Key Issues Memorandum

Scottish Public Services Ombudsman

For the year ended 31 March 2011

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To the Scottish Public Services Ombudsman (SPSO), the Audit and Advisory Committee and the Auditor General for Scotland.

The purpose of this memorandum is to highlight the key issues affecting the results of the SPSO and the preparation of the financial statements for the year ended 2011. It is also used to report to management to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) 260.

We take responsibility for this memorandum, which has been prepared on the basis of the limitations set out in 'The small print'.

This is the final year of our audit appointment, so we would like to take this opportunity to record our appreciation for the kind assistance provided by the Accountable Officer and his staff during our audit.

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1 Executive summary

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Audit opinion	• We intend to give an unqualified opinion on both the financial statements of the SPSO for 2010-11 and on the regularity of transactions undertaken during the financial year.

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Overall governance	• The SPSO has effective governance arrangements in place and these are working well.

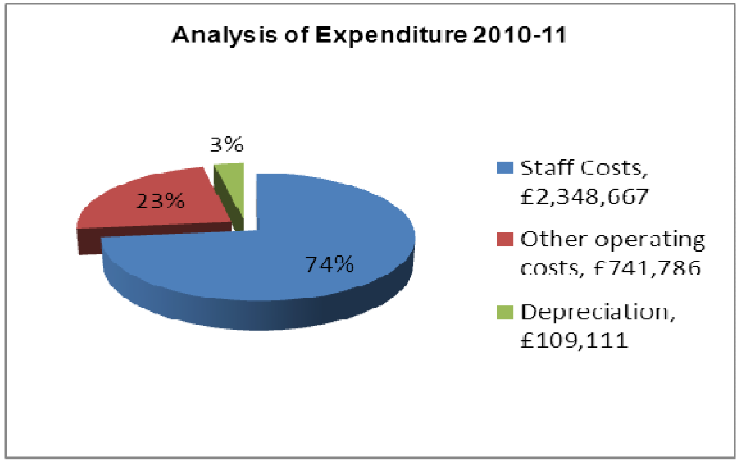
Performance and Best Value	
Performance, best value and efficiencies	SPSO has appropriate procedures in place to plan, monitor and report on best value, performance and efficiency. The organisation performed well against its key performance indicators for complaints processing, but the impact of the business change process and an increase in the number of investigations being reported to Parliament, has caused some slippage in performance in closing investigations. This outcome is expected to be temporary, and overall we consider operational performance to be good.

Looking forward	
Public Sector Reform	• SPSO faces a significant challenge during 2011-12 as it absorbs complaints services from other bodies and progresses its new complaints standards authority role. Early planning, effective project management and governance, and constant review and monitoring of budgets will be critical to a successful outcome.

2 Financial reporting

2.1 Financial statements

	2011 £'000	2010 £'000
Admin Costs		
Staff Costs	2,349	2,561
Other admin costs	741	761
Depreciation	109	106
Operating Income	(90)	(15)
Net Operating Costs	**3,109**	**3,413**



Financial Performance

The Ombudsman incurred net operating costs of £3.1 million for 2010-11, compared to £3.4 million for 2009-10 (a reduction of 9% or £304,000). The majority of this saving was achieved through lower staff costs. There was also an increase in income from SPSO running external training courses.

Staff costs accounted for 74% of the total expenditure. These costs were £137,000 under budget and £212,000 lower than 2009-10. The decrease was due to a restructure of staffing in the previous year which also included severance payments.

Other admin costs, which account for 23% of total expenditure, were £20,000 lower than 2009-10 and substantially lower than budgeted. Whilst there were increases in training material, IT costs and repairs (due to the cost of a replacement boiler), these were more than offset by planned decreases in expenditure on call charges, property repairs and, particularly, consultancy fees.

2.2 Financial position

	2011 £'000	2010 £'000
Bank balances	**204**	**52**

The Ombudsman receives funding for operating costs and capital expenditure from the Scottish Parliamentary Corporate Body (SPCB) for his annual budget.

£3.17 million of funding was received in the year, compared to £3.25 million for the previous year, a reduction of £83,000. However, the total cash requirement for 2010-11 was only £3.02 million[1], resulting in an increase in the cash at bank to £204,000 at 31 March 2011 compared to £52,000 at 31 March 2010. This was due to a short term timing difference because the cash funding for an IT project costing £147,000 had been drawn down on 31 March 2011 but will not be spent until 2011-12.

[1] *Source: Statement of Cash Flows - net cash outflow from operating activities and net cash outflow from investing activities.*

3 Financial statements

3.1 Findings and conclusions

The SPSO is required to produce financial statements under an Accounts Direction issued by the Scottish Ministers. The Accounts Direction requires the SPSO to prepare its financial statements in line with the accounting principles and disclosure requirements of the 2010-11 FReM.

We audit the financial statements and give an opinion on whether they give a true and fair view. Our opinion also covers whether the expenditure and receipts shown in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

We also review the Statement on Internal Control and consider the SPSO's compliance with Scottish Government guidance, the adequacy of the process put in place by the Accountable Officer to obtain assurances on systems of internal control and assess whether disclosures in the Statement are consistent with the information emerging from our normal audit work.

The draft financial statements and supporting working papers were presented for audit prior to the fieldwork and were of a high standard. As a result, only two audit adjustments have been identified following the audit procedures. These were not processed as they were not material to the financial statements.

We intend to give an unqualified opinion on both the financial statements of the SPSO for 2010-11 and on the regularity of transactions undertaken during the financial year.

Specific issue identified in the Audit Approach Memorandum	Auditor Response
Cost of Capital Restated HM Treasury, under the Clear Line of Sight (Alignment Project) removed the cost of capital charge from budgets and accounts from 1 April 2010. As explained in the Audit Approach Memorandum, this is a change in accounting policy and requires a prior year adjustment along with the necessary disclosures for transparency.	We reviewed the draft 2010-11 accounts to ensure that the disclosures are accurate and checked the calculation of the adjustment. We are satisfied that the financial statements comply with the relevant accounting standards.

Other Audit Issues	Auditor Response
Remuneration Report FReM Exposure Draft (10/01) was issued last year regarding information to be included in the Remuneration Report. The proposals include the inclusion of the remuneration details of all senior staff from level SCS3 and above in the Remuneration Report from 2010-11. At present, the SPSO only disclose the remuneration details of the Ombudsman, as the SPSO's view is that only the Ombudsman has overall influence and control over the whole of his operations. In our 2010-11 report, we suggested that this view may be a narrow interpretation of the FReM and that the SPSO should consider implementing the proposals of the exposure draft in the current year as best practice. Management's response last year was: "Given accepted custom and practice, the current easy access to SPSO pay band data, the number of staff affected by this proposed change, and the current status of the Exposure Draft, the management will review the position once the Draft is formalised."	We do not require the disclosures to be enhanced to include senior staff this year, but reiterate our advice for future consideration.

3.2 Unprocessed adjustments

The auditor is required to communicate all unprocessed adjustments, other than those considered to be clearly trivial, to the entity's management and to request that management corrects them. There were no processed adjustments and all unprocessed adjustments are set out below. If these adjustments had been processed, net operating costs would have reduced by £1,294.

Journal reference	Detail	Balance sheet		Operating Cost Statement (OCS)		Effect on OCS
		Dr	Cr	Dr	Cr	
		£	£	£	£	£
1	DR Accumulated Depreciation	4,534				
	CR Depreciation Charge				(4,534)	(4,534)
	Being over depreciation on fixed assets.					
2	Dr P&L Staff Costs			3,240		3,240
	Cr Holiday Pay Accruals		(3,240)			
	Being under accrual of holiday pay.					
Decrease in expenditure		4,534	(3,240)	3,240	(4,534)	(1,294)

4 Governance

4.1 Introduction

Corporate governance is the system by which organisations direct and control their functions and relate to their stakeholders, and incorporates the way in which an organisation manages its business, determines strategy and objectives and goes about achieving those objectives. It is concerned with structures and processes for decision-making, accountability, control and behaviour at the upper levels of the organisation.

4.2 Audit Approach

As part of our 2010-11 audit, we assessed the adequacy of the SPSO's governance arrangements against good practice standards for the public sector.

We issued our interim report in July 2011 during which we updated our understanding of the business through discussions with management and conducted a high level review of the governance and business planning documentation, assessing the adequacy of governance arrangements by evaluating the SPSO's approach to risk management. We also updated our understanding of the design and implementation of the internal financial control systems, including budgetary controls. Finally we considered how the SPSO demonstrates commitment and leadership in seeking to optimise performance and deliver Best Value. We concluded that the SPSO was performing well in all these areas.

We noted that the Advisory Audit Committee operates well and makes an effective contribution to the organisation's overall governance. Our overall conclusion is that the Ombudsman has good governance arrangements in place.

We note that the payment performance of creditors has slipped slightly from 94% for 2009-10 to 89% for 2010-11. Management have advised us that following a reduction in the management team, only the Ombudsman and the Director of Corporate Services are able to authorise the payment of invoices and this caused a problem particularly during the bad weather in December 2010. In addition, there were occasionally delays in invoices being posted onto the system. Management have already reacted to improve this statistic for 2011-12 by providing assistance to finance staff and propose to add the Head of Policy and Communications to the list of approved authorisers.

No new recommendations arise from our audit of the financial statements.

5 Performance and Best Value

5.1 Introduction

All public bodies in Scotland have a duty to secure best value and continuous improvement. The public sector is facing a period of significant financial austerity, and the SPCB notified its supported bodies that budget cuts are likely to be in the region of 15 - 20% in real terms by 2013-14. In many areas this means that the current level of service provision is unsustainable. Public pressure to deliver services as efficiently and cost effectively as possible means that being able to demonstrate that the organisation delivers best value is more important than ever.

5.2 Performance and best value

We examined SPSO's current strategic documents and noted that one of the Strategic Objectives in the Strategic Plan for 2011-2015 is for SPSO "to be an accountable, best value organisation" and it intends to do this by "making best use of resources and demonstrating continuous improvement in our operational efficiency and supporting the professional development of staff". It will measure this by looking at audit findings, financial performance measures, staff satisfaction, workforce statistics, ICT performance information and environmental impact assessments.

The Business Plan for 2011-2012 sets out in more detail how it will achieve this objective as follows:

a. Manage resources effectively to meet business needs

- Plan and manage **efficiency savings** in line with SPCB and legislative requirements.
- Maintain **productivity** levels in terms of the average number of cases closed / individual complaints reviewer per month and the number of cases carried forward at year end
- Support new business developments in line with statutory obligations
- Continue to explore shared service opportunities for efficiency savings where appropriate

b. Improve operational efficiency through high quality business support services

- Ensure audit processes support continuous improvement and effective management of risks
- Consult with stakeholders on the development of the strategic plan in line with statutory obligations
- Ensure realistic corporate plans and performance targets are produced on a timely basis and monitored closely
- Ensure ICT requirements are met for future needs, e.g., paperless office
- Ensure quality and value for money for all services received

c. Promote improvements in organisational performance and staff professional development through implementation of the learning and development plan

d. Continue to meet obligations and statutory duties in relation to risk, governance, health and safety, FOI/DPA requirements etc

5.3 Key performance indicators

SPSO set the following operational performance targets through its business planning process:

Key Performance Indications
KPI 1 Advice and Early Resolution - 95% of complaints at Stage 1 and 2 are closed or progressed in 10 working days or less
KPI 2 Early Resolution - 95% of complaints at Stage 3 are closed or progressed in 50 working days or less
KPI 3 Investigation 1 - 80% of complaints at Stage 4 are closed in 130 days
KPI 4 Investigations - 95% of complaints at Stages 4 and 5 are closed no later than 260 days

SPSO performed strongly against KPI 1 (97%) and KPI 4 (95%) which represents a significant improvement on the service provided to complainants.

KPI 2 fell below the target in part due to the bedding in of the new processes. The business review evaluation and the current re-writing of the guidance are anticipated to improve performance against this KPI going forward.

KPI 3 also did not meet the target set and this can be attributed to the cases laid before Parliament. This KPI includes investigations reported to Parliament (Investigation 2) and investigation decisions not reported to Parliament (Investigation 1). 81% of cases not reported to Parliament were closed within 180 working days, meeting the target set.

5.4 Efficiencies

Audit Scotland issued a series of reports in 2010-2011 detailing the need for public bodies to perform more efficiently with guidance on how to achieve this. As part of a commitment to match this trend in the public sector, the SPSO committed to realising a 15% real term reduction in budget over 3 years starting in 2010-2011 and prepared a detailed response showing how it will implement guidance from Audit Scotland in order to become a best value organisation.

The 2010-11 budget of £3.569 million included additional funds which had been agreed as transferred to SPSO for the absorption of the prison complaints and the new Complaints Standards Authority but also allowed for savings of £0.165 million as a result of absorption of staff costs relating to the work of the Prison Complaints Commissioner.

SPSO made a budget submission in August 2010 based on a 15% decrease on the 2010-11 baseline costs in the three years to 2013-14 as follows:

	2010-11 baseline £million	2011-12 £million	2012-13 £million	2013-14 £million
Capital and revenue budget	3.569	3.353	3.186	3.026

SPSO believes it can achieve these targets because:

- the case handling system introduced in 2009-10 has resulted in a more efficient service
- staff numbers are to remain constant despite additional responsibilities
- income from shared services is to increase by providing office space to other organisations
- the Ombudsman is predicting a levelling out of complaints received.

5.5 Conclusion

SPSO regularly reports to the Audit Advisory Committee and publishes its performance statistics on its website. Best value and improvements in performance are embedded in its corporate documents. Further it regularly monitors performance through a number of Key Performance Indicators.

From our knowledge of SPSO over the past five years, we know that the organisation has good financial management arrangements and has always met budget.

Management plan ahead and monitor financial and operational performance on a regular basis and have good partnership working arrangements with the SPCB to revise budget spend should the need arise.

We conclude that SPSO has appropriate arrangements to plan, monitor and report on best value, performance and efficiencies but there will be significant challenge in the year ahead in managing the new expanded responsibilities and the infrastructure that come with that. See Section 6 for further comment.

6 Looking forward

Against a background of significant public service spending cuts and a Scottish Government policy of no compulsory redundancies, the SPSO will face significant challenges in 2011-12 as it takes on new responsibilities.

The SPSO absorbed the Prison Complaints Service from October 2010 and during 2011-12 will absorb Waterwatch, the water complaints service, as well as set up a Complaints Standards Authority. This means that during 2011-12, SPSO will see an increase in its staff numbers at all levels as well as an additional operating location to manage. At present, submitted budgets for 2011-12 are based on SPSO's original budgets plus the budgets of the Prison Complaints Service and Waterwatch, but the Ombudsman knows that there will need to be some restructuring of the new expanded SPSO to reach the optimum structure and this may take some time to achieve.

There is a risk that the increase to jurisdiction and functions is not matched by a sufficient increase in resources and effective planning at an early stage is key to ensuring that the Ombudsman can cope with all of these new functions whilst not affecting service delivery to stakeholders.

Crucial to success will be preparing budgets for each possible outcome ranging from the current operational structure to the eventual optimum structure of the expanded SPSO. This must all be managed whilst ensuring that the recent improvements in processing and closing cases do not fall back because it has had to move resource to other areas.

7 The small print

ISAUK 260 requires communication of:

- relationships that have a bearing on the independence of the audit firm and the integrity and objectivity of the engagement team
- nature and scope of the audit work
- the form of reports expected

Purpose of memorandum

This Key Issues Memorandum has been prepared for the benefit of discussions between Grant Thornton, the Audit and Advisory Committee and the Scottish Public Services Ombudsman (the Ombudsman).

The purpose of this memorandum is to highlight the key issues affecting the results of the Ombudsman and the preparation of the organisation's financial statements for the year ended 31 March 2011.

This document is also used to report to management to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) 260.

We would point out that the matters dealt with in this report came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements of the organisation.

This memorandum has been made available to management to facilitate discussions; it may not be taken as altering our responsibilities to the organisation arising under the Code of Audit Practice.

The report will be submitted to the Auditor General for Scotland and will be published by him on his website at **www.audit-scotland.gov.uk.**

Responsibilities of the Ombudsman, Accountable Officer and auditors

The Ombudsman is responsible for the preparation of the financial statements and for making available to us all of the information and explanations we consider necessary. Therefore, it is essential that the Ombudsman confirms that our understanding of all the matters in this memorandum is appropriate, having regard to his knowledge of the particular circumstances.

Clarification of roles and responsibilities with respect to internal controls

The Ombudsman is responsible for the identification, assessment, management and monitoring of risk, for developing, operating and monitoring the system of internal control and for providing assurance that he has done so.

The Ombudsman is required to review the organisation's internal financial controls. In addition, he is required to review all other internal controls and approve the statements included in the annual report in relation to internal control and the management of risk.

The Ombudsman should receive reports from management as to the effectiveness of the systems he has established as well as the conclusions of any testing conducted by internal audit or ourselves.

We have applied our audit approach to document, evaluate and assess your internal controls over the financial reporting process in line with the requirements of auditing standards.

Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to you.

In consequence, our work cannot be relied upon to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify.

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Independence and robustness

Ethical standards require us to give you full and fair disclosure of matters relating to our independence.

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opnion on the financial statements.

In accordance with best practice, we analyse our fees below:

	£ incl VAT
Grant Thornton UK LLP	20,000
Audit Scotland fixed charge	2,100
Total	22,100