challenging due external pressures. The key risks identified are similar to the prior year and are summarised in the table below.

#### **Key risks identified**

- completion of HMP Low Moss;
- funding and successful completion of HMP Low Moss operational start-up project; and
- the risk of growth in the prisoner population

**Audit Scotland national studies**

Audit Scotland periodically undertakes national studies on topics relevant to the performance of central government bodies.

While the recommendations from some of the studies may have a national application, elements of the recommendations are also capable of implementation at board level, as appropriate.

Audit Scotland's corporate plan 2009-12 reinforces a commitment to maximising the impact of their work and demonstrating this impact. As part of this process, external auditors are required to provide information on how bodies respond to national performance audit reports.

Management has procedures in place to consider individual reports. In addition, where appropriate, management will carry out a self-assessment against the national study and implement local action plans as required.

In 2010-11 a more targeted follow-up was to be completed by auditors in respect of SPS's actions following publication of the joint Accounts Commission / Auditor General for Scotland report, "Improving Public Sector Purchasing" published in July 2009.

Our work centred around the answers to three questions to facilitate analysis of the Board's arrangements. Overall, taking into account the size and nature of the Board, we found that processes are appropriate and mitigate the issues highlighted by the report. We noted that in the two procurement capability assessments that SPS had participated in in 2009 and 2010, SPS had been graded superior.

We have provided a separate report to management and Audit Scotland in respect of this follow-up work.

**Over-arching and supporting corporate governance arrangements remain primarily unchanged and provide a sound framework for organisational decision-making.**

<p><b>Corporate governance framework</b></p>	<p>Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviour. The three fundamental principles of good corporate governance – openness, integrity and accountability – apply to all bodies. Through its chief executive, the Board 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:</p> <ul style="list-style-type: none"> <li>- the Board’s reviews of its systems of internal control, including its reporting arrangements;</li> <li>- the prevention and detection of fraud and irregularity; and</li> <li>- standards of conduct and arrangements for the prevention and detection of corruption.</li> </ul>
<p><b>Statement on internal control</b></p>	<p>The statement on internal control provides details of the purpose of the framework of internal control, along with an analysis of its effectiveness. This statement is in compliance with guidance issued by the Scottish Government.</p>
<p><b>Internal controls</b></p>	<p>Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls are designed appropriately and operating effectively.</p>
<p><b>Internal audit</b></p>	<p>Internal audit have submitted all but one of their planned reports for the year. We have relied on a number of reports, including those in respect of budget planning and monitoring, financial management and control, cash and banking, general procurement, review of payroll, review of efficiency savings and delegated financial authority. These reports do not make any ‘critical’ recommendations.</p> <p>Internal audit’s 2010-11 annual report provides assurance that <i>“there are no material issues that would affect the Statement on Internal Control for 2010-11”</i>.</p>
<p><b>Fraud and irregularity</b></p>	<p>There were four occurrences of fraud identified in 2010-11. Two of the occurrences of fraud were at HMP Edinburgh, which involved falsification of accounting records. The first occurrence related to falsification of stock records and resulted in a sum of £29k being written off. The second related to falsification of cash entries. This resulted in £9k being written off. The two other frauds identified did not result in financial loss to SPS. Following investigation and adjudication, all staff were dismissed. The Fraud Response Group, working with the Investigation Unit, worked closely with the finance team to put in place appropriate controls to prevent the frauds reoccurring. Internal audit will review these controls in 2011-12.</p> <p>SPS participated in the National Fraud Initiative (NFI) exercise in the year and has a low number of matches which are being investigated.</p>



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# Appendix

**We have not identified any high risk recommendations however there are a number of areas where management could approve efficiencies going forward.**

We have noted a number of areas where SPS may be able to improve its operating effectiveness and efficiency. These recommendations are low priority areas and do not merit a formal action plan. Management may wish to consider these going forward.

### [Increased use of information technology to reduce the paper trail](#)

In our view the Service continues to be very paper based in its processes and efficiencies could be achieved in certain areas through improved use of information technology.

For example, amendments to the payroll system concerning, bank details, change of name or change of address could be managed through a self help IT module rather than through a paper trail. Removing, where the control environment permits, such paper trails will generate savings in terms of storage, printing and staff time. It could also enhance the overall control environment.

It was also noted that invoices are not scanned and stored electronically but are instead retained manually at a number of establishments. Efficiencies may be gained by investment in a document management system.

### [Assets under construction](#)

Assets under construction are currently not added to the Britannia fixed asset register until the assets come into use. It may be possible to add these items to the fixed asset register at a zero rate of depreciation and thus avoid completing a reconciliation between the ledger and the fixed asset register.

### [Use of space at Calton House](#)

It has been noted that the SPS headquarters at Calton House has spare capacity. At other central government clients where this situation has arisen, spare office space has been rented to other government agencies thus creating savings for the lease holder.



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