The Skills Development Scotland Co. Limited
Annual audit report to The Skills Development Scotland Co. Limited and the Auditor General for Scotland
Year ended 31 March 2009
15 December 2009
AUDIT
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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 only The Skills Development Scotland Co. Limited 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.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the beneficiaries) for any purpose or in any context. Any party other than the beneficiaries that obtains access to this report or a copy and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.
Skills Development Scotland was established in response to the Scottish Government’s Skills for Scotland strategy and brings together skills and training services previously provided by Scottish Enterprise and Highlands and Islands Enterprise, together with similar services provided by the former Scottish University of Industry. The latter changed its name to Skills Development Scotland in 2007 before the transfer of activities from Scottish Enterprise and Highlands and Islands Enterprise on 1 April 2008.

The manner in which the new organisation was established resulted in a number of challenges for management during 2008-09, particularly in relation to governance and risk management arrangements, workforce management and financial reporting. Skills Development Scotland operated under a number of legacy policies during 2008-09, including those relating to corporate governance, such as procurement and contracting, and risk management arrangements were not formally consolidated until late in the year. Inconsistencies in procurement procedures contributed to weaknesses in the operating effectiveness of controls in this area. We identified five contracts that should, under Skills Development Scotland’s policies, have been subject to competitive tender, but this does not have a material impact on the financial statements.

Progress has been made in harmonising arrangements and supporting policies, but continued development is required in 2009-10, which includes the need to ensure that revised policies are appropriately communicated across the organisation and that there is a mechanism to ensure that they are operating as intended.

Management gave early consideration to the workforce requirements of the new organisation’s strategic objectives and had planned to commence a voluntary severance scheme in 2008. However, the timing of approval of the scheme by the Scottish Government meant that the process of making offers to individuals did not commence until May 2009. Consequently it will be 2010-11 until the full year benefit of reduced staff costs is realised. Skills Development Scotland received a number of equal pay claims during the year, the majority of which were settled during 2008-09 at a cost of £5.1 million.

Staff who transferred to Skills Development Scotland were members of one of four pension schemes and existing staff continued to participate in the Skills Development Scotland Retirement Benefits Scheme. The financial and accounting implications of participating in five pension schemes are complex and were not fully resolved at the time of preparing the financial statements, which reflect the nature of Skills Development Scotland’s participation in each scheme based on legal and actuarial advice. Management’s decision to transfer all relevant employees from the Highlands and Islands Superannuation Scheme to the Skills Development Scotland Retirement Benefits Scheme on 1 April 2009 resulted in a charge of £1.6 million in the 2008-09 financial statements to reflect a liability in respect of cessation costs. Management plans to harmonise arrangements in the short to medium term and needs to ensure that agreement is reached with the trustees of the Scottish Enterprise Pension and Life Assurance Scheme over responsibility for past service liabilities that arose during the period prior to 1 April 2008. The cost of exiting three of the four remaining schemes may be significant and the extent to which this would be funded by Scottish Government grant-in-aid needs to be considered.

The group financial statements report a deficit of £1.2 million, which arose primarily due to the nature of the funding agreement with the Scottish Government and the requirement to account for income on a cash basis. Total expenditure was within the funding allocation from the Scottish Government, but only £177 million of allocated funding was received in cash and therefore recognised as income. The remaining £18 million of allocated cash cannot be carried forward into 2009-10.
Executive summary (continued)

Financial reporting processes should be improved by preparing monthly management accounts on the same basis as the financial statements. There is a risk that continuing to prepare monthly finance reports on a cash basis for both income and expenditure could result in management committing expenditure in excess of available cash, which is allocated on a one-year basis by the Scottish Government, and reporting deficits on a recurring basis. The profile of Skills Development Scotland changed following significant growth through the transfer of activities from other organisations and there is increased public and political interest. This increases the reputational risk that may arise through recurring financial deficits or significant fluctuations in financial expectations and subsequent results.

Achievement of the 2009-10 financial plan will present new challenges in securing funding to meet the costs of the voluntary severance scheme, in relation to which discussions have already been held with the Scottish Government, and, in the current economic climate, the impact of competing cost pressures at the Scottish Government on securing recurring funding to support the modern apprentices initiative in future years.

Budgets transferred from Scottish Enterprise and Highlands and Islands Enterprise were reduced by £8 million by the Scottish Government to reflect the anticipated efficiency savings to be realised through increased synergy. Management plans to realise recurring efficiency savings in 2009-10 and future years through increased partnership working and the voluntary severance exercise.

Preparation of the financial statements was complex due to a number of issues arising as a result of 2008-09 being the first reporting period of the new organisation. While some of the issues, such as pensions, the overall presentation of the financial statements and amendment to the directors’ report, remuneration report and statement on internal control, were agreed later than planned, effective joint working with management ensured that a reasonable draft of the financial statements were presented to the scheduled audit committee on 11 August 2009.
Introduction

Scope

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.

Audit framework
This year was the first year of our appointment by the Auditor General for Scotland as external auditors of The Skills Development Scotland Co. Limited. This report to the board of Skills Development Scotland and the Auditor General provides our opinion and conclusions and highlights significant issues arising from our work.

We outlined the framework under which we operate, under appointment by Audit Scotland, in the audit plan overview discussed with the audit committee on 31 March 2009 and 19 May 2009.

The purpose of this report is to report our findings as they relate to:

- the financial statements and our audit opinions on the surplus or deficit and the regularity of transactions;
- use of resources, including financial outturn for the year ended 31 March 2009 and financial plans for 2009-10 and beyond;
- arrangements around governance and accountability, including risk management, systems of internal control, partnership working and our consideration of the work of internal audit; and
- performance management and Skills Development Scotland’s arrangements to achieve efficiency savings.

Best Value
Audit Scotland and the Scottish Government have been committed to extending the Best Value audit regime across the whole public sector for some time now, with significant amounts of development work having taken place during the last year. Using the former Scottish Executive’s nine Best Value principles as the basis for audit activity, Audit Scotland selected five areas as priority development areas (use of resources, governance and risk management, accountability, review and option appraisal, and joint working). Audit Scotland is developing a series of toolkits that auditors will use in future years.

Responsibilities of Skills Development Scotland and its auditors
External auditors do not act as a substitute for Skills Development Scotland’s own responsibilities for putting in place proper arrangements to account for the stewardship of resources made available to it and its financial performance in the use of those resources, to ensure the proper conduct of its affairs, including compliance with relevant guidance, the legality of activities and transactions, and for monitoring the effectiveness of those arrangements and, through the accountable officer, to make arrangements to secure Best Value.

Action plan
This report includes an action plan containing areas for development or improvement identified during our financial statements audit fieldwork. We have also included the six ‘grade one’ recommendations reported earlier in the year. Responsibility for taking action and monitoring progress in response to all our recommendations lies with management.

Acknowledgement
We wish to record our appreciation of the continued co-operation and assistance extended to us by your staff during the course of our work.
Introduction

Background – overview of activities

The Cabinet Secretary for Education and Lifelong Learning announced in September 2007 that Careers Scotland, Scottish University for Industry and skills and training elements provided by Scottish Enterprise and Highlands and Islands Enterprise would be brought together to form a new single body to take forward and deliver on the vision set out in the Scottish Government’s skills strategy Skills for Scotland. The Scottish Government set up a programme to establish Skills Development Scotland and The Scottish University for Industry Trust Limited changed its name to The Skills Development Scotland Co. Limited on 20 December 2007. In addition to its status as a company under the Companies Act 1985 Skills Development Scotland is also a non-departmental public body and is fully accountable to the Scottish Ministers.

Skills Development Scotland brings together partner organisations with a shared vision to drive forward real, positive and sustained change in Scotland’s skills performance. Skills Development Scotland’s role is to:

- promote availability of access to, and create demand for, relevant, high quality and innovative learning and skills development for the Scottish population;
- advance education and skills development and the promotion of lifelong learning and skills development amongst individuals and businesses;
- provide information, advice and guidance, including guidance relating to career and learning choices, to people of all ages;
- provide support and funding to individuals for learning and skills development;
- advance and provide training programmes to build employability skills and to provide information and support to employers to develop the skills of employees;
- promote and facilitate local lifelong learning opportunities and local development of skills;
- foster collaborative partnerships in lifelong learning and skills development; and
- promote and deliver equality of access and opportunity in service delivery.

During 2008-09 management initiated a voluntary severance scheme to facilitate restructuring in line with new strategic and organisational objectives. Consultation was ongoing over the year end and, at the time of this report, decisions have been made to approve over 130 requests for voluntary severance.

Scottish Enterprise and Highlands and Islands Enterprise provided interim transactional and corporate services to Skills Development Scotland during the year, primarily in relation to the recording of financial transactions, legal and procurement services. Discussions with both organisations over the long term provision of interim transactional and corporate services are ongoing.
We have issued unqualified opinions on the financial statements and the regularity of transactions reflected in those financial statements. Key matters arising from our audit were:

- restructuring – the financial statements include a charge of £5.1 million in respect of equal pay claims; £237,000 was not settled at 31 March 2009 and is included as a liability at the year end;
- pension schemes – the financial statements have been prepared on the basis of consistent assumptions and include a liability in respect of cessation costs that arose following the decision to exit the Highlands and Islands Superannuation Scheme from 1 April 2009. Management needs to liaise with the trustees of the Scottish Enterprise Pension and Life Assurance Scheme during 2009-10 to clarify the extent to which Skills Development Scotland are responsible for the relevant assets and liabilities arising prior to 1 April 2008. The financial statements have been prepared on the basis that Scottish Enterprise retains all such assets and liabilities;
- the net impact of adjustments to the financial statements was to decrease the deficit by £3.3 million; and
- revenue recognition – grant-in-aid from the Scottish Government is recognised on a cash basis because the nature of the funding agreement with the Scottish Government means that funding that is not drawn down in cash during the year is not carried forward into the next financial year.

Our opinion on the regularity of transactions in the financial statements is unqualified, but we highlight the following issues, which are not considered to be material:

- internal compliance testing of payments in respect of national training programmes identified potential overpayments of up to £522,000; and
- there is no formalised process to record the receipt, distribution and subsequent action taken in response to circulars received from the Scottish Government and other regulatory bodies.

Skills Development Scotland is required to restate its 2008-09 financial statements under the IFRM by 28 November 2009 and plans have been prepared to manage this process.

Recommendations
The action plan includes recommendations to improve the following areas.

<table>
<thead>
<tr>
<th>Area for development</th>
<th>Action plan reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agreeing the basis of participation in the Scottish Enterprise Pension and Life Assurance Scheme.</td>
<td>1</td>
</tr>
<tr>
<td>Implementing a mechanism to record receipt, distribution and action taken in response to circulars.</td>
<td>2</td>
</tr>
</tbody>
</table>
Financial statements

Audit opinions and key issues

Reporting arrangements and timetable
Draft financial statements were available in advance of the audit fieldwork in line with the agreed timetable. The first draft was primarily complete, but significant presentational and numerical amendments were required following resolution of key issues (summarised below) identified in our audit plan overview. The majority of issues arose due to this being the first reporting period for the new organisation and the complexity of issues arising due to the manner in which it was established. A number of drafts of the financial statements were prepared during the audit process, following effective joint working with management. Timely preparation and senior management review of narrative statements accompanying the financial statements would increase the efficiency of the overall process.

The net impact of adjustments to the draft financial statements identified by both management and us was to reduce the deficit by £3.3 million. The financial statements were also adjusted to reflect late finalisation of actuarial assessment of net pension liabilities and recognition of net pension liabilities of £17.7 million.

Audit opinion
Following approval we issued an audit report expressing unqualified opinions on the financial statements for the year ended 31 March 2009 and on the regularity of transactions reflected in those financial statements.

Key issues arising during our audit of the financial statements
Our audit plan overview and interim management report identified a number key risk areas impacting on the financial statements. These risks, together with the conclusions reached, are summarised below.

<table>
<thead>
<tr>
<th>Key risk area</th>
<th>Conclusions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Restructuring</td>
<td>Skills Development Scotland received numerous equal pay claims and sought legal advice to assist them in determining the extent and amount of obligations to settle these claims. The financial statements reflect costs of £3.6 million incurred during the year and liabilities of £0.7 million at 31 March 2009.</td>
</tr>
</tbody>
</table>
| Financial statements preparation and disclosure requirements | The circumstances surrounding the creation of Skills Development Scotland were such that activities were transferred from two external organisations and combined with services provided by the former Scottish University for Industry's subsidiary, which were also transferred to Skills Development Scotland on 1 April 2008. The impact of these transfers on the 2008-09 financial statements was:  
  • The financial statements include a prior year adjustment to reflect the change in consolidation accounting policy. The group financial statements consolidate the results of Scottish University for Industry Limited and Careers Trust Scotland. The latter was transferred from Scottish Enterprise to Skills Development Scotland under Machinery of Government regulations.  
  • The financial statements comply with Financial Reporting Standard 3: Reporting financial performance (“FRS 3”) and separately report the performance of activities performed by Skills Development Scotland, and its predecessor, from those acquired from Scottish Enterprise and Highlands and Islands Enterprise.  
  • No assets and liabilities transferred from Scottish Enterprise or Highlands and Islands Enterprise. |
### Key risk area

<table>
<thead>
<tr>
<th>Key risk area</th>
<th>Conclusions</th>
</tr>
</thead>
</table>
| **Pension schemes** | Staff employed by Skills Development Scotland are members of one of five pension schemes. Management considered the assumptions used by the actuaries of each scheme and requested changes to ensure consistency in material assumptions. Two specific issues arose in relation to individual schemes:  
  **Scottish Enterprise Pension and Life Assurance Scheme**  
  A number of employees transferred from Scottish Enterprise, but remained in the Scottish Enterprise Pension and Life Assurance Scheme (“the SE Scheme”). The Trustees of the SE Scheme, Scottish Enterprise and Skills Development Scotland, entered into an agreement effective from 1 April 2008 whereby these employees will continue to participate in the SE Scheme. This is in accordance with the Deed of Agreement and Trust and other governing documentation of the SE Scheme.  
  The Deed of Participation, admitting Skills Development Scotland as a participating employer to the SE Scheme, does not address how past service liabilities and therefore the assets and liabilities of the SE Scheme relating to Skills Development Scotland’s employees former participation in the SE Scheme, as employees of Scottish Enterprise, should be determined and accounted for. The Trustees of the SE Scheme have not yet determined a basis for apportionment of assets and liabilities between Scottish Enterprise and Skills Development Scotland. As a result, for the purposes of FRS 17, Scottish Enterprise continues to account for all assets and liabilities of the Scheme prior to 1 April 2008. We agree with management’s view that the future apportionment of the assets and liabilities of the Scheme is unlikely to have a material impact on the net assets of Skills Development Scotland.  
  It is important that management work with Scottish Enterprise and the Trustees of the SE Scheme to clarify the basis of Skills Development Scotland’s participation in the SE Scheme. |
| **Highlands and Islands Enterprise Superannuation Scheme** | Similar to Scottish Enterprise, employees transferring from Highlands and Islands Enterprise on 1 April 2008 remained in the Highlands and Islands Enterprise Superannuation Scheme (“the HIE Scheme”). The agreed period of participation was one year and management took the decision during 2008-09 to transfer these employees, at least on a temporary basis into the Skills Development Scotland Retirement Benefits Scheme (“the SDS Scheme”) on 1 April 2009. The financial statements include a liability in respect of Skills Development Scotland’s obligation to pay £1.6 million to the trustees of the HIE Scheme as a result of this decision. |

**Action plan recommendation one**
### Audit opinions and key issues (continued)

#### Key risk area

<table>
<thead>
<tr>
<th>Pension schemes (continued)</th>
<th>Conclusions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Harmonisation of retirement benefits</strong></td>
<td>Ultimately management plans to harmonise retirement benefits for all employees, although this is unlikely to be completed in the short term. A number of significant risks are likely to arise during this process:</td>
</tr>
<tr>
<td>- Decisions to exit individual pension schemes are likely to result in significant obligations to make payments to the trustees of each scheme in respect of past liabilities, but the value of these liabilities will depend on the financial position of individual schemes. Management should proactively discuss these costs with the Scottish Government prior to formally giving notice to individual schemes to mitigate the financial risk that funding is not available and the reputation risk that Skills Development Scotland could be subject to criticism for using grant-in-aid allocated to skills and training to buy-out pension schemes.</td>
<td></td>
</tr>
<tr>
<td>- The extent to which Skills Development Scotland is liable for past service costs and related assets and liabilities in the SE Scheme will need to be determined before any decisions on withdrawing from the SE Scheme can be made. Participation in the SE Scheme was agreed with the trustees of that scheme for the two years to 31 March 2010, which indirectly sets a deadline for agreement of the basis of participation and decisions on any continued participation in the SE Scheme after this date.</td>
<td></td>
</tr>
<tr>
<td>- The four pension schemes in which Skills Development Scotland currently participates, together with its previous participation in the HIE Scheme, offer different benefits to staff. The SDS Scheme retained the pre-exiting benefits for staff transferred from the HIE Scheme at 1 April 2009. Going forward, management should consider the legal and logistical options of maintaining different retirement benefit entitlements for individual groups of staff.</td>
<td></td>
</tr>
</tbody>
</table>

We identified two additional risk areas during our audit of the financial statements.

**Accruals**

Our testing of the completeness and existence of accruals at 31 March 2009 identified a number of adjustments:

- £1.6 million of accruals were reversed following management review. The two main individual adjustments related to £300,000 of costs to be incurred on office refurbishments in 2009-10 and £0.7 million that had been accrued on the basis of budget expenditure rather than actual costs. 
- Accruals for payments under national training programmes did not include payments made after 30 April 2009 that related to activity completed during the 2008-09 financial year. Claims received in May 2009 totalled £600,000. This amount is offset by £400,000 of costs included in the 2008-09 financial statements in respect of payments made in May and June 2008 that related to the previous financial year. The net impact is £200,000 and we concur with management’s view that this is not significant to the financial statements and remains unadjusted. Management is reviewing national training programme agreements with a view to clarifying the time period in which claims must be raised.
Income recognition
The Scottish Government confirmed to Skills Development Scotland on 23 February 2009 that its final grant-in-aid allocation for 2008-09 was £195 million. The nature of Skills Development Scotland’s funding agreement with the Scottish Government means that cash not drawn down during the financial year to which it relates is not carried forward into future years. Consequently, Skills Development Scotland accounts for grant-in-aid from the Scottish Government on a cash basis i.e. cash received during the year. The table below summarises the funding available to Skills Development Scotland from the Scottish Government in 2008-09 and the income recognised in the financial statements on the basis of cash received during the year.

<table>
<thead>
<tr>
<th>Grant-in-aid: core funding</th>
<th>£’000</th>
<th>£’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grant-in-aid: transition costs</td>
<td>15,687</td>
<td>6,305</td>
</tr>
<tr>
<td>Grant-in-aid: individual learning accounts</td>
<td>3,000</td>
<td>2,324</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>195,417</strong></td>
<td><strong>176,854</strong></td>
</tr>
</tbody>
</table>

The financial statements correctly reflect Scottish Government income of £177 million together with £6 million of income received from other sources. This other income is recognised in the period to which it relates and correctly includes amounts for which cash has not yet been received. The financial statements were adjusted as a result of the audit process to include an additional £1.6 million of income from the Scottish Government following confirmation that this would be made available to meet the costs of exiting from the Highlands and Islands Superannuation Scheme. The financial statements reflect Skills Development Scotland’s obligation of £1.6 million at 31 March 2009 and it is therefore appropriate to recognise the matching income.
Financial statements

Regularity

Regularity of transactions
We obtained an understanding of the framework under which Skills Development Scotland operates, and tested compliance with arrangements that aim to ensure that Skills Development Scotland’s income and expenditure transactions are in accordance with appropriate authorities, and that the accounting presentation and disclosure conforms to applicable statutory and other requirements.

National training programmes
To gain assurance over the regularity of core expenditure we placed reliance on the work of the compliance services team, who provide assurance that expenditure on national training programmes and individual learning accounts has been incurred within the terms of the national training programmes and individual learning accounts. Management report the results of compliance testing to the board and audit committee on a regular basis. We used statistical sampling methods to test a sample of compliance service reports used by management to monitor whether expenditure had been incurred properly. Our testing did not identify any weaknesses in the design, implementation or operating effectiveness of controls.

Contract monitoring and compliance testing of payments under national training programmes performed by the compliance services team is performed on a routine basis. Extrapolation of reported national training programme compliance errors suggests that up to £522,000 may have been paid in error. Our extrapolation is likely to be the maximum potential error – sample testing on a risk-based approach reduces the likelihood that payments not tested include the same proportion of errors. These payments are not recoverable and the potential error does not impact on the reported deficit for the year. We agree with management’s decision not to adjust the financial statements in this respect.

Payments in respect of national training programmes and individual learning accounts by Highlands and Islands Enterprise are checked prior to payment so erroneous claims are not paid.

Scottish Government and other guidance
There is no standard process to monitor the receipt, distribution and action of circulars from the Scottish Government or other regulatory bodies. Guidance received from the Scottish Government is directed to a senior officer in the relevant department, for example, finance or human resources, but there is no central record of action taken, or the decision that action is not required.

Action plan recommendation two
We have considered the specific requirements of a number of financial circulars, particularly those in relation to remuneration and procurement, and did not identify any instances of non-compliance.
Financial statements

Implementation of International Financial Reporting Standards

The 2007 Budget had announced that central government and health bodies would report under international financial reporting standards ("IFRS"), as adapted by HM Treasury through the financial reporting manual ("IFReM"), from 2008-09. Following consultation with Government departments and the Financial Reporting Advisory Board on the technical work needed to implement this change, the Government now intends to move to IFRS from 2009-10 as announced in the 2008 Budget.

Central government bodies will be required to prepare their financial statements on the basis of the IFReM from 2009-10. Shadow IFReM financial statements, including an opening balance sheet, will be required for 2008-09. The majority of central government bodies prepared an IFReM compliant balance sheet at 1 April 2008 during the latter months of 2008 and this was subject to a 'dry run' review in February 2009.

The timing of Skills Development Scotland’s creation meant that it was exempt from this process. However, management will be required to comply with 'stage two', which requires that the 2008-09 financial statements are restated in compliance with the IFReM by 28 November 2009. This will include restatement of the opening balance sheet at 1 April 2008. We are required to review the restated financial statements and report to management on the preparation process and any issues identified by 28 February 2010.

It is important that management fully document consideration of key issues that may change under the IFReM, such as leases and staff benefits, regardless of whether, ultimately, the numbers are subject to change. Accounting policies and financial statement disclosures are typically significantly longer under IFRS. Our experience across the central government and NHS sectors suggests that the conversion process requires more time and input than initially expected. Management has employed a qualified accountant, who has experience of IFRS transition in the private sector, for six months to provide a dedicated resource to support existing finance staff in preparing the restated financial statements.
Use of resources

The surplus of £1.4 million reported to the board in the month 12 management accounts subsequently moved to a deficit of £4.3 million in the draft financial statements presented for audit. Adjustments identified by management and us during the audit process reduced the deficit by £3.3 million and the reported position is a deficit of £1.2 million.

Annual budgets and monthly financial reports are not prepared on an accruals basis.

Budgeting processes were enhanced during preparation of the 2009-10 budget and now include input from directorate heads and project managers outwith the finance department.

The efficiency savings target of £8 million was achieved during 2008-09 and the recently announced voluntary severance scheme will contribute to the 2009-10 target of £12 million.

Human resources staff are working towards harmonisation of staff contracts, terms and conditions and implementation of the voluntary severance scheme under which, at the date of this report, over 130 people will leave during 2009-10.

Five contracts with a combined value of £200,000 were not subject to a tender process as required by Skills Development Scotland’s procedures. The board recently approved a consolidated procurement strategy that aims to enhance existing processes and harmonise tendering and contracting limits.

A number of partnership working arrangements exist and others are being developed in recognition of management’s awareness that this is a key element of Skills Development Scotland’s role in increasing employability across Scotland.

Recommendations

The action plan includes recommendations to improve the following areas.

<table>
<thead>
<tr>
<th>Area for development</th>
<th>Action plan reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enhancing financial budgeting and reporting by preparation on an accruals basis.</td>
<td>3</td>
</tr>
<tr>
<td>Advancing consideration of plans to spend anticipated Scottish Government funding for modern apprentices.</td>
<td>4</td>
</tr>
<tr>
<td>Introducing a consistent performance management framework for all staff.</td>
<td>5</td>
</tr>
<tr>
<td>Harmonising staff terms and conditions.</td>
<td>6</td>
</tr>
<tr>
<td>Monitoring compliance with revised procurement, tendering and contracting procedures.</td>
<td>7</td>
</tr>
</tbody>
</table>
Use of resources

Financial management

Financial position
The annual budget was set by the finance directorate and senior management and approved by the board in February 2008. The director of finance and audit presented monthly reports to the board on performance against the budget.

The tables below summarise movements in the outturn between the annual budget, month 12 management accounts and financial statements.

<table>
<thead>
<tr>
<th>Movement</th>
<th>£’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual budget surplus</td>
<td>15,619</td>
</tr>
<tr>
<td>Decrease in grant-in-aid</td>
<td>(5,210)</td>
</tr>
<tr>
<td>Decrease in grant-in-aid transition funding</td>
<td>(12,069)</td>
</tr>
<tr>
<td>Decrease in individual learning account funding</td>
<td>(1,176)</td>
</tr>
<tr>
<td>Decrease in invoiced income</td>
<td>(1,429)</td>
</tr>
<tr>
<td>Increase in other income</td>
<td>436</td>
</tr>
<tr>
<td>Decrease in business enhancement projects</td>
<td>5,202</td>
</tr>
<tr>
<td>Decrease in national training programme costs</td>
<td>3,086</td>
</tr>
<tr>
<td>Increase in staff costs</td>
<td>(1,739)</td>
</tr>
<tr>
<td>Increase in infrastructure and administration costs</td>
<td>(1,128)</td>
</tr>
<tr>
<td>Other movements</td>
<td>(200)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Movement</th>
<th>£’000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Movement accounts surplus</td>
<td>1,392</td>
</tr>
<tr>
<td>Increase in national training programme costs</td>
<td>(1,209)</td>
</tr>
<tr>
<td>Decrease in staff costs</td>
<td>1,807</td>
</tr>
<tr>
<td>Inclusion of restructuring costs</td>
<td>(6,201)</td>
</tr>
<tr>
<td>Other movements</td>
<td>(118)</td>
</tr>
<tr>
<td>Draft financial statements deficit</td>
<td>(4,329)</td>
</tr>
<tr>
<td>Decrease in accruals</td>
<td>3,084</td>
</tr>
<tr>
<td>Increase in provisions</td>
<td>(1,600)</td>
</tr>
<tr>
<td>Consolidation of Careers Trust Scotland</td>
<td>208</td>
</tr>
<tr>
<td>Increase in grant-in-aid income</td>
<td>1,600</td>
</tr>
<tr>
<td>Other movements</td>
<td>(211)</td>
</tr>
<tr>
<td>Final financial statements deficit</td>
<td>(1,248)</td>
</tr>
</tbody>
</table>

The table above highlights a number of individually and cumulatively significant movements, which are explained in more detail below, and the level of volatility in Skills Development Scotland’s results during the year.

Income
Grant-in-aid income received is significantly below the original budget because it is recognised on a cash basis. The original budget assumed that the full allocation of £195 million would be received in cash during the year, compared to actual receipts of £177 million.

Expenditure
Decreased spend on business enhancement projects was the result of lower than predicted projects arising from the changing economic climate in the last quarter of the financial year. Following discussion with the Scottish Government, management had profiled higher than average spend towards the end of the financial year.

The shortfall in national training programme spend was primarily due to the impact of the economic slowdown and employers decreasing discretionary training spend. Movements in staff costs reflect the timing of decisions over the appropriateness and financial viability of paying staff bonuses.
Increases in infrastructure and administration costs include unanticipated rent increases and refurbishment costs to comply with health and safety regulations or lease requirements.

**Financial position**

The group financial statements report a deficit for the year of £1 million. Total expenditure of £186 million was less than the combined grant-in-aid allocation (£195 million) and other income receivable (£6 million). However, the requirement to recognise grant-in-aid on a cash basis reduces income in the financial statements to £185 million, which results in the reported deficit.

The deficit could have been reduced had management drawn down sufficient cash from the Scottish Government to match expenditure. This cash would have subsequently been used to pay creditors in April 2009. However, the cash balance at 31 March 2009 was £4.4 million and Skills Development Scotland interpreted guidance as meaning that no further draw down was possible. Alternatively, tighter management of creditors and increased payments prior to the year end would have maximised cash spend, and therefore management’s ability to draw down additional cash from the Scottish Government. However, the nature of national training programmes and the requirement for training providers to claim in arrears means that Skills Development Scotland may always have a minimum creditor balance at 31 March of around £5 million in relation to amounts due to training providers that cannot be paid until valid claims are received in April or May.

There was a significant difference between the forecast outturn reported to the board in the month 12 management accounts and the draft financial statements subsequently presented for audit. This is partly due to differences between annual budgeting and monthly reporting, which are prepared on a cash basis for both income and expenditure, and the financial statements, in which expenditure is recognised on an accruals basis. Good practice in robust financial monitoring requires that monthly financial reports are prepared on a full accruals basis.

Managing the combination of cash and accruals will continue to present a challenge for management in 2009-10 and future years. The introduction of accruals accounting on a monthly basis would assist in both managing expenditure commitments and managing the profile of cash draw downs from the Scottish Government during the year with a view to maximising Skills Development Scotland’s use of its funding allocation. The profile of Skills Development Scotland changed following the significant growth through the transfer of activities from other organisations and, similarly, there is increased public and political interest. This increases the reputational risk that may arise as a result of recurring financial deficits of significant fluctuations in financial expectations and subsequent results.

**Action plan recommendation three**

**Financial management and budgetary control**

The finance team and senior management were responsible for setting the 2009-10 budget. The process was based on meetings with the recently appointed directorate heads and consideration of financial performance in 2008-09, projected salary increases, and operational expenditure plans based on projections submitted by national training programme project managers. The process was enhanced for 2009-10 following an incomplete process in 2008-09 when budget setting was performed primarily by the finance department during the creation of the organisation.
A programme of quarterly meetings between finance management and directorate heads has been established. Frequency increased to monthly during the last quarter of the financial year.

**Efficiency savings**

The Scottish Government issued the *efficient government programme for 2008-09 – 2010-11*, which provides details on the background, its application in various sectors, the types of savings and the method of reporting efficiencies. The Scottish Government set a target of £8 million efficiency savings and removed this amount from Skills Development Scotland’s funding allocation for 2008-09 i.e. Skills Development Scotland were tasked with delivering the same level of services as those provided by its predecessor and legacy organisations within a reduced financial envelope.

Management obtained agreement from the Scottish Government that managing this reduction in funding would be accepted as efficiency savings and that no further savings would be required. The £8 million reduction was more than double the 2% target required by other non-departmental public bodies. Management has reported, and subsequently received positive feedback from the Scottish Government, that costs were reduced by:

- securing synergies from the review and co-ordination of the activities undertaken by previously separate organisations;
- streamlining resources in the new directorate structure;
- improved partnership working with other agencies; and
- designing new skills projects for employers and the adult workforce.

The Scottish Government has set similarly challenging targets for Skills Development Scotland in 2009-10 and 2010-11, which will require savings of £12 million and £19 million respectively. These targets are in excess of 6% of annual funding allocations. Management plans to deliver savings through the voluntary severance scheme, which will be implemented in 2009-10, and increased partnership working.
Use of resources

Financial management (continued)

Financial planning
In March 2009 the board approved the 2009-12 corporate plan, which includes a balanced budget for 2009-10 against an anticipated cash allocation of £188 million; an increase of £11 million (6.3%) from 2008-09. The annual funding letter received from the Scottish Government included £16 million funding for 2009-10 for additional modern apprenticeships, although this initiative was for three indicative years. This amount was subject to parliamentary approval at the autumn budget revision and consequently management did not include this funding and related expenditure in the 2009-10 budget.

While we do not disagree with management’s prudent approach, it is important that plans are made and can be implemented within a timely manner in the second half of the financial year following approval of this funding to mitigate the risk that any unused funding is not available in future years. Financial and operational planning and forecasting is subject to further uncertainty due to the fact that modern apprentices funding is not guaranteed in future years. Consequently, Skills Development Scotland faces the risk that its response to this new initiative is established late in 2009, with no continued funding commitment from the Scottish Government.

<table>
<thead>
<tr>
<th>£'000</th>
<th>2009-10 business plan</th>
<th>2008-09 actual</th>
</tr>
</thead>
<tbody>
<tr>
<td>National training programmes</td>
<td>101,750</td>
<td>103,814</td>
</tr>
<tr>
<td>Business enhancement projects</td>
<td>15,210</td>
<td>6,386</td>
</tr>
<tr>
<td>Staff costs and salaries</td>
<td>44,500</td>
<td>51,791</td>
</tr>
<tr>
<td>Infrastructure, management and administration</td>
<td>10,957</td>
<td>11,906</td>
</tr>
<tr>
<td>Information technology and systems</td>
<td>4,047</td>
<td>3,710</td>
</tr>
<tr>
<td>Individual learning accounts</td>
<td>11,500</td>
<td>3,123</td>
</tr>
<tr>
<td><strong>Total spend</strong></td>
<td><strong>187,964</strong></td>
<td><strong>180,730</strong></td>
</tr>
</tbody>
</table>

Expenditure to 31 May 2009 totalled £20.1 million, amounting to 8.9% of the planned cash spend for 2009-10. Cash spend to date is £6.4 million lower than budgeted. This compares to actual expenditure of £24.5 million, which represented 13.1% of the planned cash spend for 2008-09. Spend is behind budget primarily because management implemented a new business project approval policy. The revised policy requires projects managers to obtain the necessary approvals prior to commencing projects. There was also a timing difference on a national training programme payment, which was not processed until the beginning of June 2009.
Use of resources

Management arrangements

Workforce management
Skills Development Scotland’s internal human resources team is responsible for managing all employee related issues. Appraisals and staff consultations are conducted under guidelines monitored by the human resources team, but there are no organisation-wide employee performance management arrangements.

Action plan recommendation five
The joint consultative and negotiations committee comprises representatives of senior management, human resources staff and trade unions. That committee provides a forum for consultation on a variety of issues, including salary reviews and holiday entitlements. During the year, discussions focussed on resolving and settling equal pay claims and the legal framework in which Skills Development Scotland announced its voluntary severance scheme. In 2009-10 the committee is working towards harmonisation of job terms and conditions because as employees are still bound by their previous legacy contracts.

Action plan recommendation six
Management had planned to commence the voluntary severance scheme in 2008 with a view to realising some savings in the 2008-09 financial year and ensuring that the full year impact would be realised in 2009-10. However, the timing of approval of the scheme by the Scottish Government meant that the scheme was only opened to consultation in February 2009 and the process of making offers to individuals did not commence until May 2009. Consequently, it will be 2010-11 until the full year benefit of reduced staff costs is realised. Under accounting standards there was no legal obligation to make payments to any individual members of staff at 31 March 2009 and the total costs of the scheme will therefore be reported in the 2009-10 financial statements. At the same time, management introduced restrictions on external recruitment and only ‘business critical’ appointments were made and were subject to prior approval by the strategic management team and relevant directorate head on a case by case basis. Appointments made during this period including the heads of the six directorates, a procurement specialist and two accountants.

One of the interim directors appointed during the creation of Skills Development Scotland left the organisation during the year following the establishment of the permanent senior management structure. The cost was £438,000, which is correctly disclosed in the remuneration report accompanying the 2008-09 financial statements.

Procurement
During 2008-09 arrangements over the procurement of goods and services continued to follow those established by legacy organisations and thresholds for initiating a tender process ranged from £35,000 to £50,000. With the exception of the differing thresholds, our testing confirmed that controls are designed and implemented appropriately. However, we identified a number of instances where the tender process was not followed and conclude that controls are not operating effectively.

Five contracts with a combined value of £200,000 were not subject to competitive tendering, despite individual contracts being in excess of the stated tendering limits. In the majority of cases management decided to award contracts to specific organisations due to their previous involvement with Skills Development Scotland and consequent ability to provide tailored services within tight timescales. The individual contacts and total value of contracts not subject to tender are not considered material, but management should ensure that, following harmonisation of procedures and tendering limits, appropriate mechanisms are established to ensure that controls operate consistently and effectively.

Action plan recommendation seven
Skills Development Scotland recruited a procurement specialist on a temporary basis to produce an effective procurement policy that complies with all relevant regulations required by the Scottish Government and the European Union. The policy was presented to the senior management team in June 2009, but has yet to be approved. The policy aims to formalise procedures and eliminate inconsistencies that arose during 2008-09.

**Partnership working**

The Scottish Government actively encourages public sector bodies to work and follow an integrated approach to meeting the objectives of its economic strategy. Skills Development Scotland’s chief executive has a specific responsibility to ensure that arrangements have been established to secure Best Value and one area where management has developed arrangements is through partnership working. Within the public sector there are a number of organisations whose goals are closely aligned to those of Skills Development Scotland.

Management has reported that significant partnerships include the following:

- working closely with the Scottish Funding Council to develop a integrated approach to skills utilisation and broker deeper relationships with Scotland’s college’s and universities;
- working with Jobcentre Plus in rolling out integrated employment and skills services and other welfare reforms;
- working with the Scottish Qualifications Authority to develop the learning continuum and ensure that qualifications match learner and employer needs; planning, co-ordinating and delivering services at a local level as part of single outcome agreements developed by local authorities;
- continuing close working with Scottish Enterprise and Highlands and Islands Enterprise to assist employers that are important to sustainable economic growth in Scotland;
- working with the Scottish Trades Union Congress and focusing on skills utilisation and other aspects of employee and workforce development; and
- working with the NHS and local health boards to deliver employability, health and wellbeing and promoting social cohesion.

Achievement of future budgets and increasing efficiency savings will require a continued focus on partnership working, both to deliver operational services and potential shared financial and other support services.
Skills Development Scotland operated under a number of legacy policies on governance, risk management, financial procedures and workforce matters during 2008-09. Progress has been made in harmonising arrangements and supporting policies, but continued development is required in 2009-10.

There was a lack of comprehensive internal audit coverage in 2008-09. An internal audit plan has been approved for 2009-10.

Financial controls are generally designed appropriately and operate effectively, but there are a numbers of areas for enhancement of information technology controls in supporting financial systems and applications.

Formal arrangements to prevent and detect fraud and irregularity are in draft form and will be approved in 2009-10. The compliance services team adopts a risk-based approach to testing payments made to providers of national training programmes and the team reported actual fraud of £87,000 during the year, which is not considered to be material to the financial statements.

**Recommendations**

The action plan includes recommendations to improve the following areas.

<table>
<thead>
<tr>
<th>Area for development</th>
<th>Action plan reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Enhancing audit committee arrangements.</td>
<td>8</td>
</tr>
<tr>
<td>Implementing a framework to evidence consideration and action in response to Audit Scotland’s national reports.</td>
<td>9</td>
</tr>
</tbody>
</table>
Governance and accountability

Corporate governance arrangements

Introduction
Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviour. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all bodies.

Through its chief executive, Skills Development Scotland 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:

- Skills Development Scotland’s reviews of its systems of internal control, including its reporting arrangements;
- the prevention and detection of fraud and irregularity; and
- standards of conduct and arrangements for the prevention and detection of corruption.

Governance framework
All board members of Skills Development Scotland are appointed by the Scottish Ministers, and the chief executive is designated as Skills Development Scotland’s accountable officer. The board has corporate responsibility to ensure that Skills Development Scotland fulfils the aims and objectives as set by the Scottish Ministers. There are two sub-committees: audit and remuneration. The operation of the audit committee would be enhanced by agreeing meeting dates at the start of each financial year and minutes being taken by someone independent of the finance function.

Action plan recommendation eight
The period of time between announcement and creation of Skills Development Scotland on 1 April 2008 was relatively short and little progress was made in establishing an appropriate governance framework in advance of this date. However, Skills Development Scotland still operated three separate frameworks at each legacy organisation throughout 2008-09. Our work, combined with that of internal audit, over the design and implementation of organisation-wide controls confirmed that, the design and implementation of individual controls is generally appropriate, but there is a lack of consistency and some areas for enhancement.

In response to a recommendation in our interim management report (May 2009) management implemented a programme to develop policies tailored to Skills Development Scotland. In particular, progress has been made in developing risk management arrangements; embedding arrangements at an operational level will be a key area for development in 2009-10. It is important that management’s programme is completed in a timely manner, that all revised policy are approved by the board or one of its committees, and that staff are formally made aware of the existence of revised policies.

Internal audit
Internal audit arrangements did not operate consistently during 2008-09, but management commissioned reviews from three different providers during the year to obtain some assurance over systems of internal control. Internal audit providers reported only one ‘grade A’ recommendation regarding the lack of a formal risk management system, but also concluded that the interim transactional and corporate service arrangements were inefficient and did not meet Skills Development Scotland’s requirements. One provider has agreed an internal audit plan for 2009-10. This contract was not subject to tender in line with Skills Development Scotland’s financial procedures, but was approved by the audit committee in advance.
Governance and accountability

Corporate governance arrangements (continued)

Internal controls
There have been weaknesses in the design and operation of controls over payroll, one minor weakness in relation to bank reconciliations and inconsistencies in the process for checking payments to payroll providers. With the exception of these points, our testing of the design and operation of controls over significant risk points confirms that controls are designed appropriately and operating effectively.

Our review and testing of information technology controls and systems did not identify any significant weaknesses, but a number of areas for development were reported to management. These areas primarily relate to system access and management of programme changes.

Statement on internal control
The statement for 2008-09 provide details of the internal control environment and risk management and control framework. Amendments were required to the statement on internal control to reflect the transitional nature of corporate governance and risk management arrangements during the year, lack of comprehensive internal audit coverage and areas identified for development in 2009-10. Subject to these amendments, the statement will comply with the Scottish Government guidance.

Equality and diversity
As a public body Skills Development Scotland is legally required to be proactive in pursuit of equality in relation to race, disability and gender. Management have yet to produce an organisation wide equality and diversity policy, however employees remain under the obligations of their former legacy organisation agreements. The human resources director is currently assessing the impact of new legislations before implementing an organisation wide policy.

Prevention and detection of fraud and irregularity
Management prepared a draft fraud response plan that clearly documents the procedures to be followed by employees in the event, or suspicion, of fraudulent activity. There is a formal whistle-blowing policy governing the procedures to be followed in the event of fraud or suspected fraud. Where management is made aware of a suspected fraud, the internal fraud response group is convened to co-ordinate an investigation. Attendance at the fraud response group depends on the nature of the alleged fraud, but will usually include senior management from finance, human resources and internal audit.

There were no material instances of fraud reported during 2008-09.

National training programmes
The compliance services team provides assurance to management that expenditure incurred under national training programmes and individual learning accounts has been properly incurred. The work of the compliance services team also considers whether the systems and processes operated by third party training providers demonstrate compliance with policies and rules specified by their contracts with Skill Development Scotland. Compliance services staff adopt a risk-based approach under which training providers are visited at least once each year. New training providers and those assessed as ‘high’ risk are visited more frequently and subject to increased sample sizes for compliance testing.

The actual error rates for 2008-09 ranged from 0% to 8.58%, based on a sample of 7.5% of total spend of £91.7 million. The value of errors identified in the sample tested totalled £87,000 across all programmes.
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 local level, as appropriate.

There is no formal process to evidence consideration of such national reports. Audit Scotland requested that all auditors report on actions taken by individual bodies, including details of the type of committee that considered each report, the existence of local self-assessments and, where appropriate, local action plans and a timetable of subsequent reporting of progress made to a board committee or working group. We have reported to Audit Scotland, in July 2009, that Skills Development Scotland did not consider the report on central government’s use of consultancy services. This was the report identified as relevant by Audit Scotland.

Management should implement a framework for considering all Audit Scotland national reports and documenting decisions that they are not relevant or require local self-assessment and formal reporting.

*Action plan recommendation nine*
Performance management arrangements have been established and include regular reporting to the board. All key performance indicators identified in the operating plan for 2008-09 have been reported as achieved by Skills Development Scotland during the year. Progress on the key performance indicators is reviewed and reported to the board on a monthly basis.

Public reporting would be enhanced by making board papers and minutes available on the website.

Arrangements to achieve Best Value have not been explicitly considered and an over-arching strategy, together with supporting operational processes, should be developed during 2009-10.

**Recommendations**

The action plan includes recommendations to improve in the following areas.

<table>
<thead>
<tr>
<th>Area for development</th>
<th>Action plan reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increasing availability of board papers and minutes by the public.</td>
<td>10</td>
</tr>
<tr>
<td>Implementing a process to demonstrate consideration and achievement of Best Value.</td>
<td>11</td>
</tr>
</tbody>
</table>
Performance management

Performance management arrangements
The finance directorate is responsible for three distinct areas, one of which is performance management. The performance management team monitors performance against key performance indicators that are approved by the Scottish Government at the beginning of each year. Performance is reported to the board on a monthly basis. Performance against targets in the annual report includes high level targets that have been identified as being key to Skills Development Scotland’s success. These indicators have been selected by management as the most relevant to the business and accurately reflect performance against objectives. These targets are supported by a number of operational indicators, which are also reported to, and reviewed by, the board on a monthly basis.

Performance against targets in 2008-09
The table below summarises management’s reports on actual performance for 2008-09 against targets included in the operational plan.

<table>
<thead>
<tr>
<th>Measure</th>
<th>Target</th>
<th>Actual</th>
<th>Achieved</th>
</tr>
</thead>
<tbody>
<tr>
<td>The number of learner engagements with individuals who access learning opportunities through branded learning centres and use ILA to fund their course</td>
<td>699,000</td>
<td>729,705</td>
<td>✓</td>
</tr>
<tr>
<td>The number of small and medium size enterprise engagements to encourage and support small businesses to develop and train their staff</td>
<td>15,550</td>
<td>33,117</td>
<td>✓</td>
</tr>
<tr>
<td>The number of learning enquiries through the Careers Scotland and Learndirect Scotland branded websites, telephone contact centres, branded public access centres and organised events</td>
<td>563,000</td>
<td>627,667</td>
<td>✓</td>
</tr>
<tr>
<td>The number of additional learning providers added to the National Learning Opportunities Database to increase the learning opportunities available to the individuals with whom we engage</td>
<td>200</td>
<td>332</td>
<td>✓</td>
</tr>
<tr>
<td>The number of branded learning centres which meet or exceed the requirements of the quality enhancement and development strategy</td>
<td>400</td>
<td>427</td>
<td>✓</td>
</tr>
<tr>
<td>The number of significant / national initiatives in which the organisation is involved</td>
<td>30</td>
<td>37</td>
<td>✓</td>
</tr>
</tbody>
</table>

Public performance reporting
The corporate plan for 2009-12 is published on the website and management also plans to publish the annual report and financial statements on the website. Board meeting minutes and papers are not available on the website. A large number of public bodies publish board minutes on their websites and an increasing number also provide copies of all board papers to allow the user to understand, in more detail, the topics being discussed. Management should consider the reputational benefits and comply with best practice by proactively making this information available to the public.

Action plan recommendation 10
Performance management (continued)

**Best Value**
Management has not explicitly considered the existence or appropriateness of existing arrangements to demonstrate Best Value and there is no Best Value strategy. However, indirect consideration of Best Value is evident through shared service arrangements and increased partnership working with bodies across the public sector in Scotland. Like many organisations Skills Development Scotland will face challenges associated with tightening financial settlements and recurring efficiency targets. In addition to the need to retain, or, in some cases, reduce, expenditure is matched by the need for the Accountable Officer to be able to demonstrate that there are robust arrangements to achieve Best Value. This should be documented in an over-arching Best Value strategy, which is supported by evidence of consideration of Best Value at an operational level, during board discussions and throughout the decision making process. It is important that arrangements to achieve Best Value are embedded in operational practice, but sufficiently explicit to ensure that the board and Accountable Officer can demonstrate commitment to this key initiative.

*Action plan recommendation 11*
### Priority rating for recommendations

- **Grade one** (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of Scottish Enterprise or systems under consideration. The weakness may therefore give rise to loss or error.

- **Grade two** (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.

- **Grade three** (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the controls to meet their objectives in any significant way. These are less significant observations than grades one and two, but we still consider they merit attention.

<table>
<thead>
<tr>
<th>No.</th>
<th>Issue and recommendation</th>
<th>Management response</th>
<th>Officer and due date</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>The Deed of Participation admitting Skills Development Scotland as a participating employer to the Scottish Enterprise Pension and Life Assurance Scheme does not address how to determine and account for the past service liabilities and therefore the assets and liabilities of this Scheme relating to Skills Development Scotland’s employees former participation in the Scheme, as employees of Scottish Enterprise. It is important that management work with Scottish Enterprise and the Trustees of the Scheme to clarify the basis of Skills Development Scotland’s participation in the Scheme without further delay. <em>(Grade one)</em></td>
<td>Accepted.</td>
<td>Human resources director 31 March 2010</td>
</tr>
<tr>
<td>2</td>
<td>A standard process to monitor the receipt, distribution and action of circulars from the Scottish Government or other regulatory bodies should be implemented. <em>(Grade two)</em></td>
<td>Accepted.</td>
<td>Head of public affairs and governance (corporate office) 31 December 2009</td>
</tr>
<tr>
<td>3</td>
<td>There was a significant difference between the forecast outturn reported to the board in the month 12 management accounts and the draft financial statements subsequently presented for audit. This is partly due to annual budgeting and monthly reporting being on a cash basis for both income and expenditure. Good practice in robust financial monitoring requires that monthly financial reports are prepared on a full accruals basis. However, management may wish to set a guide financial limit and cut-off timetable to mitigate the risk of inefficiencies and delays incurred through accruing insignificant items. The introduction of accruals accounting on a monthly basis would assist in both managing expenditure commitments and managing the profile of cash draw downs from the Scottish Government during the year with a view to maximising Skills Development Scotland’s use of its funding allocation. <em>(Grade one)</em></td>
<td>Accepted.</td>
<td>Head of finance 30 September 2009</td>
</tr>
</tbody>
</table>
## Appendix one – action plan

<table>
<thead>
<tr>
<th>No.</th>
<th>Issue and recommendation</th>
<th>Management response</th>
<th>Officer and due date</th>
</tr>
</thead>
<tbody>
<tr>
<td>4</td>
<td>The funding letter received from the Scottish Government includes £16 million funding for additional <em>modern apprenticeships</em>. This amount is subject to parliamentary approval in at the autumn budget revision. Financial and operational planning and forecasting is subject to further uncertainty due to the fact that <em>modern apprentices</em> funding is not guaranteed in future years. Consequently, Skills Development Scotland faces the risk that a new initiative is established late in 2009, with no continued funding commitment from the Scottish Government. <em>(Grade one)</em></td>
<td>Accepted. Confirmation of the £16 million allocation has now been received for 2009-10 on a one-year basis.</td>
<td>Complete.</td>
</tr>
<tr>
<td>5</td>
<td>Appraisals and staff consultations are conducted under guidelines monitored by the human resources team, but there are no organisation-wide employee performance management arrangements. <em>(Grade one)</em></td>
<td>Accepted.</td>
<td>Human resources director 31 March 2010</td>
</tr>
<tr>
<td>6</td>
<td>Staff continue to be employed under contracts originating by legacy organisations, although management is working towards harmonisation of job terms and conditions. Risks over consistency and equality continue to exist until contracts are harmonised. <em>(Grade one)</em></td>
<td>Accepted.</td>
<td>Human resources director 31 March 2010</td>
</tr>
<tr>
<td>7</td>
<td>Five contracts with a combined value of £200,000 were not subject to competitive tendering, despite individual contracts being in excess of the stated tendering limits. The individual contacts and total value of contracts not subject to tender are not considered material, but management should ensure that, following harmonisation of procedures and tendering limits, appropriate mechanisms are established to ensure that controls operate consistently and effectively. <em>(Grade one)</em></td>
<td>Accepted.</td>
<td>Director of finance and audit 31 December 2009</td>
</tr>
<tr>
<td>8</td>
<td>The operation of the audit committee would be enhanced by agreeing meeting dates at the start of each financial year and minutes being taken by someone independent of the finance function. <em>(Grade two)</em></td>
<td>Accepted, subject to agreement of members of the audit committee.</td>
<td>Director of finance and audit 31 August 2009</td>
</tr>
<tr>
<td>9</td>
<td>Management should implement a framework for considering all Audit Scotland national reports and documenting decisions that they are not relevant or require local self-assessment and formal reporting. <em>(Grade two)</em></td>
<td>Accepted.</td>
<td>Head of public affairs and governance (corporate office) 31 December 2009</td>
</tr>
</tbody>
</table>
## Appendix one – action plan

<table>
<thead>
<tr>
<th>No.</th>
<th>Issue and recommendation</th>
<th>Management response</th>
<th>Officer and due date</th>
</tr>
</thead>
</table>
| 10  | Board meeting minutes and papers are not available on the website. Management should consider the reputational benefits and comply with best practice in proactively making this information available to the public.  
  *(Grade two)*                                                                                                                                  | Accepted.            | Head of public affairs and governance (corporate office)  
  31 December 2009                                                                         |                      |                                                             |
| 11  | Management has not explicitly considered the existence or appropriateness of existing arrangements to demonstrate Best Value and there is no Best Value strategy. It is important that arrangements to achieve Best Value are embedded in operational practice, but sufficiently explicit to ensure that the board and Accountable Officer can demonstrate commitment to this key initiative.  
  *(Grade one)*                                                                                                                                  | Accepted.            | Director of finance and audit  
  31 March 2010                                                                         |                      |                                                             |
## Appendix two – audit recommendations in 2008-09

We raised 14 recommendations in our interim management report (issued in May 2009), of which six were ‘grade one’. We have summarised these six recommendations, together with progress made by management in taking appropriate action to mitigate the key risks identified. Responsibility for implementing, and monitoring implementation, recommendations lies with management. We do not routinely follow up our recommendations, but, in its first year of operation we have considered, and report below, progress made by management in this respect.

<table>
<thead>
<tr>
<th>No.</th>
<th>Issue and recommendation</th>
<th>Management response, responsible officer and due date</th>
<th>Update at July 2009</th>
</tr>
</thead>
</table>
| 1   | Skills Development Scotland received equal pay claims from a number of staff and made a payment of £5.2 million to staff during March 2009. Management should consider the regularity of payments made to current employees that relate to a period of employment prior to joining Skills Development Scotland on 1 April 2008. | This will be provided.  
Human resources and organisational director  
31 May 2009 | This was received and the financial statements reflect payments made during 2008-09 and obligations at 31 March 2009. |
| 2   | A number of staff participate in the Scottish Enterprise retirement benefits scheme. Management should progress discussions with the trustees of this scheme to agree the basis of separation of assets and liabilities before requesting a finalised actuarial report from the scheme’s actuary. | Discussions have taken place with both Scottish Enterprise and Highlands and Islands enterprise financial controller / statutory accountants. We have to accept consistent and prudent actuarial recommendations from experts in relation to pensions schemes in which we participate but do not control. Overall this area is very complex and the timescales are very tight in this year to enact any major influence, although we do not believe there is anything of concern given professional advice being taken with regard these matters. Having discussed this with external audit, we are looking at increasing consistency in assumptions.  
Finance and audit director  
30 June 2009 | The financial statements were prepared on the basis of consistent assumptions based independent advice obtained by management.  
The Deed of Participation on which Skills Development Scotland’s participation in the SE Scheme is based is unclear and does not address how the assets and liabilities of the SE Scheme relating to Skills Development Scotland’s employees former participation in the Scheme, as employees of Scottish Enterprise, should be determined and accounted for.  
This requires to be resolved, through discussion between management, Scottish Enterprise and the trustees of the SE Scheme, during 2009-10.  
Action plan recommendation one |
| 3   | As an existing company at 1 April 2008, the financial statements for 2008-09 will need to reflect the transfer of activities, assets and liabilities from other organisations in line with the requirements of financial reporting standard 3: reporting financial performance. Management will need to give the accounting and disclosure requirements early consideration as part of the financial statement preparation process. | Accepted.  
Finance and audit director  
31 May 2009 | Completed. |
## Appendix two – audit recommendations in 2008-09

<table>
<thead>
<tr>
<th>No.</th>
<th>Issue and recommendation</th>
<th>Management response, responsible officer and due date</th>
<th>Update at July 2009</th>
</tr>
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</table>
| 4   | Three governance and policy frameworks continue to operate, which reflect the three organisations from which Skills Development Scotland was formed. Management should prepare and implement a programme of review and approval of tailored arrangements that reflect the specific needs of Skills Development Scotland and its status as a non-departmental public body and the requirements of the financial reporting manual and Scottish public finance manual. | A project has been set up to look at this specific area and will be ongoing over the next three months to ensure that common policies are agreed and implemented across the organisation.  
*Finance and audit director*  
*30 September 2009* | Progress has been made in harmonising policies and management anticipate this process will be completed in 2009-10.                                                                                                             |
| 5   | The continued use of different financial ledgers increases the risk that accounting policies are applied inconsistently and this will need to be considered and documented as part of the 2008-09 financial statement preparation process. | From 1 April 2009 Scottish Enterprise national training programme payments (£100 million), salaries (£45 million), projects and invoicing are going through one system (Exchequer). We will move the small remainder of expenditure and Highlands and Islands Enterprise national training programme payments by the end of July 2009 so that all financial transactions will go through one system controlled entirely by Skills Development Scotland finance staff.  
*Finance and audit director*  
*31 July 2009* | The majority of transactions are now recorded in Skills Development Scotland’s financial ledger and the remaining areas will transfer over the summer of 2009.                                                           |
| 6   | There was an inconsistent and incomplete internal audit programme in 2008-09. There is a risk that the accountable officer has insufficient evidence to form his opinion on the systems of internal control. The nature of the internal audit programme should be appropriately reflected in the 2008-09 statement of internal control and formal arrangements established for the full 2009-10 financial year. | Accepted in part, although this was difficult given the nature of shared services, which may mean, for example, Scottish Enterprise auditing their systems and processes. We now have an audit plan for 2009-10 for the audit committee to consider and would look to implement this during 2009-10 to ensure that the accountable officer has enough assurance around work done in the year in relation to controls.  
*Finance and audit director*  
*31 May 2009* | There was a lack of a comprehensive internal audit programme during 2008-09, but an annual plan has been approved by the audit committee for 2009-10.                                                                 |

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