

# Scottish Government

2018/19 Annual Audit Report



 AUDIT SCOTLAND

Prepared for the Scottish Government and the Auditor General for Scotland

December 2019

## Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



## About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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# Key messages

## 2018/19 annual report and accounts

- 1** The financial statements of the Scottish Government give a true and fair view of the financial position and expenditure and income of its core portfolios and bodies within the consolidated accounting boundary. The expenditure and income were incurred or applied in accordance with any applicable enactments and guidance, and the other information in the annual report and accounts was consistent with the financial statements and prepared in accordance with legal requirements.

## Financial management

- 2** The Scottish Government operated within its 2018/19 budget limits. The Consolidated Accounts show that total net expenditure was £36,137 million, £778 million less than budget.
- 3** In recent years, the Scottish Government has taken a direct role in providing financial support to private companies. In 2018/19, the Scottish Government provided a further loan of £30 million to Ferguson Marine Engineering Limited (FMEL) in addition to a loan of £15 million in 2017/18. The Scottish Government impaired the value of the loans to nil at the end of the financial year due to its assessment of the recoverability of these amounts in light of the challenging financial position of FMEL. The valuation of loans and guarantees to other private companies also declined significantly during 2018/19.
- 4** Other than payroll, the Scottish Government's main systems of internal control operate effectively covering SEAS (General ledger); Payables; Receivables and Banking. Improvements are required in some areas, mainly Payroll and SEAS, to ensure controls operate as expected and risks are minimised.

## Financial sustainability

- 5** The Scottish Government needs to improve the quality of financial reporting to better support Parliament. In May 2019, the Scottish Government published its second medium-term financial strategy, but it does not reflect all the basic components of a medium-term financial plan. It does not include indicative spending plans or priorities, or links to outcomes and there is no detail on how the Scottish Government would address a possible £1 billion shortfall due to forecast errors. In addition, the Government has still not fulfilled its commitment to publish a consolidated account covering the whole devolved public sector in Scotland. This would fill an important gap and improve strategic public financial management, support Parliamentary scrutiny and enable better decision making.
- 6** Overall, the Scottish Government's preparations for EU withdrawal were reasonable and proportionate given the considerable level of uncertainty over the detailed implications of withdrawal. Although plans were untested with the postponement of the withdrawal date, the initial work undertaken provides a good basis for the Scottish Government to develop further its resilience arrangements in anticipation of the UK's withdrawal on 31 October 2019.

## Governance and transparency

- 7** The Scottish Government made some improvements to its governance arrangements during 2018/19 including the appointment of new Non-Executive Directors. They have also taken some initial steps to improve the effectiveness of their role in sponsoring public bodies. The Government's Audit and Assurance Committee needs to provide greater scrutiny and challenge to support the advice and assurances given to the Permanent Secretary as the Principal Accountable Officer. This is particularly important given the scale of challenges facing the Scottish Government including the implementation of new powers, continued pressures on public finances and the uncertainty and risks associated with the UK's withdrawal from the European Union.

## Value for money

- 8** The Scottish Government's performance report provides only very limited information on the Scottish Government's own progress towards its overall aims and objectives. This means that the reader is unable to see the links between the money spent by the Scottish Government, what it has achieved, and progress made towards achieving national outcomes.

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# Introduction

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1. This report summarises the findings from our 2018/19 audit of the Scottish Government.
2. The scope of our audit was set out in our Annual Audit Plan presented to the Scottish Government Audit and Assurance Committee on 11 March 2019. This report comprises the findings from:
  - an audit of the Scottish Government's annual report and accounts
  - consideration of the four audit dimensions that frame the wider scope of public audit set out in the [Code of Audit Practice 2016](#) as illustrated in [Exhibit 1](#).

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## Exhibit 1 Audit dimensions



Source: *Code of Audit Practice 2016*

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3. The main elements of our audit work in 2018/19 have been:
  - a review of the Scottish Government's main financial systems
  - an audit of the Scottish Government's 2018/19 annual report and accounts including the issue of an independent auditor's report setting out our opinions
  - consideration of the four audit dimensions of public audit.

## Adding value through the audit

4. We aim to add value to the Scottish Government through the audit by:

- identifying and providing insight on significant risks, and making clear and relevant recommendations for improvements that have been accepted by management
- reporting our findings and conclusions in public
- sharing intelligence and good practice through our national reports ([Appendix 3](#)) and good practice guides
- Providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability

5. In so doing, we aim to help the Scottish Government promote improved standards of governance, better management and decision making and more effective use of resources.

## Responsibilities and reporting

6. The Scottish Government has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts that are in accordance with the accounts direction from the Scottish Ministers. The Scottish Government's annual report and accounts includes the following:

- Performance Report
- Accountability Report (which includes the Corporate Governance Report and Remuneration and Staff Report)
- Financial statements and supporting notes.

7. The Scottish Government is also responsible for establishing appropriate and effective arrangements for governance, propriety and regularity that enable the board to successfully deliver its objectives.

8. Our responsibilities as independent auditor are established by the Public Finance and Accountability (Scotland) Act 2000 and the [Code of Audit Practice 2016](#), and supplementary guidance and International Standards on Auditing in the UK.

9. As public sector auditors we give independent opinions on the annual report and accounts. Additionally, we conclude on:

- the appropriateness and effectiveness of the performance management arrangements,
- the suitability and effectiveness of corporate governance arrangements,
- the financial position and arrangements for securing financial sustainability.

10. In doing this we aim to support improvement and accountability. Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.

11. This report raises matters from the audit of the annual report and accounts and consideration of the audit dimensions. Weaknesses or risks identified are only those which have come to our attention during our normal audit work and may

not be all that exist. Communicating these does not absolve management from its responsibility to address the issues we raise and to maintain adequate systems of control.

- 12.** Our annual audit report contains an agreed action plan at [Appendix 1](#). It sets out specific recommendations, responsible officers and dates for implementation. It also includes any outstanding actions from last year and progress in implementing these.
- 13.** We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and therefore the 2018/19 audit fee of £1,107,750 as set out in our Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.
- 14.** This report is addressed to both the Scottish Government's Audit and Assurance Committee and the Auditor General for Scotland and will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk) in due course.
- 15.** We would like to thank all Scottish Government employees who have been involved in our work for their cooperation and assistance during the audit.

# Part 1

## Audit of 2018/19 annual report and accounts



### Main judgements

**The financial statements of the Scottish Government give a true and fair view of income and expenditure during the year and the financial position of organisations within the consolidation boundary.**

**The expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.**

**The audited part of the remuneration and staff report, performance report and governance statement were all consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.**

### Audit opinions on the annual report and accounts

**16.** The annual report and accounts for the year ended 31 March 2019 were approved by the Scottish Government Assurance and Audit Committee on 23 September 2019. We reported within our independent auditor's report that:

- the financial statements give a true and fair view and were properly prepared
- expenditure and income were regular and in accordance with applicable enactments and guidance issued by Scottish Ministers
- the audited part of the remuneration and staff report, performance report and governance statement were all consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

**17.** Additionally, we have nothing to report in respect of misstatements in information other than the financial statements, the adequacy of accounting records and the information and explanations we received.

### Submission of annual report and accounts for audit

**18.** The preparation of the annual report and accounts is a key activity in demonstrating stewardship of public finances. We received the unaudited core schedules on 7 June 2019 and the first version of the unaudited consolidated accounts on 26 July 2019. The unaudited consolidated accounts received were incomplete and did not include key information relating to the Remuneration and Staff Report, Performance Report, Governance Statement, Financial Assets and Cash Flow Statement. We acknowledge that the Scottish Government were dealing with unprecedented levels of activity which accounted for some omissions. Nevertheless, we would expect to see comprehensive unaudited annual report and accounts provided at the start of the audit process. The first complete version was received on 30 August 2019

with further submissions of key aspects of the Consolidated Accounts received during September.

19. The working papers provided were of a sufficient standard and finance staff provided good support to the audit team. We recognise those involved in preparing the annual report and accounts extended beyond finance staff which often led to delays in information provided. There is a need for greater oversight and coordination of the preparation and completion of the Consolidated Accounts process. This would help the Scottish Government to demonstrate its commitment to the process and would help policy and other corporate areas provide comprehensive and timely information. [See Appendix 1 Action point 1.](#)

## Whole of Government Accounts

20. The draft Whole of Government Account (WGA) pack was provided on 28 August 2019. A further version is expected to be received following the signed consolidated accounts and other counter party information. Our audit work on the WGA pack will commence after this has been received.

## Risk of material misstatement

21. [Appendix 2](#) provides a description of those assessed risks of material misstatement in the annual report and accounts and any wider audit dimension risks that were identified during the audit planning process. These risks had the greatest effect on the overall audit strategy, the allocation of staff resources to the audit and directing the efforts of the audit team. It also summarises the work we have done to gain assurance over the outcome of these risks with associated recommendations included in our Action Plan at Appendix 1.

## Materiality

22. Misstatements are material if they could reasonably be expected to influence the economic decisions of users taken based on the financial statements. The assessment of what is material is a matter of professional judgement and involves considering both the amount and nature of the misstatement. It is affected by our perception of the financial information needs of the users of the financial statements.
23. Our initial assessment of materiality for the annual report and accounts was carried out during the planning phase of the audit. On receipt of the unaudited annual report and accounts we reviewed our materiality calculations and concluded that the basis of the calculations remained appropriate. The calculation of materiality based on the unaudited accounts is summarised in [Exhibit 2](#).
24. With regards to the annual accounts, we assess the materiality of uncorrected misstatements both individually and collectively.

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## Exhibit 2

### Materiality values

Materiality level	Amount
Overall materiality	£360 million

This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It was set at one per cent of gross expenditure for the year ended 31 March 2019.

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Materiality level	Amount
<p><b>Performance materiality</b></p> <p>This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality, this would indicate that further audit procedures should be considered. Using our professional judgement, we have calculated performance materiality at 15 per cent of overall materiality.</p> <p>Given the specific nature of the Scottish Government audit and the lower materiality levels in respect of individual errors identified, we apply judgement and consider the nature and circumstances of each error identified. Therefore, in practice, we work to much lower materiality levels and any individual error in the range £10 million to £20 million and above may be material depending on its nature and impact.</p>	£54 million
<p><b>Reporting threshold</b></p> <p>We are required to report to those charged with governance on all unadjusted misstatements in excess of the 'reporting threshold' amount. This was calculated at one per cent of overall materiality but capped at £0.25 million.</p>	£0.25 million

Source: Scottish Government Annual Audit Plan 2018/19

## Significant findings from the audit in accordance with ISA 260

25. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the body's accounting practices covering accounting policies, accounting estimates and financial statements disclosures.
26. The significant findings are summarised in [Exhibit 3](#) and include the qualitative aspects of the Scottish Government's accounting practices. Where a finding has resulted in a recommendation to management, a cross reference to the Action Plan in [Appendix 1](#) has been included.

## Exhibit 3 Key issues from the audit of financial statements

Issue	Resolution
<p><b>1. Health accruals</b></p> <p>Included in the payables and other current liabilities balance on the Statement of Financial Position was an accrual of £27 million relating to expenditure on the GP premises sustainability loan scheme. Based on the evidence received we queried whether this accrual was valid.</p>	<p>We concluded that the accrual was not valid as at 31 March 2019 and requested it to be removed from 2018/19 expenditure. The Scottish Government agreed and amended the accounts accordingly.</p> <p><a href="#">See Appendix 1 Action point 2</a></p>
<p><b>2. Social Security Scotland</b></p> <p>The 2018/19 financial year is the first year that Social Security Scotland, an executive agency, was consolidated into the Scottish Government's accounts as a separate component audited body.</p>	<p>We concluded that, for 2018/19, the likely amount of maximum error incurred in Carer's Allowance is unlikely to be significant enough to influence the economic decisions of the users of the accounts. Looking ahead, as the level of benefits expenditure is expected to increase significantly in the next few</p>

Issue	Resolution
<p>The 2018/19 Social Security Scotland annual report and accounts were qualified by the auditor. The auditor qualified his regularity opinion in relation to Carer's Allowance expenditure of £152 million because available estimates of error and fraud levels from DWP do not provide enough evidence to determine whether this spending was in line with the relevant legislation.</p> <p>We considered the potential impact of this opinion on the Scottish Government's consolidated accounts.</p>	<p>years, the consolidation of Social Security Scotland's accounts will have a considerable and increasing influence on the Consolidated Accounts and on future audit opinions.</p>
<p><b>3. Impairment of financial assets (student loans)</b></p> <p>The Scottish Government's financial assets include student loans. Every year, the value of student loans is assessed to reflect the new loans issued, repayments and the likelihood that loans are not repaid. The value of student loans outstanding is then adjusted accordingly. During the year, as part of an impairment review, the Scottish Government identified that an adjustment was required to correct how previous years' impairment charges were calculated. In the 2018/19 unaudited accounts, the Scottish Government applied an additional impairment to 2018/19 to adjust for this. We reviewed the correction and queried its categorisation in the accounts, including the absence of a prior year adjustment.</p>	<p>Based on available information, we assessed the prior year impairment adjustment to be £255 million and requested that the Scottish Government remove from this amount from 2018/19 and apply it to 2017/18 in line with accounting standards (IAS 8).</p> <p>The Scottish Government agreed and amended the accounts accordingly.</p>
<p><b>4. Impairment of financial assets (loans to private companies)</b></p> <p>The Scottish Government's loans to private companies are included within financial assets. As part of our audit work, we reviewed the Scottish Government's valuation of loans provided to Ferguson Marine Engineering Limited and Burntisland Fabrications Limited.</p>	<p>In total, at the end of March 2019, the Scottish Government had issued loans of £45 million to FMEL and £37.4 million to BiFab. The Scottish Government impaired its loan to FMEL to nil and its loan to BiFab (converted to an equity stake) to £2 million. Based on the information available, our conclusion was that the impairments were reasonable and fairly stated.</p>
<p><b>5. Financial guarantee</b></p> <p>In December 2016, the Scottish Government entered into a 25-year financial guarantee relating to power purchase obligations of the hydro plant and aluminium smelter at Lochaber. The Scottish Government receives an annual fee in return for the guarantee which was classed as a financial asset in the consolidated accounts. The calculation of the Government's potential exposure to default payments was updated, resulting in the creation of a new provision of £27 million. Based on the information received we queried the value of the new provision.</p>	<p>We reviewed the Scottish Government's assessment of the new provision based on due diligence reports prepared by external advisors.</p> <p>Based on the information available, we agree that a new provision should be created, however we found that the value should be £33 million based on the final version of the advisor's report.</p> <p>The Scottish Government agreed and amended the accounts accordingly.</p>
<p><b>6. Cash management</b></p> <p>As at 31 March 2019, the Scottish Government held cash balances of £1 billion. This represents a significant increase from £585 million held at the end of March 2018. This includes £979 million</p>	<p>We queried the significant increase, and level, of cash held by the Scottish Government. The Scottish Government stated that this was due to poor cash forecasting.</p>

Issue	Resolution
<p>drawn down from the Scottish Consolidated Fund that remained unused and is therefore due to be returned to the SCF.</p> <p>The Scottish Government draws amounts from HM Treasury (via the SCF) every month. The amounts are based on forecasts determined by the Scottish Government over how much cash it will need. This draws on information supplied across business areas including executive agencies.</p>	<p>The Scottish Public Finance Manual states that the principles underlying the operation of government bank accounts should be the same as those applied to commercial bank accounts. This includes keeping balances to a minimum consistent with the principles of not providing funding in advance of need.</p> <p><a href="#">See Appendix 1 Action point 3</a></p>
<p><b>7. Financial redress scheme for survivors of historic child abuse in care</b></p> <p>In April 2019, the Scottish Government launched an advanced financial redress scheme for survivors of historic child abuse in care. The Scottish Government set aside £10 million within the 2019/20 budget to cover advanced payments. As part of our 2018/19, we queried whether the Scottish Government had considered including a provision within 2018/19 in relation to the scheme.</p>	<p>We considered the information provided by the Scottish Government and agreed that there was no present obligation as at 31 March 2019 in relation to the scheme. Therefore, we agreed that there was no requirement to include a provision within the 2018/19 accounts.</p> <p>We will review payments and disclosures in relation to the advanced scheme in our 2019/20 audit.</p>

Source: Audit Scotland

## How we evaluate misstatements

27. There were a number of presentational and monetary adjustments to the unaudited annual report and accounts arising from our audit. These were discussed with senior officials who agreed to make the necessary changes.
28. Gross monetary misstatements (errors) for the Scottish Government core portfolios, in excess of the 'reporting threshold' amount (£0.25 million) totalled £307 million and were adjusted in the final accounts. Of this balance, £255 million related to a prior year adjustment relating to the impairment of student loans as noted in Exhibit 3.
29. We are required to report to those charged with governance all unadjusted misstatements which we identified during our audit, other than those of an insignificant small amount. The total unadjusted errors within the consolidated accounts is £56.4 million. This balance is made up of £20.6 million relating to NHS bodies and £35.8 million relating to agencies and other consolidated bodies. Appendix 3 shows the unadjusted errors and their impact on the annual report and accounts. If these errors been adjusted, the net impact would have been to decrease net assets and increase net expenditure by £1.8 million.
30. It is our responsibility to request that all misstatements, other than those below the reporting threshold, are corrected. The final decision on making the correction lies with those charged with governance considering advice from senior officers.

## Follow up of prior year recommendations

31. The Scottish Government has made some progress in implementing our recommendations from 2017/18. Details of new and prior year recommendations and the Scottish Government's planned actions are detailed in Appendix 1.

# Part 2

## Financial management



### Main judgements

The Scottish Government operated within its 2018/19 budget limits. The Consolidated Accounts show that total net expenditure was £36,137 million, £778 million less than budget.

In recent years, the Scottish Government has taken a direct role in providing financial support to private companies. In 2018/19, the Scottish Government provided a further loan of £30 million to Ferguson Marine Engineering Limited (FMEL) in addition to a loan of £15 million in 2017/18. The Scottish Government impaired the value of the loans to nil at the end of the financial year due its assessment of the recoverability of these amounts in light of FMEL's challenging financial position.

The valuation of loans and guarantees to other private companies has also declined significantly during 2018/19. Financial support provided to Prestwick Airport, Burntisland Fabrications Limited and the Lochaber Aluminium Smelter has declined in value as a result of future expected losses. The Scottish Government has not yet implemented the recommendation to develop a framework to clearly outline its role in financial interventions in private companies.

Other than payroll, the Scottish Government's main systems of internal control operate effectively covering SEAS (General ledger); Payables; Receivables and Banking. Improvements are required in some areas, mainly Payroll and SEAS, to ensure controls operate as expected and risks are minimised.

### Financial performance in 2018/19

32. The main financial objective for the Scottish Government is to ensure that the financial outturn for the year is within the budget allocated by Scottish Ministers.
33. The Scottish Government relies on Budget holders and Budgetary Control Liaison Officers (BCLOs) to scrutinise and monitor spend against budgets. The system relies on directorates providing early warning if budgets are likely to be under or over spent. Budgets are monitored on a monthly basis, with scrutiny taking place at People and Finance group meetings and the relevant Director General assurance group meeting.
34. The Scottish Government reported an outturn of £36,137 million remaining within its overall budget for 2018/19 with an underspend of £778 million. The financial performance is shown in [Exhibit 4](#).

### Exhibit 4

#### Performance against budget in 2018/19

Performance	Final budget £m	Outturn £m	Over (under) spend £m
Resource	35,109	34,601	(508)
Capital	1,806	1,536	(270)
<b>Total</b>	<b>36,915</b>	<b>36,137</b>	<b>(778)</b>

Source: Scottish Government Consolidated Accounts 2018/19

**35.** Variations in each portfolio are managed by the Scottish Government to ensure overall spending remains within budget. Around half of the underspend relates to the transport, infrastructure and connectivity portfolio including spending on projects being deferred to future years and lower than anticipated unitary payments for revenue-financed projects. High-level reasons for significant variances between actual and budgeted spend are included in the Consolidated Accounts. Further information is given in the accounts of other bodies.

### Financial support to private companies

- 36.** In recent years, the Scottish Government has taken a direct role in providing financial support to private companies in addition to support provided through its enterprise agencies; Scottish Enterprise and Highlands and Islands Enterprise. This includes:
- the purchase of Prestwick Airport together with loans of £39.9 million
  - loan facilities of £45 million to Ferguson Marine Engineering Limited (FMEL)
  - loan facilities of £51 million to Burntisland Fabrications Limited (BiFab) including a conversion to equity stake.
  - a financial guarantee for power purchase obligations at the hydro plant and aluminium smelter at Lochaber with a value of £21.4 million at the time of agreement.
- 37.** In November 2013, the Scottish Government purchased Prestwick Airport for a nominal price of £1 with the stated aim of protecting jobs and safeguarding what it considered to be a strategic infrastructure asset. As at 31 March 2019, the Scottish Government's level of loan support to the Airport totalled £39.9 million. In its 2018/19 annual accounts, Transport Scotland impaired the value of this loan by £33 million to reflect expected losses in line with new accounting requirements. In June 2019, the Scottish Government announced that the sale of Prestwick Airport was being progressed, in keeping with its long-term objective that the airport should be returned to the private sector. Prestwick Airport is currently assessing expressions of interest in purchasing the airport. No date has been set to complete the sale but Transport Scotland anticipates that it may be achievable by the end of 2019/20.
- 38.** In September 2017, the Scottish Government provided a commercial loan facility of £15 million to FMEL, a ship-building and engineering company based in Port Glasgow. The purpose of the loan was to support FMEL's completion of a contract to build two 'dual-fuel' ferry vessels for Caledonian Maritime Assets Limited (CMAL) valued at around £97 million. In June 2018, the Scottish Government provided FMEL with an additional £30 million loan to improve their cash flow position to help support the delivery of the CMAL vessels and improve the prospects of the company and shipbuilding on the Clyde. CMAL is a company wholly owned by the Scottish Government in which Scottish

Ministers are the sole shareholders. It does not fall within the consolidated boundary of the Scottish Government Consolidated Accounts and appoints its own external auditors.

39. By April 2019, FMEL had drawn down the full loan facility of £45 million and no extended facilities were provided. The Scottish Government impaired the value of its loans to zero in the Consolidated Accounts reflecting its view that the loans were unlikely to be repaid given FMEL's challenging financial position.
40. In August 2019, FMEL entered administration which led to the Scottish Government outlining plans to bring the company into public ownership if a private sale is not achieved. The Scottish Government reported that completing the two ferry vessels and securing jobs and the long-term future of the yard was their main priority in acquiring the company. An agreement was reached with the Administrator to allow the Scottish Government to oversee operations while the sale process for the business takes place. The Scottish Government appointed a turnaround director to manage the company and both the Government and Scottish Enterprise will be represented on a new oversight Board. The Board is expected to produce an operational plan including timescales and estimated costs of completing the ferries by the end of October 2019.
41. In November 2017, the Scottish Government entered into an agreement to offer a commercial loan facility of £15 million to Burntisland Fabrications Limited (BiFab), a fabricator of oil, gas and offshore wind structures, to support the completion of two key contracts. Between January and April 2018, the Scottish Government extended the loan facility up to £41 million as a result of increasing costs associated with the completion of contracts for the Beatrice Offshore Wind Farm. Included in the agreement with BiFab is a provision for the loan to be converted to an equity stake, not exceeding a 38 per cent shareholding in BiFab. A further £10 million loan was also made available to BiFab in April 2018 to support business restructuring following the completion of the contracts taking the total loan support available to BiFab up to £51 million.
42. At the end of March 2019, BiFab had drawn down £37.4 million of the £41 million loan facility. This was subsequently converted to equity by the Scottish Government representing a total equity stake of 32 per cent. In the 2018/19 consolidated accounts, the Scottish Government impaired the value of its equity stake by £37.4 million to £2 million to reflect expected losses in line with new accounting requirements. This followed an assessment of the valuation of the Scottish Government's equity stake by external professional advisors. The Scottish Government plans to monitor options for when it will sell its shareholding, but no decision has yet been made.
43. In December 2016, the Scottish Government entered into a 25-year financial guarantee relating to the hydro plant and aluminium smelter at Lochaber. This involved the Government guaranteeing the power purchase obligations of the smelter if the business does not fulfil its obligations to pay for contracted power. The guaranteed annual amounts vary between £14 million and £32 million over the lifetime of the contract. The Scottish Government receives an annual fee in return for the guarantee which was classed as a financial asset in the consolidated accounts. The asset was valued at £21.4 million at the time of agreement in 2016/17. In 2018/19, the value of asset was impaired to nil as a result of a review of expected credit losses in line with new accounting standards. Similarly, the calculation of the Government's potential exposure to default payments was also updated, resulting in the creation of a new provision of £33 million.
44. The Scottish Government has not yet implemented a framework to clearly outline its role in financial interventions in private companies. Last year, we highlighted the need for the Scottish Government to be more transparent about its overall approach in providing significant public funds to support private companies. This included a recommendation that the Scottish Government

should develop a framework that clearly outlines its role in financial interventions in private companies to support decision making over where, when and at what level to invest. Such a framework should provide clear information on financial capacity, risk tolerance and expected outcomes. In doing so, the Scottish Government will provide the Parliament with greater assurance and better information over its strategic objectives in entering these agreements and allow for greater scrutiny of the risks and opportunities that exist, including the opportunity costs involved. [Appendix 1 Action point 4.](#)

## European Social Fund

45. The Scottish Government is responsible for managing two European Structural and Investment Funds for the period 2014 to 2020. One of the programmes, the European Social Fund, aims to help people improve their lives by learning new skills and finding better jobs. In February 2019, the European Commission (EC) notified the Scottish Government that the ESF had been placed in 'pre-suspension' as a result of serious deficiencies in the management and control system following issues identified by their auditors. The issues mirror similar difficulties with the 2007-13 ESF programme.
46. The EC's aims to avoid making payments where there is a risk that the Scottish Government and lead partners (32 councils and other public bodies), have not followed the rules on how funds are spent. EC payments are stopped until it considers such risks have been removed. Pre-suspension means that the EC stop making payments, and the Scottish Government cannot make claims, until the issues identified are resolved.
47. The Scottish Government has until November 2019 to resolve the issues before the pre-suspension can be lifted and payments can be made. Lead partners are continuing to make payments to beneficiaries from their own budgets during this time. The Scottish Government will not reimburse lead partners on related issues until they have confirmation that the pre-suspension will be lifted. The Scottish Government are currently working with lead partners to resolve the issues that led to pre-suspension. The Scottish Government could face a financial penalty if the EC place the programme in full suspension. The EC can impose a maximum penalty of up to 25 per cent of the whole programme, which would be in the region of £190 million, although the possibility of such a significant amount is remote. Any penalty would be subject to negotiation between the Scottish Government and the Commission.
48. A contingent liability of £10.4 million is included in the consolidated accounts to reflect the amounts paid by the Scottish Government to lead partners but subsequently withdrawn from declarations to the EC as a result of the pre-suspension.

## Systems of internal control

49. As part of our audit we identify and inspect the key internal controls in those accounting systems which we regard as significant to produce the financial statements. Our objective is to gain assurance that the Scottish Government has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.
50. Our findings from the review of systems of internal controls were included in our Management Report presented to the Scottish Government Audit and Assurance Committee on 24 June 2019. We concluded that other than payroll, the controls tested were operating effectively. Our testing identified a number of cases where controls did not operate as expected, including several within the payroll system. It is essential that management act to address these weaknesses to ensure that risks to the systems are minimised and the integrity of the systems is maintained. Control weaknesses which are not addressed by planned management actions increase the risk of fraud and error remaining undetected.

- 51.** No significant internal control weaknesses were identified during the audit which could affect the Scottish Government's ability to record, process, summarise and report financial and other relevant data to result in a material misstatement in the financial statements. The issues identified as part of our payroll testing were due to poor administrative controls in practice.

## Grant management

- 52.** Every year, the Scottish Government issues a variety of different grants to public sector bodies and other organisations such as charities and voluntary groups. The grants awarded are usually made with several associated terms and conditions to ensure value for money is achieved. The Scottish Government is responsible for monitoring the terms and conditions to ensure that recipients are meeting their obligations prior to any payments being issued. Our 2018/19 audit work included expenditure testing of a number of grant payments across several Scottish Government portfolios. We found that there was an inconsistent approach across the organisation in how grant conditions were being monitored and, in many cases, it was unclear if effective monitoring had taken place.
- 53.** The Scottish Public Finance Manual states that grants provided must be made subject to binding agreements and that business areas are responsible for ensuring that grants are spent for their intended and authorised purposes. Our audit work highlighted that there is a risk that the Scottish Government is not adhering to the SPFM and therefore may not be able to demonstrate that value for money is being achieved from its grant funding arrangements. [Appendix 1 Action point 5.](#)

## Dependency on key suppliers

- 54.** The impact of a failure or collapse of a key supplier can be significant to an organisation and can result in either delays or non-completion of major contracts or, disruptions in the continued provision of vital services. This has brought into focus the risk of key supplier failure and the risk of underperformance in suppliers that are experiencing difficult trading conditions.
- 55.** The Scottish Government identified around 41 key suppliers relating to the core Scottish Government only. These were valued at approximately £670 million. Two of the suppliers were identified as being based outside of the UK, one in the USA and one in Europe. Of the 39 based in the UK, 15 had parent companies based overseas.
- 56.** The Scottish Government defines strategic contracts as those that are high value or high risk (generally valued at over £2 million), or those deemed business critical or with a limited supply chain. These are identified at the initial procurement stage and contract managers are responsible for carrying out annual due diligence checks. Where supplier risks are identified these are added to divisional risk registers and escalated if necessary, to directorate and corporate risk registers. At the time of our audit, there were no risks identified on the corporate risk register relating directly to concerns over key suppliers. The Scottish Government are currently implementing a contract management system module and a training programme for Contract and Supplier Management as well as reviewing current practices including risk identification and monitoring.

## ICT controls

- 57.** As part of our audit, we carried out a high-level IT security review of the main financial systems (SEAS financial management, EaseBuy procurement and HR/Payroll). We reported the results in our 2018/19 Management Report presented to the Scottish Government's Audit and Assurance Committee on 24 June 2019.

**58.** Our review found examples of poor practice relating to system access controls including cases where there was no evidence of training, no authorisation of access rights or removal of rights following the departure of staff. We have reported previously that while there are established controls in place, the application of these controls across various systems remains inconsistent. We also reported issues relating to SEAS patch management, failover testing and staffing capacity. The risks of not ensuring appropriate access controls or maintaining ICT systems are significant. These include cyber security risks as well as risks of system failure or fraud and error.

# Part 3

## Financial sustainability



### Main judgements

The Scottish Government needs to improve the quality of financial reporting to better support Parliament. In May 2019, the Scottish Government published its second medium-term financial strategy, but it does not reflect all the basic components of a medium-term financial plan. It does not include indicative spending plans or priorities, or links to outcomes and there is no detail on how the Scottish Government would address a possible £1 billion shortfall.

The 2019 strategy now includes principles and policies on reserves and borrowing powers. This is a positive step and will help to improve the transparency of decision making on the capital programme such as the level, type and timing of borrowing, and will support a more transparent approach in managing the Scotland Reserve.

The Scottish Government has still not fulfilled its commitment to publish a consolidated account covering the whole public sector in Scotland. This would fill an important gap and improve strategic public financial management, support Parliamentary scrutiny and enable better decision making.

Overall, the Scottish Government's preparations for EU withdrawal were reasonable and proportionate given the considerable level of uncertainty over the detailed implications of withdrawal. Although plans were untested with the postponement of the withdrawal date, the initial work undertaken provides a good basis for the Scottish Government to develop further its resilience arrangements in anticipation of the UK's withdrawal on 31 October 2019.

### Financial planning

59. Financial sustainability looks to the medium and longer term to consider whether an organisation is planning its finances effectively to respond to existing and emerging risks and challenges. The Scottish Government's budget is now intrinsically linked to the performance of the Scottish economy relative to the performance of the rest of the UK's economy. If the Scottish economy performs better than the rest of the UK economy, then Scotland retains any surplus in devolved taxes receipts compared to the block grant adjustment applied.
60. The performance of the Scottish economy is also influenced by macroeconomic policies set by the UK as well as taxpayer's behaviour as a result of tax policies set and applied in Scotland, which in turn also impacts the Scottish Budget. The Scottish Government needs to ensure it has good scenario planning in place taking all these factors into account, when setting budgets to support fiscal decisions such as the level of borrowing.
61. In May 2019, the Scottish Government published its second medium-term financial strategy, Scotland's Fiscal Outlook. The strategy, to be updated annually, aims to provide an assessment of the medium-term outlook for Scotland's public finances as the new financial powers from the Scotland Acts 2012 and 2016 come into effect. The production of a financial strategy followed

a recommendation from the Parliament's Budget Process Review Group (BPRG) in 2017. The BPRG said that such a strategy should set out expectations and broad financial plans for at least five years ahead, including clear policies and principles for using, managing and controlling the new financial powers.

62. The strategy provides an explanation of the fiscal framework and outlines potential funding scenarios for the Scottish budget over the next five financial years to 2023/24 based on independent forecasts carried out by the Scottish Fiscal Commission. The strategy includes the Scottish Fiscal Commission's income forecasts, which show a potential £1 billion cumulative reduction to the Scottish budget over the next three years. The Scottish Government project that available funding for resource spending will grow annually by 1.1 per cent in real terms over the next five years.
63. The 2019 strategy now includes principles and policies on reserves and borrowing powers. This is a positive step and will help to improve the transparency of decision making on the capital programme such as the level, type and timing of borrowing, and will support a more transparent approach in managing the Scotland Reserve.
64. The strategy does not reflect all the basic components of a medium-term financial plan. It does not include indicative spending plans or priorities, or link to outcomes and there is no detail on how the Scottish Government would address the possible £1 billion shortfall due to forecast errors. There is also little evidence to demonstrate that the strategy is a key component of the Government's financial decision making. The 2018 strategy included spending scenarios for the Scottish Government's priority areas. The 2019 strategy does not include such scenarios, instead focusing on the key financial challenges and opportunities and setting out a framework for a future Spending Review.
65. Overall, the 2019 strategy represents a missed opportunity and a step backwards for the Scottish Government's financial reporting. The absence of high-level financial plans, priorities and scenarios will make the Parliament's scrutiny of the forthcoming 2020/21 budget more difficult. This is particularly challenging when considering the impact of changes in spending patterns on outcomes set out in the National Performance Framework. [Appendix 1 Action point 6.](#)

## 2018/19 financial position

66. The Consolidated Statement of Financial Position is one of the primary financial statements in the Consolidated Accounts. It summarises what is owned and owed by the core Scottish Government and those public bodies within the consolidated boundary. This shows taxpayers' equity – an accounting measurement of the amount of taxpayers' money applied that has continuing public benefit. It shows how much of this has arisen from the application of parliamentary funding (arising from the Scottish Block Grant, capital borrowing and devolved taxes) and how much resulted from changes in the value of physical assets over time.
67. Taxpayers' equity has increased in each of the last five years, largely due to an increase in physical assets (such as property and roads) and financial assets (such as loans and investments). Total liabilities (such as payments for private-financed projects) have also increased from £5.9 billion to £8.8 billion. It is important to note that the position does not reflect all the assets and liabilities of the Scottish public sector. For example, key liabilities are excluded such as capital borrowing, local government borrowing, and all public sector pension liabilities funded from the Scottish budget.

## Borrowing

- 68.** Under the terms of the Scotland Act 2016, Scottish Ministers' can borrow up to £3 billion for capital purposes with an annual borrowing limit of 15 per cent (£450 million) of the overall borrowing cap. In 2018/19, the Scottish Government borrowed £250 million. This was less than the £450 million outlined by Scottish Ministers as part of the 2018/19 Scottish budget. Repayments of the loan, from the National Loans Fund, are to be made over the next 10 years in line with timescales outlined in the Fiscal Framework.
- 69.** The Scottish Government reported that 2018/19 borrowing was used to support its overall capital programme including major projects such as the completion of the Forth Replacement Crossing, trunk road programmes, NHS hospital building programmes and Forth Valley College. This is the fourth year that the Scottish Government has used its capital borrowing powers and, as at 31 March 2019, the total principal level of capital borrowing outstanding was £692.9 million with interest of £126.7 million applying over its remaining life.
- 70.** Details of the overall loan, repayments and interest payments are outlined in the consolidated accounts. The Scottish Government's borrowing and associated repayments are made via the Scottish Consolidated Fund. Borrowed amounts and repayments are made between the Scottish Consolidated Fund and HM Treasury with the corresponding adjustments made to funding received by the Scottish Government from the SCF. This means there is no associated liability disclosed in the Statement of Financial Position within the Scottish Government's consolidated accounts. Details of the amount of capital borrowing and the associated liability are set out within a separate account prepared for the Scottish Consolidated Fund.
- 71.** The Scotland Acts of 2012 and 2016 also allow for revenue borrowing in specific circumstances such as forecast error or in-year cash management. By the end of March 2019, the Scottish Government had not borrowed for revenue purposes.

## Public consolidated accounts for Scotland

- 72.** In 2016, the Scottish Government committed to producing a consolidated account to cover the whole devolved public sector in Scotland including total assets, investments and liabilities such as local government borrowing and public sector pension liabilities. The Scottish Government had designated 2016/17 as a 'shadow year' with a view to producing the account for audit during 2018 but this did not happen, and progress slowed. In November 2018, the Scottish Government confirmed to the Public Audit and Post-Legislative Scrutiny Committee that an account would be published using 2017/18 data by the end of March 2019. Although work was undertaken to develop the new account, the planned publication did not happen. In July 2019, the Scottish Government issued a draft account to its Audit and Assurance Committee for consultation. Audit Scotland will contribute to that process.
- 73.** The use of the new borrowing powers increases the need for a public consolidated account to provide a comprehensive and transparent assessment of the state of Scotland's public finances. This is important for decision making over the longer term as it will provide important information about the impact of past decisions on future budgets, the scale of liabilities, and potential risks to financial sustainability. The Scottish Government needs to quicken the pace of its development and should aim to finalise the account for audit by the end of the 2019/20 financial year. [Appendix 1 Action point 7.](#)

## UK withdrawal from the European Union

- 74.** The uncertainty over the UK's withdrawal from the European Union placed considerable pressure on the Scottish Government's capacity and capability during 2018/19. The Scottish Government made changes to its governance

arrangements, processes and staff roles and responsibilities in preparation for the original planned withdrawal date of 29 March 2019. Resilience arrangements were adapted and used to direct and scrutinise preparations and assess the most critical risks with a focus on civil contingencies such as food supply, public order and access to medicines. New processes for quick, short-term funding and staff redeployment decisions were put in place to support contingency planning and around £32 million, using Barnett Consequentials, was used during the year to manage associated funding pressures. Preparations evolved and intensified over the first quarter of 2019 with an increasing focus placed on a 'no-deal' scenario as UK and EU negotiations failed to reach an agreement.

- 75.** Overall, the Scottish Government's preparations for EU withdrawal were reasonable and proportionate given the considerable level of uncertainty over the detailed implications of withdrawal. Scottish Government staff were expected to plan for EU withdrawal at the same time as working towards Programme for Government commitments resulting in additional pressures on staff wellbeing. Although plans were untested with the postponement of the withdrawal date, the initial work undertaken provides a good basis for the Scottish Government to develop further its resilience arrangements in anticipation of the UK's withdrawal on 31 October 2019.
- 76.** Looking ahead, the Scottish Government will need to ensure that planning arrangements are sufficiently flexible to respond quickly to the scale and pace of change from any further developments. The significant risks facing the Scottish Government extend well beyond 31 October 2019 and they are expected to dominate the public sector landscape in Scotland for years to come. In addition to addressing the short-term risks of EU withdrawal, with or without a trade deal, the Scottish Government will need to ensure it is able to transition effectively to any new partnership or trade arrangements, new funding mechanisms and legislation as well as responding to any adverse impacts on the Scottish economy and public finances.

# Part 4

## Governance and transparency



### Main judgements

**The Scottish Government made some improvements to its governance arrangements during 2018/19 including the appointment of new Non-Executive Directors. We found that there was greater consistency in approach to Directors General assurance meetings, a greater focus on corporate and directorate risks and more detailed reports on corporate performance.**

**The Scottish Government's Audit and Assurance Committee needs to provide greater scrutiny and challenge to support the advice and assurances given to the Permanent Secretary as the Principal Accountable Officer. The Committee does not produce an annual report to summarise its work from the past year, nor does it undertake a review of its own effectiveness as required by its own terms of reference.**

**The Scottish Government has made some improvements in its transparency of information but there remains scope for further progress particularly in relation to financial and performance reporting.**

### Governance arrangements

- 77.** The Scottish Government has improved aspects of its governance arrangements during 2018/19 such as greater consistency in approach to Directors General assurance meetings, a greater focus on corporate and directorate risks and more detailed reports on corporate performance. In addition, the Scottish Exchequer, created in 2017, now has an organisational structure in place and appointments have been made to all key posts. The Exchequer has set its objectives and a transformation programme is in place to direct its activities. It will be important for the Exchequer to continue to develop its arrangements through its transformation programme to ensure that both fiscal risks and opportunities are managed effectively.
- 78.** The Scottish Government's Audit and Assurance Committee is responsible for advising and supporting the Permanent Secretary in her responsibilities for issues relating to risk, control and governance. The Committee's membership is made up of non-executive directors. The Committee receives regular reports from both internal and external audit but the Committee's consideration of their findings and recommendations remains limited. There is a need for the Committee to provide greater scrutiny and challenge to support the advice and assurances given to the Permanent Secretary as the Principal Accountable Officer. The Committee does not produce an annual report to summarise its work from the past year, nor does it undertake a review of its own effectiveness as required by its own terms of reference. The Committee should address this to ensure it operates in line with the Scottish Government's own good practice guidance on audit and assurance committees. [Appendix 1 Action point 8.](#)
- 79.** The Scottish Government has taken initial steps to improve the effectiveness of their role in sponsoring public bodies. The Scottish Government has an important leadership role in supporting public bodies to better understand the risks and challenges facing them. In June and July 2019, the Scottish

Government held workshops, supported by its internal auditors and Audit Scotland, to discuss common themes and issues amongst sponsors. These covered governance and accountability, risk management and relationships. They highlighted the need for greater engagement on shared issues and risks between the Scottish Government and public bodies. This is an area that requires ongoing attention and we welcome these initial developments.

- 80.** In March 2019, the Scottish Government appointed four new non-executive directors and two deputy non-executive directors to strengthen its capacity in this area. The new appointees have a wide-range of knowledge and experience from across both private and public sectors. It will be important for the Scottish Government to take advantage of the non-executive directors' expertise to strengthen both support and challenge to their decision making and assurance processes. This is particularly important given the scale of challenges facing the Scottish Government including the implementation of new powers, continued pressures in public finances and the uncertainty and risks associated with the UK's withdrawal from the European Union.

## Governance Statement

- 81.** A Governance Statement prepared by the Permanent Secretary is a key feature of the Consolidated Accounts. It forms part of a wider accountability report and summarises how the core Scottish Government organisation is controlled and directed. HM Treasury's Financial Reporting Manual (the FReM) states that the Scottish Government must prepare an annual governance statement within the annual report and accounts. Guidance is set out within the SPFM for the content of the governance statement and provides assurances around the achievement of the organisation's strategic objectives.
- 82.** The SPFM does not prescribe a format for the annual governance statement but sets out minimum requirements for central government bodies. The process undertaken by management included conducting an assurance mapping exercise and working to an assurance plan that assessed the evidence underpinning the preparation of the governance statement.
- 83.** The statement confirms that it complies with relevant guidance on corporate governance. It also highlights some of the main risks and opportunities for the organisation and any significant internal control issues in 2018/19. We are content that the Governance Statement is consistent with the financial statements and has been prepared in accordance with guidance issued by the Scottish Ministers.

## Risk Management

- 84.** The Scottish Government's approach to risk management centres on the escalation of risks from divisional level through to their consideration at corporate level. Risk registers are considered at the appropriate governance groups but there remains some variation across directorates over the quality and description of risks, risk scoring and the effectiveness of mitigating actions. In 2019, the Scottish Government commenced a Risk Management Improvement Project with the aim of identifying areas for improvement and proposing the functions and structures needed. The project has identified a number of priorities including the consistency of approach to risk management as well as developing capacity to better identify, assess and manage medium-term financial risks related to sustainability.

## Standards of conduct for prevention and detection of fraud and error

- 85.** Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.

- 86.** We have reviewed the arrangements in place to maintain standards of conduct including the Staff Handbook and Civil Service and Members' Codes of Conduct. There are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.
- 87.** Based on our review, we concluded that the Scottish Government has appropriate arrangements in place for the prevention and detection of fraud, error and irregularities, bribery and corruption. We are not aware of any specific issues that we need to bring to your attention.

## National Fraud Initiative

- 88.** The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise coordinated by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify 'matches' that might suggest the existence of fraud or irregularity.
- 89.** As part of the 2018/19 exercise, 3,461 data matches were identified. To date 1,215 have been investigated, with no instances of fraud or irregularity identified. Each of the data matches are allocated a fraud risk score and there is evidence that the Scottish Government consider these matches to be a priority and they aim to address these promptly.
- 90.** While we have concluded overall improvements from prior NFI exercises, communication of Scottish Government specific outcomes is not being comprehensively reported. Currently NFI is included in the Annual Fraud Report which is presented to SGAAC, however it only refers to outcomes for the exercise across Scotland and not on the Scottish Government's specific results and progress.

## Transparency

- 91.** Transparency means that the public have access to understandable, relevant and timely information about how the Scottish Government is taking decisions and how it is using resources such as money, people and assets.
- 92.** The Scottish Government has made commitments to increase transparency through the Open Government Partnership. There is some evidence of the Scottish Government's commitment to transparency such as:
- Minutes of the Corporate Board are publicly available on the Scottish Government's website
  - Publication of Corporate Board members' register of interests within the Consolidated Accounts
  - The medium-term financial strategy now includes principles and policies on reserves and borrowing powers.
- 93.** There continue to be areas where the Scottish Government could increase transparency including:
- Publishing the minutes of other corporate governance groups such as the Audit and Assurance Committee.
  - Publishing details of indicative spending plans and priorities within its medium-term financial strategy, with links to outcomes, including details of how the Scottish Government would address the possible £1 billion shortfall.
  - Publishing a consolidated account to cover the whole public sector in Scotland

- Publishing a performance report that clearly links to the financial resources outlined in the Consolidated Accounts.

## Freedom of Information

- 94.** The Scottish Government has its own corporate performance monitoring and reporting. This considers performance across a number of corporate areas such as sickness absence, ministerial replies, parliamentary questions and Freedom of Information (FOI) requests.
- 95.** In July 2019, the Information Commissioner published an update report following his 2017 intervention on the Government's FOI performance and practice. The Commissioner found significant improvement in performance from 63 per cent of cases responded to within the statutory timeline in April 2017, to 91 per cent in 2018. The Commissioner noted that performance to May 2019 had remained at 91 per cent. The Scottish Government's internal target for 2019 is 95 per cent within the statutory timescales. The Commissioner also noted that performance varied across different directorates and agencies.

## Internal audit

- 96.** The governance structures within the Scottish Government draw on several sources of assurance, with substantial reliance placed on the work of internal audit. An efficient and effective internal audit function is a key element of good governance. Internal audit review whether the framework of internal control operates satisfactorily, and proper arrangements are in place for the prevention and detection of fraud and corruption.
- 97.** Each year, we undertake an overview of the Scottish Government's internal audit arrangements in accordance with International Standard on Auditing 610 Using the work of internal auditors. Our 2018/19 overview found clear improvements in the standard of internal audit work undertaken compared with 2017/18. We did not find any areas of significant non-compliance with the Public Sector Internal Audit Standards (PSIAS).
- 98.** The complex and uncertain environment within which the Scottish Government now operates means there is an increasing need for a strong and effective internal audit function. Our work found that Internal Audit continues to experience challenges in recruiting the necessary staff and skills required to deliver its audit plans. The 2018/19 Scottish Government internal audit plan was not complete by the year end and Internal Audit reported capacity issues in undertaking unplanned work such as investigating fraud or whistleblowing allegations. Recruitment campaigns during the year did not result in all vacancies being filled. In August 2019, Internal Audit agreed a co-sourcing arrangement with EY to help increase capacity and access specialist skills.
- 99.** From 1 April 2019, the Directorate of Internal Audit and Assurance was formed which encompasses Internal Audit, the Digital Assurance Office (formerly Office of the Chief Information Officer) and the Project and Programme Management Centre of Expertise. The new Directorate is headed by the Director of Internal Audit and Assurance. It is critical that Internal Audit ensures that its independence is not lost in this new arrangement to ensure that it can support the organisation's assurance requirements with independent audit judgements and conclusions.

# Part 5

## Value for money



### Main judgement

The Scottish Government's performance report provides only very limited information on the Scottish Government's own progress towards its overall aims and objectives. This means that the Consolidated Accounts focus on the Government's finances. They do not report on the performance of individual portfolios or the Scottish Government as a whole, limiting the reader's ability to see the Government's own contribution to national outcomes. This means that the reader is unable to see the links between the money spent by the Scottish Government, what it has achieved, and progress made towards achieving national outcomes.

### Performance management

- 100.** The 2018/19 Consolidated Accounts include a performance report and an accountability report in line with the requirements of the Government Financial Reporting Manual (FRoM). The performance report summarises financial performance for the year, with emphasis on performance against budget. It also contains some specific performance information which is required by current guidance on supplier payment performance and signposts where more information is available on sustainability and environmental performance. The report provides only very limited performance information on the Scottish Government's own progress towards its overall aims and objectives, with users of the accounts directed to the National Performance Framework (NPF).
- 101.** This means that the Consolidated Accounts focus on the Government's finances. They do not report on the performance of individual portfolios or the Scottish Government as a whole, limiting the reader's ability to see the Government's own contribution to national outcomes. This means that the reader is unable to see the links between the money spent by the Scottish Government, what it has achieved, and progress made towards achieving national outcomes.
- 102.** As Scotland's fiscal responsibilities grow, it is increasingly important for the Scottish Government to produce more detailed and transparent performance reporting, that better links spending with outcomes. The Parliament's new budget process places a greater emphasis on the need for better performance reporting to provide a clearer focus on the delivery of outcomes. This includes better information about what activity public spending will support, its aims, and the contribution it expects to make to national outcomes. [Appendix 1 Action point 9.](#)
- 103.** The revised National Performance Framework provided the opportunity for the Scottish Government to better improve the links between Government spending and what it delivers but the performance report does not provide this detail. The Scottish Government should prepare a performance report that clearly links to the financial resources outlined in the Consolidated Accounts. Greater transparency around the Scottish Government's own performance towards meeting its strategic objectives would provide greater accountability for the use of its financial resources. This would provide a more rounded

account of the Scottish Government's overall performance and would enhance reporting to the Scottish Parliament and the public and help strengthen accountability and scrutiny.

### **National performance audit reports**

**104.** Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. In 2018/19 several reports were published which are of direct interest to the Scottish Government. These are outlined in [Appendix 3](#).

# Appendix 1

## Action plan 2018/19



No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p><b>Preparation of Annual Report and Accounts</b></p> <p>The consolidated accounts presented for audit were incomplete and did not include key information relating to the Remuneration and Staff Report, Performance Report, Governance Statement, Financial Assets and Cash Flow Statement. We acknowledge that the Scottish Government were dealing with unprecedented levels of activity which accounted for some omissions. In addition, the preparation of the annual report and accounts extends beyond finance staff which often led to delays in information being provided.</p> <p><b>Risk:</b> There is a risk that the Scottish Government are unable to complete lay their annual report and accounts in the Scottish Parliament within the timescales set.</p>	<p>The Scottish Government should ensure a comprehensive unaudited annual report and accounts are provided at the start of the audit process in line with the timetable agreed.</p> <p>There is a need for greater oversight and coordination of the annual audit and accounts preparation and completion process to ensure policy and other corporate functions can provide comprehensive and timely information for finance staff, and subsequently, for audit.</p>	<p>The timetable followed was in line with previous years: key deadlines were met and outputs delivered largely to the expected plan and timeline. Our processes allow for material to be made available to audit in advance of the point when it is possible to deliver a set of consolidated accounts. This is a complex account that has grown in scale and breadth over the last two financial years as a consequence of new powers and the accounts production plan has to allow for procedures that take place locally, the availability of information from external sources (such as myCSP), the availability of the audited information of the bodies to be consolidated and the related timetable of the assurance processes which feed into the narrative reporting in the accounts. Financial Management Directorate colleagues always welcome further discussions with the intended audit team about possible improvements to the accounts production and the related audit scheduling which would help to achieve earlier completion of the near-final set of accounts for approval.</p> <p>A post-audit review meeting was held with Non-Executive Directors (NXDs) and Audit Scotland on 27 November and a range of actions agreed for inclusion in the audit process for 2019/20 Accounts. A subsequent joint planning meeting with the audit team</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
			<p>took place on 17 December 2019.</p> <p><b>31 March 2020</b></p> <p><b>Deputy Director, Financial Management Directorate</b></p>
2	<p><b>Assessment of accruals</b></p> <p>The consolidated accounts include several judgements relating to accrued income and expenditure within the financial year. As with 2017/18, we queried the inclusion of some accruals relating to NHS expenditure and concluded that one was not valid as at the financial year end. Information to support the Scottish Government's assessment of accrued expenditure was not always readily available from finance teams.</p> <p><b>Risk:</b> There is a risk that the Scottish Government inaccurately records income and expenditure for the year without a thorough assessment of accruals as part of the annual accounts preparation process.</p>	<p>The Scottish Government should ensure a thorough assessment of potential accrued income and expenditure is carried out as part of the annual accounts preparation process with appropriate evidence made available to audit on request.</p>	<p>There is clear guidance and associated process in place to assure the quality of accruals and the NHS example mentioned was not a typical one. For future years, Finance officials will continue to review material accruals that have not resulted from core Scottish Government processes. Working papers to support the draft accounts are held electronically and these are available to audit. It is not, however, practical for the central Finance teams to hold the supporting information for all transactions relevant to all bodies within the consolidation boundary. Finance officials will continue to facilitate the necessary engagement for the audit team and earlier visibility of audit scheduling would be helpful in that respect. Arrangements for the 2019/20 Accounts will be monitored closely during the audit process, with associated early flagging of areas of concern.</p> <p><b>Deputy Director, Financial Management Directorate</b></p>
3.	<p><b>Cash management</b></p> <p>As at 31 March 2019, the Scottish Government held cash balances of £1 billion. This represents a significant increase from £585 million held at the end of March 2018. The Scottish Government stated that the significant balances held were due to poor cash forecasting.</p> <p>The Scottish Public Finance Manual states that the principles underlying the</p>	<p>The Scottish Government should undertake a review of its cash forecasting procedures to ensure that forecasts are as accurate as possible and therefore minimising the level of cash balances held at any point in time.</p>	<p>All funds are held within Government Banking. The year-end balance was significantly affected by the timing of receipts and payments to farmers, which proved difficult to forecast. Accuracy of forecasting is important in respect of the HM Treasury cash management regime which penalises variations from forecast; Scotland achieved a net rebate performance position in 2018/19. The process for</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>operation of government bank accounts should be the same as those applied to commercial bank accounts. This includes keeping balances to a minimum consistent with the principles of not providing funding in advance of need.</p> <p><b>Risk:</b> There is a risk that the Scottish Government are not complying with the requirements of the Scottish Public Finance Manual.</p>		<p>forecasting cash requirements and draw-down of funds has become more complex and challenging, particularly with the new flows of funds in respect of borrowing and Social Security. A review of cash management was commissioned in July 2019 and its findings reported through the financial report to the November Corporate Board. This will see a steady reduction in the opening cash balance, with £300 million set as the ultimate target by year-end. A review of cash management has been completed and reported to Corporate Board. Implementation to be monitored and then reviewed as part of close-down procedures for the 2019/20 budget year.</p> <p><b>March 2020</b></p> <p><b>Chief Financial Officer</b></p>
4.	<p><b>Financial support to private companies</b></p> <p>The Scottish Government has not yet implemented a framework to clearly outline its role in financial interventions in private companies. This was a recommendation made as part of our 2017/18 audit.</p> <p>A framework will provide the Parliament with greater assurance and better information over its strategic objectives in entering these agreements and allow for greater scrutiny of the risks and opportunities that exist, including the opportunity costs involved.</p> <p><b>Risk:</b> There is a risk that the Scottish Government provides financial support to private companies without understanding its overall financial capacity, risk tolerance or expected outcomes, potentially</p>	<p>The Scottish Government should develop a framework that clearly outlines its role in financial interventions in private companies to support decision making over where, when and at what level to invest. Such a framework should provide clear information on financial capacity, risk tolerance and expected outcomes.</p>	<p>The Scottish Government accepts the importance of an effective approach to decision-making in these cases and have developed existing guidance to support such activity. In relation to a specific framework, as we have noted previously decisions on the use of resources in this way are made within the extensive framework of legislation, economic policy, the Scottish Public Finance Manual and related guidance, procedures, practice and expertise which exists. The Scottish Public Finance Manual (SPFM) was extended, significantly, to make clearer the procedural approach that should be taken, including specific decision-making guidance, for situations where Scottish Ministers are considering investment in private businesses. Further updates to economic policy</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	increasing the risk of poor decision making.		and SPFM will be considered as necessary.  <b>Chief Financial Officer</b>
5	<p><b>Grant management</b></p> <p>Our 2018/19 audit work included expenditure testing of a number of grant payments across several Scottish Government portfolios. We found that there was an inconsistent approach across the organisation in how grant conditions were being monitored and, in many cases, it was unclear if effective monitoring had taken place.</p> <p><b>Risk:</b> There is a risk that the Scottish Government is not adhering to the SPFM and therefore may not be able to demonstrate that value for money is being achieved from its grant funding arrangements.</p>	The Scottish Government should ensure that guidance issued about grants to other bodies is appropriately adhered to by all business areas, including the monitoring of grant terms and conditions.	<p>Internal processes had previously identified risks in relation to compliance with grant administration and guidance. As a consequence, a review was built into the 2019/20 Internal Audit plan. A Cross Cutting Grant Management Review report has now been produced and was considered by the December Audit and Assurance Committee. A Management Action Plan is being progressed in respect of the recommendations with a number of actions identified for progress in the final quarter of 2019/20. Further actions will be agreed with the March 2020 Audit and Assurance Committee.</p> <p><b>Chief Financial Officer</b></p>
6	<p><b>Medium-term financial strategy</b></p> <p>In May 2019, the Scottish Government published its second medium-term financial strategy, Scotland's Fiscal Outlook. The strategy does not reflect all the basic components of a medium-term financial plan. It does not include indicative spending plans or priorities, or links to outcomes and there is no detail on how the Scottish Government would address the possible £1 billion shortfall.</p> <p><b>Risk:</b> With the absence of high-level financial plans, priorities and scenarios, there is a risk that it will make the Parliament's scrutiny of the forthcoming 2020/21 budget more difficult. This is particularly challenging when considering the impact of</p>	The Scottish Government should improve the quality of its medium-term financial strategy to include the basic components of a financial strategy, including indicative spending plans and priorities, clear links to outcomes and plans to address any funding shortfalls.	The Scottish Government fully agrees that that the medium-term financial strategy has an important role to play in Parliamentary scrutiny in combination with the wider annual budget or spending review process. However, the Scottish Government does not accept the specific criticisms of the May 2019 output and believes that the strategy is fully in line with the written agreement between the Parliament's Finance and Constitution Committee and the Scottish Government, reflecting the recommendations made by the Budget Process Review Group. The document makes clear how the strategy relates to other parts of what is a coherent and systematic budget process. The UK Government's decision not to


**No. Issue/risk**

changes in spending patterns on outcomes set out in the National Performance Framework.


**Recommendation**

**Agreed management action/timing**

conduct a multi-year spending review and the subsequent deferral of the UK Budget should not be overlooked, as these unanticipated external factors have had an impact on the overall budget process.

The 2019 medium-term financial strategy included frameworks for both Scottish capital and resource spending reviews. In relation to resource it noted that all spending proposals would be expected to focus on outcomes and to evidence as far as possible the impact on four priority themes of wellbeing (driven by Scotland's National Performance Framework), sustainable and inclusive economic growth, tackling child poverty and tackling climate change. In relation to capital, it noted that the Infrastructure Commission for Scotland would provide long-term strategic advice on national infrastructure priorities, based on evidence and good practice, and to align investment with long-term inclusive economic growth and low-carbon objectives. It highlighted that the six overarching objectives of the Commission's remit are informed by the Scottish Government's National Performance Framework, Economic Strategy and Economic Action Plan. These are:

- Delivering sustainable and inclusive growth across Scotland.
- Managing the transition to a more resource efficient, lower carbon economy.
- Supporting delivery of efficient, high quality, modern public services.



No. Issue/risk



Recommendation



Agreed management action/timing

- Increasing industry competitiveness, whilst tackling inequality.
- Enhancing societal living conditions now and in the future.
- Ensuring alignment with the new National Planning Framework.

The Scottish Government does not believe it is reasonable to have expected the 2019 medium-term financial strategy to set out indicative spending plans, as this would have anticipated decisions made during spending review processes. It was also not envisaged at the time of publication that the Scottish Budget 2020/21 would be deferred as a result of the delayed UK Budget and UK general election.

The medium-term financial strategy clearly set out the forecasts of income tax reconciliations under the Fiscal Framework, and these were incorporated in forecasts of the funding outlook.

At the time of publication of the 2019 medium-term financial strategy, no income tax reconciliations had been confirmed. As of December 2019, the reconciliation applying to the 2020/21 Budget has been confirmed, but those applying in 2021/22 and 2022/23 remain forecasts.

Given the UK Government's decision not to undertake a Budget before the end of the 2019 calendar year, there is no certainty on the Scottish Government's budget in 2020/21 let alone later years.

The medium-term financial strategy did, however, set out fiscal principles and policies which will guide the use of the Scottish Government's borrowing and reserve powers,



**No. Issue/risk**



**Recommendation**



**Agreed management action/timing**

including in relation to managing any such reconciliations.

The Scottish Government's position is that decisions on management of income tax reconciliations will be taken in each Budget process at which stage the Scottish Budget for that year, and the reconciliation applying in that year, will be known. The Scottish Government remains committed to ensuring that the medium-term financial strategy supports Parliamentary scrutiny. The Cabinet Secretary for Finance, Economy and Fair Work discussed this with the Finance and Constitution Committee on 2 October 2019. He noted that he understood the Auditor General's concerns and would consider them in development of further publications.

**Deputy Director, Fiscal Sustainability**

**7 Public consolidated accounts for Scotland**

The Scottish Government has committed to producing a consolidated account to cover the whole public sector in Scotland but this has not yet happened. This has been a longstanding audit recommendation and was repeated as part of our 2017/18 audit.

This is important for decision making over the longer term as it will provide important information about the impact of past decisions on future budgets, the scale of liabilities, and potential risks to financial sustainability.

**Risk:** There is a risk of poor financial decision-making as it is not clear what is owned and

The Scottish Government needs to quicken the pace of its development and should aim to finalise the account for audit by the end of the 2019/20 financial year.

Although the target date for publishing such an account by March 2019 was not achieved, largely as a consequence of the need to divert resources to support Brexit planning and to support the first publication of accounts for the new Social Security Agency, considerable progress has been made in what is a complex endeavour. We have progressed a plan to achieve audit and publication of a 2017/18 product, to be followed by a similar product for the 2018/19 financial year. A draft of the accounts for 2017/18 was passed to Audit Scotland in July and we await their views on its form, content and the general approach that we have taken. It has also been shared for internal consultation within the Scottish Government, including the Audit and Assurance



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>owed by the wider public sector in Scotland.</p>		<p>Committee. Now that the annual accounts for public bodies for 2018/19 are available, work has begun on the 2018/19 output.</p> <p>A meeting took place with Audit Scotland on 12 December where key views were expressed. This will now allow a final plan to be agreed for the audit and publication, ideally by end March 2020. In the meantime, work continues on the 2018/19 data collection and review.</p> <p><b>Deputy Director, Financial Management Directorate</b></p>
8	<p><b>Audit and Assurance Committee</b></p> <p>There is a need for the Audit and Assurance Committee to provide greater scrutiny and challenge to support the advice and assurances given to the Permanent Secretary as the Principal Accountable Officer.</p> <p><b>Risk:</b> Without appropriate levels of scrutiny and challenge, there is a risk that the advice or assurances given to the Permanent Secretary may not be as accurate, informed or as comprehensive as they should be.</p>	<p>The Committee should produce an annual report to summarise their work from the past year. This should include a review of its own effectiveness as required by its own terms of reference.</p> <p>The Committee should also include an audit recommendations tracker to assess the Scottish Government's progress with audit recommendations at each meeting. This could be used for both external and internal audit recommendations.</p>	<p>At its September 2019 meeting, the Committee scrutinised the Scottish Government's Annual Accounts for 2018/19 and the associated Audit Scotland section 22 report. The Committee considered Audit Scotland's recommendations and agreed to undertake a review of its operations and effectiveness to ensure that it operates in line with good practice. The review would be led by the Chair and lead NXD for the Scottish Government.</p> <p>A draft report by the Chair of the Scottish Government's Audit and Assurance Committee and the lead NXD for the Scottish Government was considered by the Committee at its December 2019 meeting. Feedback received will be incorporated and the Committee will be requested to approve the report and its recommendations in January 2020. Should the Committee be content with the proposals, an implementation plan will be developed by the Board Secretary to the Scottish Government, the Chair and the lead NXD for Committee approval. Work is also underway to improve the</p>



**No. Issue/risk**



**Recommendation**



**Agreed management action/timing**

current mechanism for the tracking of audit recommendations and Scottish Government responses.

**Scottish Government Audit and Assurance Committee**

**9 Performance reporting**

The Scottish Government's performance report provides only very limited information on the Scottish Government's own progress towards its overall aims and objectives. This means that the Consolidated Accounts focus on the Government's finances. They do not report on the performance of individual portfolios or the Scottish Government as a whole.

**Risk:** There is a risk that this limits the reader's ability to see the Government's own contribution to national outcomes. This means that the reader is unable to see the links between the money spent by the Scottish Government, what it has achieved, and progress made towards achieving national outcomes.

The Scottish Government should prepare a performance report that clearly links to the financial resources outlined in the Consolidated Accounts.

The Scottish Government accepts that improved material on Scottish Government performance should be developed and in the 2018/19 Consolidated Accounts we have included new material that better demonstrates how the funding that is provided to the Government is spent. This signposts readers to existing performance reporting on some areas of major spending within each portfolio, providing more depth on the range of activities and progress towards the longer-term outcomes contained within the National Performance Framework. These more detailed reports are likely to provide information at a more meaningful level for most users. The changes made this year are a first step towards the longer-term aim of better linking spend and outcomes across the budget cycle. Over the coming year we intend to explore a number of further improvements to monitoring, reporting, presenting and evaluating key policy deliverables and their contribution to national outcomes, and to consider the material provided through the range of budget-related documentation that is published over the course of the year. Additional signposting information on performance has been provided in this year's Accounts and further work is being taken forward this year.



No.	Issue/risk	Recommendation	Agreed management action/timing
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Deputy Director,  
Performance and Outcomes

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### Follow up of prior year recommendations where not repeated above

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1.	<p><b>Capital borrowing</b></p> <p>In March 2018, the Scottish Government borrowed its full annual capital borrowing limit of £450 million. This was in line with plans outlined by Scottish Ministers as part of the 2017/18 Scottish budget. The Scottish Government borrowed the full amount with the view that unused amounts would be carried forward to future years using the Scotland Reserve. The Scottish Government needs to finalise the internal policies and principles within which it will manage its borrowing powers.</p> <p><b>Risk</b></p> <p>There is a risk that the Scottish Government may undertake excess borrowing resulting in unnecessary interest costs.</p>	<p>The Scottish Government's should finalise the internal policies and principles within which it will manage its borrowing powers. This will help to improve decision making on capital budget management such as the level, type and timing of borrowing.</p>	<p>The Scottish Government included principles and policies on reserve and borrowing powers within its medium-term financial strategy published in May 2019. This is a positive development and will help to improve the transparency of decision making on the capital programme and how the Scotland Reserve is managed.</p> <p><b>DG Scottish Exchequer</b></p>
2.	<p><b>Funding allocations to NHS boards and local authorities</b></p> <p>In May 2018, the Scottish Government Health and Social Care Directorates finance team reviewed the current funding allocations process to NHS boards following issues arising from NHS Tayside holding money intended to fund eHealth in NHS boards. They identified areas of weakness which meant the process was open to potential manipulation. A revised process is now in operation and the Scottish Government Internal Audit Directorate are undertaking a review of the controls in place.</p> <p>On 31 January 2018, the Scottish Government announced an additional</p>	<p>The Scottish Government should ensure there is a robust and transparent process in place for funding public bodies, including allocations to NHS boards and local authorities.</p>	<p>The Scottish Government's internal auditors completed their review of the system for allocating funding to NHS Boards in November 2018. New control procedures were implemented for 2018/19 and the deadline for issuing allocations brought forward to September. The new procedures set out responsibilities of all staff involved in the allocations process and require clarity with Boards on expected outcomes and monitoring arrangements. This requires the review of all allocations for appropriate supporting documentation and authorisation. The Scottish Government is also developing a standardised allocation</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>£159.5 million of general revenue grant funding for local authorities at stage one of the 2018/19 Budget Bill. Of this additional sum, £34.5 million was reallocated from projected 2017/18 underspends within other government portfolios and was paid on 28 March 2018.</p> <p><b>Risk</b></p> <p>Late allocations and reduced transparency over the funding process increases the risk of manipulation of financial targets or funding levels</p>		<p>funding letter for NHS Boards for next financial year.</p> <p><b>Deputy Director, Health Finance</b></p>
3.	<p><b>Procurement</b></p> <p>The procurement team's contract review reports and our review of the evidence highlighted that limited financial due diligence for some contracts, managed by business areas, is carried out post-contract award.</p> <p><b>Risk</b></p> <p>Failure to undertake regular checks on the financial health of the supplier increases the risk to the Scottish Government.</p>	<p>The Scottish Government should review and confirm that the level and selection of contracts for financial due diligence assessments during the lifespan of the contract is appropriate to manage this supplier risk to the Scottish Government.</p>	<p>The next stage of the contract management improvement plan was to include those contracts deemed to be higher risk and managed by business areas on our contract management system. The information recorded on the system will include dates of when financial due diligence assessments should be carried out. This will act as a trigger/prompt for business areas to ensure that such diligence is carried out. All business areas will be reminded of the need to carry out assessments more generally and further training for staff on interpreting company accounts will be delivered across 2020. The Scottish Government have uploaded 110 SPCD led contracts (above £50,000) onto the e-Contract Management system (up from 70 at the time of the previous update). The remainder are scheduled to be uploaded by the end of December 2019. Contract Managers are provided system access following completion of the Contract &amp; Supplier Management (CSM) training programme. The CSM team is developing a</p>



**No. Issue/risk**

**Recommendation**

**Agreed management action/timing**

			<p>7-module training programme which will be made available to all staff during the course 2019/20. The first module (CSM Essentials) went live on the SG Learning Portal w/c 2nd December – it is now available to all SG staff in e-learning format.</p> <p>The training programme also includes a financial diligence module, the first classroom-based training course took place on 11th December – the e-learning course is expected in early 2020.</p> <p><b>Deputy Director, Scottish Procurement and Property Directorate</b></p>
<p><b>4.</b></p>	<p><b>IT security</b></p> <p>The Scottish Government's IT Security Policy and Security Policy Statement are out of date.</p> <p><b>Risk</b></p> <p>This highlights a number of risks such as: guidance is not available for users to consult; tools that used to be available to assess security of applications is no longer available; and risk of local decisions and security lapses impacting on the network.</p>	<p>The Scottish Government should update both the IT Security Policy and the Security Policy Statement.</p>	<p>The Scottish Government reported in June 2019 that work continues on IT Security Policy re-development and alignment with the latest National Cyber Security Centre guidelines. They also reported that work has been undertaken by iTECS on reviewing the IT Security Policy.</p> <p>Work continues on IT Security Policy re-development and alignment with the latest National Cyber Security Centre guidelines. A draft version is currently being peer reviewed. Once complete this will need to be approved by colleagues in HR and CSGU. An SG wide communication strategy has been developed by SBC and iTECS will feed in to this. This strategy has been approved by the SBC Governance Board. Due to competing priorities and resource pressures the delivery of this has now slipped to the end of March 2020.</p> <p><b>Chief Operating Officer for IT Services</b></p>
<p><b>5.</b></p>	<p><b>Business Continuity Arrangements</b></p>	<p>An overarching view of business continuity arrangements is required to ensure all plans can be</p>	<p>The Security and Business Continuity Governance Board takes an overarching view of business continuity in the</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>Within the Scottish Government, various directorates and teams have their own business continuity planning arrangements.</p> <p><b>Risk</b></p> <p>These arrangements depend on the availability of the same resources, (for example, desk spaces in other Scottish Government office locations). There is a risk that this creates excess demand over supply and may result in ineffective continuity of service delivery.</p>	<p>executed in the event of an emergency or incident.</p>	<p>Scottish Government and it has agreed overarching high level principles for a new Scottish Government Loss of Workspace Strategy. The Strategy will ensure that there is no risk of allocating the same resources to be used by different teams in the event of the loss of a particular workspace, aligning resource with business areas' critical functions and essential services to enable continued operation of the organisation. The Strategy will also reflect the increasing use of laptops and the ability to work remotely; and the incremental introduction of smarter working to the Scottish Government, which is less dependent on staff working from specific desks.</p> <p>The Security and Business Continuity Governance Board will review progress and consider recommendations at its meeting on 5 March 2020. Our planning assumption is that the strategy will be completed by September 2020.</p> <p><b>Deputy Director, Security and Business Continuity</b></p>
6.	<p><b>Scottish Exchequer</b></p> <p>In July 2017, a new role of Director General Scottish Exchequer was created to better reflect Scotland's new fiscal responsibilities. The roles and responsibilities within the Scottish Exchequer directorate have yet to be finalised and recruitment is ongoing to fill key posts.</p> <p><b>Risk</b></p> <p>Until arrangements for the Scottish Exchequer are finalised, it will be harder for the Scottish Government to effectively manage the fiscal</p>	<p>The Scottish Government should seek to finalise the roles and responsibilities for the new Scottish Exchequer as soon as possible.</p>	<p>The organisational structures of the Scottish Exchequer are complete and appointments have been made to all key posts. New Director posts heading up the Performance &amp; Strategic Outcomes Directorate and the Tax Directorate were filled in October 2018 and January 2019 respectively, complementing the existing Budget &amp; Sustainability Directorate. Roles and responsibilities for key posts have been reviewed and from January 2020 the Tax Directorate will become the Tax &amp; Fiscal Sustainability Directorate and the Budget &amp;</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	risks and opportunities that may arise in the interim period.		<p>Sustainability Directorate will become the Budget &amp; Public Spending Directorate. These arrangements have been finalised through the appointment of Deputy Director roles leading on Tax, Fiscal Sustainability, Public Spending, Infrastructure &amp; Investment, Performance &amp; Outcomes and the Scottish Exchequer Transformation to support the effective management of fiscal risks and opportunities.</p> <p>Additional signposting information on performance has been provided in this year's Accounts and further work is being taken forward this year.</p> <p><b>Scottish Exchequer</b></p>

# Appendix 2

## Significant audit risks identified during planning

The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the annual report and accounts and those relating our wider responsibility under the [Code of Audit Practice 2016](#).

Audit Risk	Assurance procedure	Results and conclusions
<b>Risks of material misstatement in the financial statements</b>		
<p><b>1 Support to private companies – valuation of investments</b></p> <p>In 2017/18, the Scottish Government made commercial loans to two private companies, Burntisland Fabrications (BiFab) and Ferguson Marine Engineering Limited (FMEL). In the case of BiFab, the loans were converted to an equity stake in the company.</p> <p>The loans were provided to support cash flows and business growth. The nature of the investment means the valuation is uncertain and may be subject to impairment. In addition, the introduction of IFRS 9 in 2018/19 introduces new accounting requirements (see also Audit Risk 2).</p> <p>These complexities mean there is a risk the value of investments may be misstated in the consolidated accounts.</p>	<ul style="list-style-type: none"> <li>• Early engagement with officers to discuss proposed treatment of investments for 2018/19.</li> <li>• Review of reports from the Scottish Government’s advisers (PwC/ Grant Thornton).</li> <li>• Consideration of impairment reviews completed by the Scottish Government.</li> </ul>	<p>We reviewed the valuation of investments in both FMEL and BiFab and agreed their respective impairments within the consolidated accounts.</p> <p>We also repeated our 2017/18 recommendation that the Scottish Government should develop a framework to outlines its role in providing financial support to private companies.</p>
<p><b>2 Introduction of IFRS 9</b></p> <p>A significant change to the 2018/19 Government Financial Reporting Manual (FReM) is the introduction of International Financial Reporting Standard 9 (IFRS 9).</p> <p>This new standard requires a more principles-based approach to the accounting for financial instruments, including their classification and measurement. It also</p>	<ul style="list-style-type: none"> <li>• Early engagement with officers to discuss proposed approach.</li> <li>• Review of draft disclosures against IFRS 9 and associated guidance</li> </ul>	<p>We met with the Scottish Government to discuss their approach to adopting IFRS 9.</p> <p>We reviewed the disclosures within the unaudited accounts against the requirements of IFRS 9 and sought amendments as necessary.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>introduces a new model for the recognition of expected impairment losses.</p> <p>The 2017/18 Scottish Government Consolidated accounts included financial instruments totalling £17.5 billion (financial liabilities £6.7billion and financial assets £10.8 billion). Given the relatively significant changes required by IFRS 9, the value of financial instruments, and the complex nature of some financial instruments including student loans, there is a risk they could be accounted for incorrectly in the 2018/19 accounts.</p>		
<p><b>3 Group audit considerations</b></p> <p>The Scottish Government consolidated accounts are group accounts which include the financial results of a number of bodies within the Scottish Government accounting boundary, including the core Scottish Government. This means we have to ensure there are appropriate arrangements in place to confirm the information is audited appropriately and consolidated correctly. There are a number of risks associated with this for 2018/19 including:</p> <ul style="list-style-type: none"> <li>• The inclusion of the results of the new Social Security Scotland agency for the first time and the implications for the group reporting of potential fraud and error rates for certain benefits delivered by the agency.</li> <li>• Ensuring financial guarantees are appropriately disclosed.</li> <li>• Ensuring the information consolidated in the Consolidated Accounts agrees to the signed financial statements of the other bodies.</li> </ul>	<ul style="list-style-type: none"> <li>• Ongoing engagement with component auditors.</li> <li>• Guidance and information requests issued to component auditors to support group audit procedures.</li> <li>• Review of consolidation packs received.</li> <li>• Review of financial guarantee disclosures.</li> </ul>	<p>We assessed the impact of the Social Security Scotland accounts on consolidation. We met with Social Security Scotland auditors twice during the audit to discuss issues arising from their work. We also consider the impact of the auditor's qualified opinion on Social Security Scotland's accounts on the Scottish Government's consolidated accounts. <a href="#">See Exhibit 3 issue 2.</a></p> <p>We issued guidance to all component auditors and met with the auditors of Transport Scotland and the Scottish Prison Service to discuss potential consolidation issues. No separate reporting points were identified in addition to the above point relating to Social Security.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p><b>4 Business continuity risks for the SEAS accounting system</b></p> <p>The SEAS accounting system is used by the Scottish Government and many other public bodies as the main financial ledger. Our audit planning work highlighted some potential issues around the functionality and continuity of the system.</p> <p>There is an audit risk that the system does not function as required, the controls are compromised, and preparation of the annual accounts is adversely affected.</p>	<ul style="list-style-type: none"> <li>Review SEAS patching and upgrade levels.</li> <li>Key controls testing of the SEAS system.</li> <li>Ongoing engagement with corporate reporting and financial services teams.</li> </ul>	<p>We review SEAS key controls and patch management as part of our interim audit work. We raised a number of issues and reported these as part of our 2018/19 Management Report considered by the Scottish Government's Audit and Assurance Committee in June 2019.</p>
<p><b>5 Estimation and judgements</b></p> <p>There are significant degrees of management estimation in the measurement, valuation and disclosures of a number of material account areas including student loans, investments, contingent liabilities, financial guarantees and provisions. Estimations and judgements create a higher risk that material areas in the accounts are misstated.</p>	<ul style="list-style-type: none"> <li>Further review of the student loans model (assumptions and application).</li> <li>Focused substantive testing.</li> <li>Review the identification of and record of contingent liabilities, guarantees, indemnities and letters of comfort.</li> <li>Test assumptions in contingent liability financial modelling.</li> <li>Review the disclosure of student loans, investments, contingent liabilities, guarantees etc</li> </ul>	<p>We reviewed the Student Loans model and found that the Scottish Government had identified errors in how impairment charges were calculated. We reviewed the accounting treatment and sought changes to the unaudited accounts as necessary. <a href="#">See Exhibit 3 issue 3.</a></p>
<p><b>6 Risk of management override of controls</b></p> <p>Notwithstanding the existence of a control environment, ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls to change the position disclosed in the financial statements.</p>	<ul style="list-style-type: none"> <li>Detailed testing of journal entries.</li> <li>Review of accounting estimates.</li> <li>Focused testing of accruals and prepayments.</li> <li>Evaluation of significant transactions that are outside the normal course of business.</li> <li>Consider internal audit reports.</li> <li>Consideration of the results of controls testing.</li> </ul>	<p>We carried out detailed testing of journal entries, accounting estimates and unusual transactions. The results of this audit work were satisfactory.</p> <p>We reviewed relevant internal audit reports.</p> <p>We reviewed the results of controls testing and increased our testing of payroll. This additional testing did not identify any further issues.</p>
<p><b>7 Risk of fraud over income and expenditure</b></p>	<ul style="list-style-type: none"> <li>Perform detailed testing of significant transactions, particularly around the financial year-end.</li> </ul>	<p>We tested controls in this area and tested transactions around the financial year end. This did</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>ISA 240 presumes a risk of fraud in regard to revenue recognition in the financial statements in any audit. Practice Note 10 extends this to include expenditure recognition in some public sector bodies. Given the nature of income and expenditure in relation to the Scottish Government there is a risk of fraud over income and expenditure.</p>	<ul style="list-style-type: none"> <li>Carry out analytical procedures.</li> <li>Monitor budgetary process and reporting.</li> <li>Consider any internal audit reports.</li> </ul>	<p>not identify any issues of concern.</p>

### Risks identified from the auditor's wider responsibility under the Code of Audit Practice

#### Financial Sustainability

<p><b>8 UK decision to leave the European Union (EU exit)</b></p> <p>The UK's decision to leave the European Union is expected to have a fundamental impact on the Scottish Government in a number of areas including:</p> <ul style="list-style-type: none"> <li>resilience planning to ensure smooth running of public services</li> <li>workforce planning to ensure short and medium term resources are in place to respond to EU exit.</li> <li>funding for schemes such as European Structural Funds and Common Agricultural Policy, and financial planning to respond to changes</li> <li>the powers devolved to the Scottish Parliament.</li> </ul> <p>EU exit presents a number of significant risks to the capacity and capability of the Scottish Government's activities. It is important that the Scottish Government is appropriately prepared for EU exit as failure to do so will increase the risk to ongoing operations and public services.</p>	<ul style="list-style-type: none"> <li>Assessment of how the Scottish Government has prepared for EU withdrawal and how it continues to respond to any emerging risks after March 2019. Results to be reported in our Annual Audit Report.</li> <li>Consideration of actions taken by the Scottish Government to help the wider public sector assess and mitigate risks.</li> </ul>	<p>We reviewed the Scottish Government's arrangements for planning for EU withdrawal. This included reviewing papers provided to governance groups, attendance at DG assurance meetings where EU exit was regularly discussed, and discussions with SG officials. Our conclusion is reported in Part 3 above.</p>
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#### Financial Management

<p><b>9 Workforce capacity and capability</b></p> <p>Financial devolution under the 2012 and 2016 Scotland Acts</p>	<ul style="list-style-type: none"> <li>Consideration of how the Scottish Government plan and prioritise resources and whether this ensures</li> </ul>	<p>We reviewed corporate performance information including recruitment data.</p>
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Audit Risk	Assurance procedure	Results and conclusions
<p>brought more responsibility for financial management at a time of increasing pressures on resources. In addition, the decision of the UK to leave the European Union has increased pressures on capacity as resources have been diverted from day to day business to respond to preparations for EU exit.</p> <p>The Scottish Government has identified its workforce capacity at this time of change as a key business risk. There is a risk of staff being diverted into high risk areas such as EU exit and social security implementation, leaving unfulfilled gaps in other areas, affecting its ability to delivery business as usual activities.</p> <p>There is a risk that significant changes to workforce capacity and deployment impacts adversely on the effective operation of key controls and systems such as IT, payroll and finance.</p>	<p>core functions are still delivered effectively.</p> <ul style="list-style-type: none"> <li>• Further consideration of impact of social security agency/EU exit on core finance functions.</li> <li>• Consideration of Audit Scotland performance audit report on social security.</li> <li>• Consideration of Audit Scotland performance audit report on digital skills.</li> <li>• Review the National Performance Framework to assess Scotland’s performance during this period of change.</li> </ul>	<p>We also met with Scottish Government officials to discuss strategic workforce issues.</p> <p>Our performance reports covering Social Security and Digital in Central Government reported on relevant workforce capacity and capability issues.</p>
<p><b>10 Key supplier dependency</b></p> <p>The collapse of Carillion in January 2018 had a significant impact across the public sector, bringing into focus the risk of key supplier failure and the risk of underperformance where suppliers are experiencing difficult trading conditions.</p> <p>The Scottish Government depends on a large number of suppliers as part of its day to day operations and needs to have in place suitable arrangements to both manage the contracts and mitigate any problems with key supply companies that occur.</p> <p>If this risk is not managed appropriately it could have a significant impact on service delivery.</p>	<ul style="list-style-type: none"> <li>• Review of how the Scottish Government identifies key suppliers for the Scottish Government and the wider public sector.</li> <li>• Review of arrangements in place to identify risk of supplier failure and plans in place to mitigate this.</li> </ul>	<p>We reviewed Scottish Government information and guidance relating to key suppliers. We also met with Scottish Government procurement staff to discuss key supplier dependency during our audit. Our findings are included in Part 2 above.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p><b>11 Governance</b></p> <p>Our 2017/18 audit concluded that scrutiny was not as effective as it needed to be. We continue to review a number of aspects of governance including:</p> <ul style="list-style-type: none"> <li>• The role and capacity of Non-Executive Directors (NXDs) in providing effective support, scrutiny and challenge</li> <li>• The quality and timeliness of meeting papers</li> <li>• The effectiveness of the risk escalation process</li> </ul> <p>Good governance is important for longer term decision-making, efficient use of resources and accountability for stewardship of those resources.</p> <p>We will review the effectiveness of governance arrangements and assess whether they provide effective oversight, scrutiny and management of resources to achieve intended outcomes and support the Principal Accountable Officer in discharging her responsibilities.</p>	<ul style="list-style-type: none"> <li>• Review of effectiveness of governance arrangements.</li> <li>• Engagement with Internal Audit.</li> <li>• Engagement with NXDs including chair of SGAAC.</li> <li>• Attendance at SGAAC and DG assurance meetings.</li> <li>• Review of corporate and DG risk registers</li> <li>• Review of Governance Statement.</li> </ul>	<p>We attended all DG assurance meetings and all meetings of SGAAC during the year. We also met regularly with the Board Secretary and the Corporate Assurance Team to discuss governance matters. We also review the Governance Statement and corporate risk register. Our conclusions on governance are covered in Part 4 above.</p>

Source: Audit Scotland

# Appendix 3

## Summary of national performance reports 2018/19

		 <b>2018/19 Reports</b>	
Local government in Scotland: Challenges and performance 2018		<b>Apr</b>	
Councils' use of arm's-length organisations		<b>May</b>	 Scottish Fire and Rescue Service: an update
Scotland's colleges 2018		<b>Jun</b>	
		<b>Jul</b>	 The National Fraud Initiative in Scotland 2016/17
Forth Replacement Crossing		<b>Aug</b>	 Major project and procurement lessons
Children and young people's mental health		<b>Sept</b>	 Superfast broadband for Scotland: further progress update
NHS in Scotland 2018		<b>Oct</b>	
Health and social care integration: update on progress		<b>Nov</b>	 Local government in Scotland: Financial overview 2017/18
		Dec	
		Jan	
		Feb	
		<b>Mar</b>	 Local government in Scotland: Challenges and performance 2019

### Central Government relevant reports

[\*Scottish Fire and Rescue Service: an update\*](#) – May 2018

[\*Scotland's colleges 2018\*](#) – June 2018

[\*The National Fraud Initiative in Scotland 2016/17\*](#) – July 2018

[\*Forth Replacement Crossing\*](#) – August 2018

[\*Major project and procurement lessons\*](#) – August 2018

[\*Superfast broadband for Scotland: further progress update\*](#) – September 2018

# Scottish Government

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN  
T: 0131 625 1500 E: [info@audit-scotland.gov.uk](mailto:info@audit-scotland.gov.uk)  
[www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)