REPORT BY THE AUDITOR GENERAL FOR SCOTLAND UNDER SECTION 22(3) OF THE PUBLIC FINANCE AND ACCOUNTABILITY (SCOTLAND) ACT 2000

THE 2002-03 AUDIT OF THE SCOTTISH PARLIAMENTARY CORPORATE BODY

1. With assistance from Audit Scotland I have audited the accounts of the Scottish Parliamentary Corporate Body for the year ended 31 March 2003. I have provided an unqualified audit opinion on the presentation of the accounts but I have qualified my opinion on the regularity[1] of expenditure.

2. The audit identified some shortcomings in the Corporate Body's systems of internal control, caused in part at least by implementation problems with the Scottish Executive's new accounting system. There is sufficient evidence to confirm that the accounts provide a true and fair view. However my qualification arises because I have been unable to place sufficient reliance on the Corporate Body's internal controls to form an unqualified opinion regarding the regularity and propriety of transactions relating to the 2002/03 financial year. This does not of itself mean that there has been irregular or improper expenditure.

3. This report outlines the audit results and the response of the Principal Accountable Officer. I submit this report in terms of sub-section 22(3) of the Public Finance and Accountability (Scotland) Act 2000, together with the accounts and the report of my audit, which I have prepared under sub-section 22(2) of the Act.

The Scottish Parliamentary Corporate Body

4. The Corporate Body is an independent public body responsible for providing the Parliament with the property, staff and services required for the Parliament's purposes. It employs some 500 staff and its Chief Executive and Principal Accountable Officer is also the Clerk to the Parliament. The significant elements of the Corporate Body's expenditure and income in 2002-03 relate to:

- Capital costs associated with the new Parliament building (£100 million expenditure in 2002-03)
- General running costs (£49 million)
- Administration of the MSP Allowances Scheme (£9 million)
- Income is sourced mainly from the Scottish Consolidated Fund (£140 million) with additional income from broadcasting rights and the Parliament Shop (less than £1 million).

[1] The concept of regularity reflects Parliament's concern that public money should be used only for purposes it has approved. Regularity in this sense means that financial transactions are properly authorised by (and consistent with) legislation and comply with relevant regulations and Parliamentary authority. *Practice Note 10 (Revised) - Audit of financial statements of public sector entities in the UK* (Auditing Practices Board April 2001) provides further information.

Internal control weaknesses in the Corporate Body

5. During 2002-03 the Corporate Body did not in my opinion operate satisfactory internal controls and control activities in important areas were ineffective or missing. The key weaknesses were as follows:

- The Corporate Body did not perform timely and complete reconciliations between its two main bank accounts and its main accounting ledger.
- The Corporate Body did not fully reconcile its main accounting ledger to systems supporting the ledger (assets, payroll, and MSP allowances).
- Internal accounting controls needed strengthening. Documentation to support the preparation of the accounts was inadequate. Procedures for finalising the accounts were also inadequate, which gave rise to a high error rate.
- There was ineffective financial reporting. In particular the Principal Accountable Officer was not informed of the position in relation to bank reconciliations and associated losses written off. Information provided to MSPs about their expenditure on allowances – which are subject to statutory limits – could not be completely verified.

Bank reconciliations

6. It is vital that the Corporate Body can reconcile transactions in its main accounting ledger with the associated cash transactions recorded in its two main bank accounts in order to ensure the accuracy and completeness of the transactions.

7. During 2002-03 the Corporate Body did not complete the necessary periodic reconciliations between its ledger and bank accounts because the operation of a new Scottish Executive Accounting System early in 2002-03 caused significant difficulties[2]. In April 2003 the Corporate Body appointed an additional staff member to complete retrospectively the necessary reconciliation for the whole of 2002-03. This major exercise reviewed thousands of individual accounting entries. By the time that the final audit commenced in September 2003 it had resolved many earlier discrepancies but had not succeeded in eliminating all of them. Work therefore continued to complete these reconciliations.

8. By the final stage of the audit, in early December 2003[3], 290 items remained unreconciled between the Corporate Body's bank accounts and its ledger either because payments recorded through the

[2] I reported on the particular impact of the new system for the Scottish Executive's accounts in December 2002. (*Report by the Auditor General for Scotland December 2002 The 2001-02 Audit of the Scottish Executive's Core Departments' Resource Accounts* Scottish Parliament reference SE/2002/351 (http://www.scotland.gov.uk/library5/finance/Publish%202002%20Core%20Accounts.pdf)

[3] The Corporate Body provided draft financial statements for 2002-03 for audit in September 2003. The Accountable Officer signed and submitted the final version of the financial statements in December 2003.

bank were not recorded in the ledger or vice versa. The latest reconciliation available for this report, prepared on 24 November 2003, showed that, because most cases involved a mix of debit and credit entries[4], which were offset against each other, the combined net total of the unreconciled entries was very small, at just over £300. But the combined value of the 290 underlying transactions which have not so far been matched was significantly greater, some £5.3 million[5].

9. These remaining unreconciled items must still be cleared to support the cash position recorded in the financial statements for the next year 2003-04. The Corporate Body continues to pursue this.

Other reconciliations

10. The Corporate Body experienced similar difficulties in completing the necessary reconciliations between its ledger and associated financial systems. By the final stages of the audit in December 2003 it had not reconciled fully its main ledger with accounting information in its fixed assets system (a subsidiary system of the main ledger). Furthermore, it could not fully reconcile information within its ledger with information in separate systems for payroll and for processing and recording payment of MSP expenses.

Other issues relating to internal financial control

11. There is an urgent need for properly authorised standing financial instructions set by the Principal Accountable Officer in agreement with the Corporate Body and its Advisory Audit Board to govern the arrangements for day to day financial management and control.

12. Internal controls over accounting transactions including entries to the ledger required strengthening. During 2002/03 there were ill-defined responsibilities and accountabilities and a lack of evidence to show quality control. Staff below Head of Finance were able to write off debts, reconciliation variances and losses to the ledger without review or prior approval. Supporting records for ledger adjustments were not always available for audit.

13. The Corporate Body's cash and bank balance stood at some £20 million at 31 March 2003, mainly reflecting funds drawn down from the Scottish Consolidated Fund which had not been spent. It is imprudent to draw cash to fund activities significantly in advance of need. This significantly high balance should therefore have been subject to review and the balance reduced to acceptable levels.

14. The audit showed evidence of weak procedures for the preparation and maintenance of the accounts. It was necessary for the Scottish

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[4] In accounting terminology debits and credits are used for double entry accounting. For example, if a body collects £1,000 in revenue fees in the form of cash, the cash would be debited since cash is an asset and increases in assets are debited. The fees would be credited since fees are equity and any increase in equity is credited. Debits and credits can represent an increase or a decrease.

[5] In many cases the individual values were themselves the result of composite entries to the financial ledger whose individual components had not been traced. Consequently the total number and value of the underlying unreconciled transactions remains uncertain.

Parliamentary Corporate Body to resubmit its draft accounts for audit and Audit Scotland raised many issues about the second set of draft accounts that required consideration and/or adjustment in the final accounts. Final accounts testing found continuing errors affecting a wide range of matters including income overstated by almost £2 million, two compensating errors of £1 million each on fixed assets and errors in creditor accruals of £1 million.

15. Audit Scotland concluded there was a need for more effective leadership of the Finance Department. In March 2003 the Corporate Body appointed an Interim Financial Controller on a fixed term contract with a restricted remit. There remained a priority need for the Corporate Body to appoint and empower an experienced individual to the key post of Head of Finance, which had been vacant since April 2003.

Action taken by the Corporate Body

16. For 2001-02 I provided an unqualified audit opinion on the Corporate Body's accounts. However in December 2002, in completing the audit work for 2001-02, Audit Scotland drew attention to the need to improve internal financial controls, particularly the frequency and quality of reconciliations and the quality of documentation supporting the financial statements. Audit Scotland also raised questions about the staffing of the Finance Department and the need to improve its capacity and leadership.

17. The Corporate Body took steps to improve financial control. In April 2003 it appointed the additional staff member to undertake the reconciliation work (paragraph 7) and the Interim Financial Controller (paragraph 15). Later, in October 2003, it commissioned additional work from its internal auditors to review the reconciliation problems emerging during the 2002-03 audit.

18. As a result of the 2002-03 audit the Principal Accountable Officer has also taken or is considering action to improve control in the following areas.

- The Corporate Body is currently seeking to recruit a suitably qualified permanent member of staff to fill the Head of Finance post. This post was advertised in November 2003.
- The Corporate Body is continuing work to complete the outstanding reconciliations in consultation with Audit Scotland to provide a secure foundation for the 2003-04 accounts.
- The Corporate Body is addressing identified control weaknesses. For example, since April it has completed all necessary monthly bank reconciliations; the Finance Department is reviewing roles and responsibilities for postings to the ledger; the use of "composite" entries has ceased; and better supporting information is being recorded.
- The Corporate Body is preparing standing financial instructions, which it intends to introduce in March 2004.

Conclusions

19. Taken together, the weaknesses in reconciliations and other shortcomings in internal financial control created uncertainty about the Corporate Body's accounting records and its stewardship of public funds. There was sufficient evidence to confirm that the accounts are not materially misstated and no evidence was found that financial losses had occurred as a result of these weaknesses albeit investigation of some items continues. The Corporate Body has emphasised that their subsequent reconciliation work has revealed no evidence of irregularity. But because of the uncertainty and the potential risks to the use of public money I have been unable to gain sufficient assurance about the regularity and propriety of transactions. I have therefore qualified my audit opinion.

20. I consider that the action being taken by the Principal Accountable Officer in response to the audit findings should significantly improve the internal financial controls of the Scottish Parliamentary Corporate Body.

Robert W Black
Auditor General for Scotland
18 December 2003