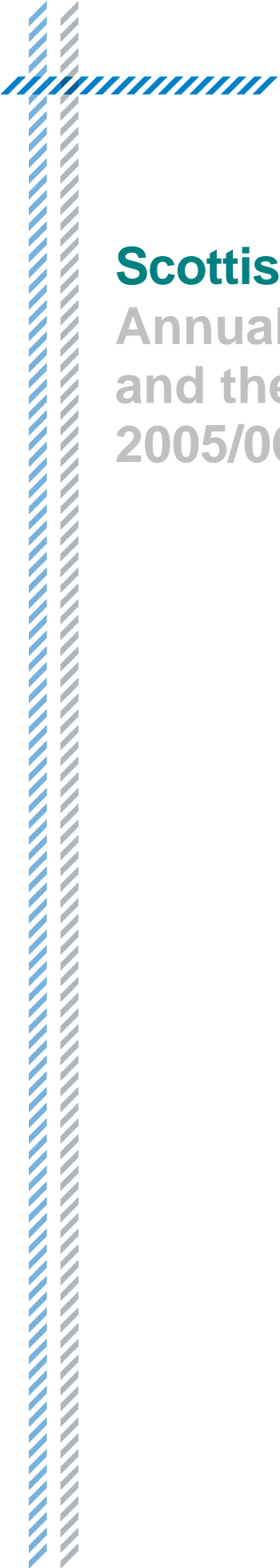




SCOTT-MONCRIEFF

EDINBURGH AND GLASGOW



Scottish Public Services Ombudsman
Annual Audit Report to the Ombudsman
and the Auditor General for Scotland
2005/06



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1 Summary

Governance

- A risk and audit committee has been established during the year with roles and responsibilities that are in line with The Combined Code on Corporate Governance. We have noted concerns over some of the processes followed during the year and the ability of the committee to perform its role given its current membership.
- There is still no internal audit function in place at the SPSO, which we would encourage the risk and audit committee to consider to allow it to fulfil its responsibilities.
- A report was issued by Audit Scotland during the year at the request of the Scottish Parliament's Finance Committee considering the opportunities for shared services and existing lines of accountability. We have considered the findings and where appropriate provided an update of the SPSO's position.

Performance

- The profile of the SPSO has increased during 2005/06 with 99% more enquiries and 24% more complaints than in 2004/05
- Changes to the complaints handling process have not only increased the accountability and transparency of investigations but has allowed the Ombudsman to submit more reports to the Scottish Parliament this year than in previous years.

Finance

- We are pleased to report that our opinion on the financial statements is unqualified
- Net expenditure for 2005/06 was within the budget level agreed with the SPCB
- Counsel's opinion has been obtained on the matter of the liability for three former ombudsmen and staff which has found that the SPSO is not liable for the costs and as a result the provision for the pension payments has been removed from the 2005/06 accounts.

Conclusion

This report concludes the 2005/06 audit of the Scottish Public Services Ombudsman. We have performed our audit in accordance with the Code of Audit Practice and Statement of Responsibilities published by Audit Scotland. Subject to the weaknesses identified in this report, we are satisfied that the Scottish Public Services Ombudsman has properly discharged its duties in accordance with the Statement of Responsibilities.

This report has been discussed and agreed with the Ombudsman and has been prepared for the sole use of the Scottish Public Services Ombudsman, the Auditor General for Scotland and Audit Scotland.

We would like to thank all members of the Scottish Public Services Ombudsman management and staff who have been involved in our work for their co-operation and assistance during our audit visits.

Scott-Moncrieff
October 2006

2 Introduction

2.1 Audit Framework

The Auditor General for Scotland is the Scottish Parliament's watchdog for ensuring propriety and value for money in the use of public funds. The Auditor General is therefore responsible for appointing auditors to central government bodies and for setting the terms of their appointment. This is the final year of Scott-Moncrieff's appointment as auditor to the Scottish Public Service Ombudsman (SPSO).

Audit Scotland is an independent statutory body that provides the Auditor General with the services required to carry out his statutory functions. Audit Scotland has prepared a Code of Audit Practice, which sets out the way in which auditors should carry out their functions, and a Statement of Responsibilities which explains where the responsibilities of the auditor begin and end.

The purpose of this report is to summarise the results of our audit work for 2005/06. The report describes the ways in which the requirements of the Statement of Responsibilities and the Code of Audit Practice have been met by both the SPSO and us.

2.2 Responsibilities of the Ombudsman

The SPSO is accountable to the public for the conduct of public business and the stewardship of funds under its control. The SPSO is therefore responsible for:

- Establishing proper corporate governance arrangements
- Maintaining proper accounting records
- Preparing the financial statements
- Safeguarding assets
- Taking reasonable steps for the prevention and detection of fraud and other irregularities
- Managing its affairs to secure the economic, efficient and effective use of resources

2.3 Responsibilities of Auditors

Our responsibilities as external auditors to the SPSO, which are significantly greater than those of auditors in the private sector, are derived from statute and from the Code of Audit Practice.

Our work can be classified under the following three headings: performance audit, governance audit and financial audit. The main objective for each of these areas is summarised below.

Audit Area	Audit Objective
Governance Audit	<p>To review and report on the SPSO's corporate governance arrangements in relation to:</p> <ul style="list-style-type: none"> • The prevention and detection of fraud and corruption • Standards of conduct, accountability and openness • The SPSO's financial position • The SPSO's review of its systems of internal control, including risk management
Performance Audit	<p>To review and report on the SPSO's arrangements for:</p> <ul style="list-style-type: none"> • Managing its performance and for securing economy, efficiency and effectiveness in its use of resources • Collecting, recording and publishing performance information
Financial Audit	To provide an opinion on the financial statements

3 Governance

3.1 Governance Arrangements

The Code of Audit Practice gives the external auditor a responsibility to review and, where appropriate, report findings on the audited body's corporate governance arrangements. In discharging this responsibility we carried out a review of the SPSO's governance arrangements during 2005/06. This review included consideration of the SPSO's codes of conduct, procedures for the prevention and detection of fraud and irregularity and risk management arrangements. We also considered the code of good practice issued by HM Treasury on Corporate Governance in Central Government Departments. Our work in this area concluded that whilst the SPSO's corporate governance arrangements are generally robust there are a number of areas with scope for improvement which, if addressed, would bring the SPSO's corporate governance regime in line with best practice. The key findings from this work are outlined below.

3.2 Risk and Audit Committee

During the year a risk and audit committee has been constituted, chaired by the Director of Corporate Services. The roles and responsibilities of the risk and audit committee includes,

- Evaluating current and potential risks and amending the risk register
- Reviewing the scheme of control
- Monitoring the integrity of financial statements
- Reviewing the effectiveness of internal controls
- Reviewing the effectiveness of internal financial controls
- Reviewing the effectiveness of risk management

Membership of the committee has been established from staff members including the Director of Corporate Services who chairs the committee. External audit were not invited to any risk and audit committee meetings to discuss the financial statements or our 2004/05 annual report. While we understand that quarterly finance reports are presented to the Executive Board, there is a concern that with neither external audit or internal audit attending the risk and audit committee meetings that the monitoring of the integrity of the financial statements is not carried out to the degree that it should be. We would recommend that the membership and attendance at risk and audit committee meetings is reviewed.

Recommendation 1

3.2.1 Internal Audit

The roles and responsibilities established for the committee are in line with The Combined Code on Corporate Governance which is seen as best practice and is followed by the private sector and public sector entities. The Combined Code also suggests that audit committees should annually review the effectiveness of the internal audit function of the entity or assess the need for an internal audit function if there is none.

In our report on the 2004/05 financial statements we noted that there was no internal audit function in place at SPSO and recommended that one was established. In November 2005, the Executive Board of the SPSO approved the establishment of an internal audit function that was to be provided by an existing member of staff. Following the agreement of a job description by the risk and audit committee the post was advertised internally, but as yet has not been filled.

We would encourage the risk and audit committee to consider the need for an independent internal audit function that would aid their review of the effectiveness of the internal control framework. **Recommendation 2**

3.2.2 Independent Non-Executive Directors

The Combined Code on Corporate Governance as noted above describes best practice for public and private sector entities. The code provisions as amended for the public sector in guidance from HM Treasury suggests that the chairman of the audit committee should be an independent non-executive member of the board and at least one of the committee members should have recent and relevant financial experience.

This was noted in our 2004/05 Annual Report and we were advised that the SPSO were taking legal advice on the possibility of appointing an independent member to the risk and audit committee. In practice however no action was taken to address this recommendation. We again advise that the Ombudsman should consider the need for an independent member on the risk and audit committee. **Recommendation 3**

3.3 Statement of Internal Control

The SPSO are required to include within their statement of accounts a statement on the system of internal control. This statement sets out the framework within which control is managed and reviewed and the main components of the system including the arrangements for internal audit.

The statement of internal control for 2005/06 highlights the improvements that have been made to the governance of the SPSO with the establishment of the Executive Board and the Risk and Audit Committee. The Scheme of Control which details the terms of reference for all groups that report to the Ombudsman and quality assurance procedures for investigations has been updated during the year.

The statement also follows up and proposes actions for two of the recommendations made in our 2004/05 report and noted again as recommendations 2 and 3 above in 2005/06. These recommendations relate to the establishment of an internal audit function and the inviting of an independent member to sit on the risk and audit committee. The SPSO had planned to form an external advisory group to the executive board and the risk and audit committee and was determining the legal position on such a group. This has been determined by the Ombudsman as not being an appropriate way forward and there are plans in 2006/07 to appoint two external persons on to the risk and audit committee. The terms of reference for the risk and audit committee are being updated to reflect this. They will also give the risk and audit committee the responsibility of commissioning audits on internal controls when deemed necessary.

3.4 Codes of Conduct

Propriety requires that public business is conducted with fairness and integrity. This includes avoiding personal gain from public business, being even-handed in the appointment of staff, letting contracts based on open competition and avoiding waste and extravagance. All staff at SPSO are required to sign up to the SPSO scheme of control which sets out standards for staff conduct in the organisation. The scheme of control continues to be updated on a regular basis. We are satisfied that the scheme of control promotes fairness and integrity in SPSO's dealings with public business.

3.5 Fraud and Irregularity

The integrity of public funds is at all times a matter of concern. As external auditors we are required to consider the arrangements made by management for the prevention and detection of fraud and irregularities. In order to do this our audit is planned so as to provide a reasonable expectation of detecting misstatements in the financial statements resulting from fraud or irregularity. We also focus on specific areas of high risk for potential fraud and irregularity within the SPSO.

As part of our 2005/06 corporate governance review we reviewed the controls for the prevention and detection of fraud, irregularity and corruption. Our review concluded that controls in place were generally satisfactory to prevent and detect fraud and other irregularities.

3.6 Risk Management

An important feature of a robust system of internal control is a developed and integrated approach to risk management. Effective risk management will deliver an appropriate balance between risk and control, more effective decision making, better use of limited resources and greater innovation.

Progress on risk management has continued during the year especially with the establishment of the risk and audit committee that reports to the Board on a regular basis. Risk management arrangements have also been incorporated within the scheme of control which all staff are required to confirm they comply with, thus increasing the awareness of risk within the organisation.

Overall SPSO has made considerable progress in developing a robust risk management strategy and has developed clear structures and processes which should support the successful implementation of its risk management framework.

3.7 Ombudsman / Commissioners Shared Services

Since the Ombudsman was appointed in September 2002 there have been a number of further commissioner appointments including Commissioners for Scottish Information, Scottish Parliamentary Standards, Children and Young People and Public Appointments. Legislation that established the Ombudsman and the Commissioners gives the Scottish Parliamentary Corporate Body (SPCB) statutory regulations – such as the payment of staff and payment of pensions – but the legislation also prescribes that the Ombudsman cannot be subject to the direction or control of the SPCB or the Scottish Parliament.

With rising projected costs for these bodies comments were made by the Scottish Parliament's Finance Committee that there were 'very serious concerns over potential gaps in accountability in respect of all parliamentary commissioners and ombudsman'. At the request of the Corporate Body's Accountable Officer, a review of the Ombudsman and Commissioners was undertaken by Audit Scotland which considered the following areas:

- Opportunities for shared services;
- Process for scrutinising budgets of the Ombudsman and Commissioners;
- Existing lines of accountability and how they work in practice.

The reports findings and recommendations have been summarised below.

3.7.1 Responsibilities of the Scottish Parliamentary Corporate Body – Current and Proposed

The current responsibilities of the SPCB with regard to the Ombudsman have been specified in legislation as follows:

- Determining the terms and conditions of the Ombudsman including salary and allowances;
- Paying the salary and allowances and any expenses of the Ombudsman;
- Making arrangements for the payment of pensions.

Whilst the legislation specifies the above it also confirms that the Ombudsman cannot be subject to the direction and control of the SPCB or any member of the Scottish Parliament, thus there is a tension between the two bodies, as while the SPCB cannot direct and control the Ombudsman they must determine her salary, terms and conditions. The report suggests the establishment of a remuneration committee for this purpose which would have a membership made up of independent experts. We recommend that the SPSO continues to look at this suggestion as well as other alternatives with the SPCB and the other Commissioners.

3.7.2 Shared Services

Of the five bodies examined in the report, three have separate rented offices in Edinburgh, which generate a significant level of cost for the bodies. The report notes that as the three largest bodies were tied into long term leases on properties there was little scope for reducing accommodation costs. The SPSO has embraced shared services as a concept and has been heavily engaged in negotiations to share services with other similar bodies during the year.

3.7.3 Governance Arrangements

Audit Scotland reviewed the arrangements in place for scrutinising the Ombudsman and Commissioners. It recommended that the SPCB should continue to be responsible for scrutiny of the SPSO's arrangements and overseeing the strategic business operations of the SPSO.

3.7.4 Remuneration

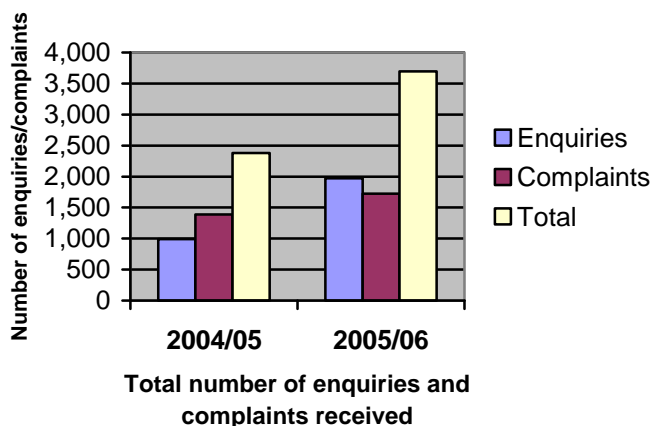
The Audit Scotland report recommended that SPCB establish a remuneration committee to consider matters associated with the remuneration and terms of reference of office holders. It was also suggested that the remuneration committee could be used in an advisory capacity to support the Ombudsman and Commissioners in dealing with strategic staffing matters including pay and terms and conditions.

We note that the terms of appointment of the Ombudsman mean that she will have completed her first term of office in September 2007 and will be available for re-appointment at that stage. The deputy ombudsmen completed their first terms of office during 2005/06 and were reappointed for a period of one year. The completion of their second terms of office at that point will require the Scheme of Control to be rewritten. We recommend that this is done in advance of September 2007 to avoid a decline of governance standards in any intervening period.

4 Performance

4.1 Ombudsman Activities

During 2005/06 the profile of the Ombudsman has increased, which can be demonstrated in the charts below (extracted from the SPSO annual report) showing the total number of enquiries and complaints received in 2004/05 and 2005/06.



During the year the Ombudsman introduced changes to the complaints handling process with the aim of increasing the accountability and transparency of investigations. The improved process has allowed the Ombudsman to submit more reports to the Scottish Parliament than in previous years.

The Ombudsman has also given evidence to two Justice Committees at the Scottish Parliament that considered the bills for the establishment of the Scottish Commissioner for Human Rights and the Independent Police Complaints Commissioner. The bill for the Independent Police Complaints Commissioner has now been passed.

The Ombudsman and Deputy Ombudsmen have spent considerable time during the year engaging with related bodies and associated stakeholders. During the year they have visited all 32 local authorities and met with Chief Executives, Council Leaders and Council Members.

Seminars have also been held within the NHS to enable clinicians to see how they can prevent, respond and learn from complaints that are made about them. A larger role for the SPSO is emerging with the NHS following the announcement that each of the NHS Boards will be entering into a partnership with local Citizens Advice Bureaux. These partnerships will

be supported by a central support unit within Citizens Advice Scotland which will be working closely with the SPSO.

The number of housing complaints has fallen year on year, partly due to the increased level of Registered Social Landlords as more local authorities choose to transfer their housing stock to an independent housing association. One of the Deputy Ombudsman has been working with the Chartered Institute of Housing in Scotland and the Scottish Housing and Support Conference to raise awareness of the SPSO. The SPSO's joint working with the Care Commission also has continued.

In October 2005 colleges and universities in Scotland were brought under the jurisdiction of the Ombudsman. In recognition of this new responsibility the Ombudsman and her deputies have since been working closely with a number of student representatives and have held a joint conference with Universities Scotland.

5 Finance

5.1 Audit Opinion

Our audit report included in the annual accounts is addressed to the Scottish Public Services Ombudsman and the Auditor General for Scotland. The report was issued on 1 November 2006 and is unqualified.

5.2 Annual Accounts and Audit Timetable

The deadline for submission of the 2005/06 audited central government body accounts to the Scottish Parliament is 31 October 2006. This deadline was not met. However, we are pleased to report that the accounts will be submitted to the Scottish Parliament prior to their deadline.

We identified no material errors during our audit. Adjustments to the financial statements arising from the audit related mainly to changes in disclosure and presentation.

We are grateful to the Ombudsman and her staff for submitting draft accounts and supporting papers of a high standard within the agreed deadlines.

5.3 Accounts Direction

The SPSO was required, in preparing its annual accounts, to comply with a Direction given by the Scottish Ministers. In 2004/05 the accounts direction given required the SPSO to prepare accounts in accordance with Companies Act requirements. This was not felt to be the most appropriate disclosure for the Ombudsman. To reflect this the Accounts Direction for the SPSO has again been changed and now requires that the financial statements comply with the principles and disclosures in the Government Financial Reporting Manual.

We are pleased to confirm that the Ombudsman's annual accounts for 2005/06 fully comply with the Accounts Direction issued by Scottish Ministers.

5.4 Summary Financial Position

5.4.1 Financial Performance

The financial performance of the SPSO against budget can be summarised as follows:

Analysis of Expenditure against Budget

	Budget £'000	Actual £'000
Income	(0)	(89)
Expenditure – Operating Activities	2,698	2,612
Fixed asset additions	29	85
Net expenditure for year	2,727	2,608

The SPSO's net expenditure for 2005/06 is within the budget level agreed with the SPCB.

5.5 Matters Arising from the Audit of the Financial Statements

5.5.1 Payroll Services

Payroll services are provided by the Home Office Payroll and Pension Service (HOPPS). This entails HR staff at the SPSO sending information regarding employee details on a regular basis. It was noted during our review of the payroll system that regular problems have been encountered with the service provided by HOPPS. Frequent mistakes are made and often changes required by the SPSO are not processed by HOPPS on a timely basis. Audit testing undertaken on the system found evidence of employees being under and over paid as a result of these errors. There is a risk that the SPSO may not be able to recover any overpayments made to staff who have continued to be paid after they have left the SPSO's employment. We recommend that the terms of the service level agreement entered into with the HOPPS are reviewed and that discussions are held with HOPPS to limit errors in the future. **Recommendation 4**

5.5.2 Pension Liability

The Scottish Public Services Ombudsman Act 2002 made the SPSO responsible for the liabilities of predecessor organisations that were merged to form the SPSO. In the 2004/05 financial statements a provision was made for the capitalised value of pension payments made to the former ombudsmen together with an associated contingent liability relating to pensions payments made on behalf of a member of staff of the former local government ombudsman. The SPSO challenged the legitimacy of this liability and after advice from external audit obtained Counsel's opinion on the matter to determine where the liability lay. Counsel's opinion documented that the liability for remuneration and pensions did not lay with the SPSO.

During 2004/05 when the SPSO were not administering their own finance function, some invoices relating to these pension payments were paid as were some payments in 2005/06 before the legitimacy of the liability was properly questioned by the SPSO. Counsel found that the Ombudsman had not accepted the liability because these payments were made during the year and that payments made under error of law may be recoverable. The provision made in the accounts for 2004/05 has been reversed in 2005/06 and steps are now being taken to reclaim payments already made.

6 Action Plan

Our annual report action plan details the key weaknesses and opportunities for improvement that we have identified during 2005/06. To assist the SPSO 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:

- Priority 1 High risk, material observations requiring immediate action.

- Priority 2 Medium risk, significant observations requiring reasonably urgent action.

- Priority 3 Low risk, minor observations which require action to improve the efficiency, effectiveness or economy of operations or which otherwise require to be brought to the attention of senior management.

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.

6.1 Matters arising from the 2005/06 audit of financial statements

Paragraph Reference	Recommendation	Responsible Officer	Management Comments	Agreed Completion Date
3.2	<p>1. We recommend that the SPSO reviews the membership and attendance at risk and audit committee meetings to ensure that there is sufficient financial experience at the meetings to monitor the integrity of the financial statements.</p> <p>Priority 1</p>			
3.2.1	<p>2. We recommend that the SPSO establishes an internal audit function to give assurance over the systems and controls put in place across the organisation.</p> <p>Priority 1</p>			

Paragraph Reference	Recommendation	Responsible Officer	Management Comments	Agreed Completion Date
3.2.3	<p>3. We recommend that an independent non-executive director with financial expertise is appointed to the risk and audit committee of the SPSO in accordance with best practice</p> <p>Priority 1</p>			
5.4.1	<p>4. We recommend that the SPSO review the terms of the Service Level Agreement held with the Home Office Payroll and Pensions Service (HOPPS) and holds discussions with HOPPS to reduce the risk of errors in the future</p> <p>Priority 2</p>			

6.2 Follow up of matters arising from the 2004/05 audit of financial statements

Title	Weakness Identified & Recommendation	Management Comments and Responsible Officer	Follow up at 31 October 2006
<p>Pension Liability</p>	<p>A liability exists to the Lothian Pension Fund with regard to pension payments due to former Ombudsmen and staff. Following legal opinion it is unclear who is responsible for the liability. It is essential in conjunction with Audit Scotland and the Scottish Parliamentary Corporate Body, that this matter is resolved as soon as possible.</p> <p>Priority 1</p>	<p>Agreed</p> <p>Professor Alice Brown</p>	<p>Legal opinion obtained by the Ombudsman during the year from James McNeill QC has determined that the SPSO has no legal liability for the payment of pensions to former Ombudsmen and staff.</p> <p>Point Cleared</p>

Title	Weakness Identified & Recommendation	Management Comments and Responsible Officer	Follow up at 31 October 2006
<p>Formal Performance Assessment</p>	<p>There has been no formal performance assessment of staff and senior managers during the year.</p> <p>With no performance assessment system in place there is a risk that key areas of weak performance in staff are not identified and addressed. Staff appraisals are also good for identifying training and development needs for staff.</p> <p>We understand that this is timetabled to be reviewed during the first review of the Scheme of Controls during 2005/06.</p> <p>Priority 2</p>	<p>A full competency framework, covering all management and staff was published in December 2005. This is currently being discussed with staff and the Trade Unions. The intention is that the managers will be formally assessed against their competency profile in 2006/07. The staff will be developed against their competency profiles in 2006/07, ahead of formal assessment in 2007/08.</p> <p>Annual SMART performance objectives for all managers will be agreed for the year 2006/07. These will be monitored on a quarterly basis.</p> <p>In addition, quarterly performance objectives will be agreed for all managers. These will be monitored on a monthly basis. The objectives for Q4 were established in December 2005.</p> <p>Richard Smith</p>	<p>There is now an annual plan for all management that includes general objectives that are reviewed on a monthly basis.</p> <p>Shadow key performance indicators are now in place and full key performance indicators will be in place from April 2007.</p> <p>Point Ongoing</p>

Title	Weakness Identified & Recommendation	Management Comments and Responsible Officer	Follow up at 31 October 2006
<p>Register of Interests</p>	<p>It was unclear during our review who had responsibility for holding and maintaining the register of interests for SPSO. It was also noted that there were no formal arrangements in place for the update of the register on a regular basis.</p> <p>This is a key document and should be held by an appropriate person in a suitable secure location.</p> <p>If there are no formal arrangements in place for the update of the register of interests there is a risk that they become out of date and thus contain incorrect information.</p> <p>We would recommend that responsibility for holding of the register of interests is given to one person who should also be responsible for issuing requests for updates.</p> <p>Priority 2</p>	<p>Agreed.</p> <p>A formal register will be established in Q1 2006/07 as part of the process for reappointing, or otherwise, the three Deputy Ombudsmen. The register will be owned by the Director of Corporate Services, as chair of the Risks and Audit Committee.</p> <p>Richard Smith</p>	<p>This action was postponed during the year until the re-appointment of the deputy ombudsmen had taken place.</p> <p>Following the re-appointment of the deputy ombudsmen the updating of the register of interests is now in progress. The register should be presented to the Executive Board by November 2006.</p> <p>Point Ongoing</p>

Title	Weakness Identified & Recommendation	Management Comments and Responsible Officer	Follow up at 31 October 2006
Fraud Policy and Whistleblowing Policy	<p>It was noted during our review that the fraud and whistleblowing policies that are in place at SPSO do not mention external or internal audit as points of contact. This is not in accordance with best practice. We recommend that the points of contact are added to the policies.</p> <p>Priority 3</p>	<p>Agreed</p>	<p>Richard Smith</p>



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