

# The Skills Development Scotland Co. Limited

2018/19 Annual Audit Report



 AUDIT SCOTLAND

Prepared for Skills Development Scotland and the Auditor General for Scotland

21 June 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

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## 2018/19 annual report and accounts

- 1 The financial statements of SDS give a true and fair view of the state of the affairs of SDS and its group as at 31 March 2019 and of the group total comprehensive expense for 2018/19.
- 2 The expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance.
- 3 The other information in the annual report and financial statements is consistent with the accounts and prepared in accordance with legal requirements.

## Financial management

- 4 SDS has effective arrangements for financial management which ensured that it operated within its resource allocation in 2018/19.

## Financial sustainability

- 5 SDS has effective financial planning which helps it to respond to changes in resource allocations.
- 6 SDS faces a potential cashflow issue in 2019/20 due to a delay in receiving grant income from the Scottish Government relating to the European Social Fund.
- 7 SDS should develop a longer-term capital plan which sets out future spending on areas such as computer hardware and leases.
- 8 SDS has taken reasonable steps in preparation for EU withdrawal.

## Governance and transparency

- 9 The governance arrangements at SDS support effective oversight of the organisation's activities and finances.
- 10 The performance element in SDS's annual report provides a balanced and comprehensive overview, with some areas for further development.
- 11 SDS continues to make publicly available only a limited amount of board papers.

## Value for money

- 12 SDS has appropriate performance management arrangements in place, with some areas under development.

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# Introduction

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1. This report summarises the findings from our 2018/19 audit of Skills Development Scotland (SDS).

2. The scope of our audit was set out in our Annual Audit Plan presented to the 6 December 2018 meeting of the Audit and Risk Committee (ARC). This report comprises the findings from:

- an audit of SDS's annual report and financial statements
- 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 SDS's main financial systems
- an audit of SDS's 2018/19 annual report and financial statements 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 add value to SDS through the audit by:

- identifying and providing insight on significant risks, and making clear and relevant recommendations for improvements that are accepted by management
- reporting our findings and conclusions in public
- sharing intelligence and good practice through our national reports ([Appendix 4](#)) and good practice guides
- Providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and actions to secure financial sustainability

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

## Responsibilities and reporting

6. SDS has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and financial statements that are in accordance with the accounts direction from the Scottish Ministers.

7. SDS 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 against 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 £85,696 remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

**14.** This report is addressed to both SDS 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 management and staff for their cooperation and assistance during the audit.

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# Part 1

## Audit of 2018/19 annual report and accounts

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### Main judgements

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**The financial statements of SDS give a true and fair view of the state of the affairs of SDS and its group as at 31 March 2019 and of the group total comprehensive expense for 2018/19.**

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

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**The other information in the annual report and financial statements is consistent with the accounts and prepared in accordance with legal requirements.**

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### Audit opinions on the annual report and accounts

**16.** The annual report and financial statements for the year ended 31 March 2019 were approved by the board on 25 June 2019. We reported within the 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 report was properly prepared in accordance with legal requirements,
- the strategic report, directors report and governance statement were all consistent with the financial statements and properly prepared in accordance with relevant legislation.

**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.** We received the unaudited annual report and accounts on 7 May 2019 in line with our agreed audit timetable.

**19.** The working papers provided with the unaudited financial statements were of a good standard and finance staff provided support to the audit team which helped ensure the final accounts audit process ran smoothly.

### Risk of material misstatement

**20.** [Appendix 2](#) provides a description of those assessed risks of material misstatement in the annual report and accounts and the wider audit dimension

risks that were identified during the audit planning process. It also summarises the work we have done to gain assurance over the outcome of these risks.

## Materiality

**21.** 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.

**22.** Our initial assessment of materiality for the annual report and accounts was carried out during the planning phase of the audit and is summarised in [Exhibit 2](#). With regards to the annual accounts, we assess the materiality of uncorrected misstatements both individually and collectively.

**23.** On receipt of the unaudited annual report and accounts we reviewed our materiality calculations and concluded that they remained appropriate.

## Exhibit 2 Materiality values

Materiality level	Amount
Overall materiality	£2.45 million
Performance materiality	£1.47 million
Reporting threshold	£24,000

Source: Audit Scotland

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

**24.** 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.

**25.** The significant findings are summarised in [Exhibit 3](#). 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 Significant findings from the audit of financial statements

Issue	Resolution
<p><b>1. Accrual of EU income</b></p> <p>A significant proportion of SDS's activities are funded by grant income from the Scottish Government relating to the European Social Fund. Due to ongoing negotiations between the EU and the Scottish Government (in its role as 'managing authority' for EU structural funds), SDS has yet to</p>	<p>SDS is in ongoing negotiation with the Scottish Government to resolve this matter and has received correspondence providing ongoing support for the provision of underlying programmes which are supported by this funding. SDS has also inserted narrative into the governance statement reflecting the issue and related risk concerning EU income.</p>

Issue	Resolution
<p>receive funding it expects from the Scottish Government for expenditure it incurred in 2018/19.</p> <p>SDS considers that the risk lies with the Scottish Government, consistent with the Scottish Public Finance Manual, and it has therefore accrued £20.4 million relating to European structural funds income, consisting of previous and future claims. SDS has carefully assessed the position and is confident that the income will be received.</p>	
<p><b>2. Property, plant and equipment</b></p> <p>Audit testing identified a payment of £1.2m in 2018/19 for IT equipment. Of this amount, management estimates around £335,000 related to laptop renewals for SDS's use. While SDS does not capitalise items on an individual basis if they are of low value, its new accounting policy for property plant and equipment requires capitalisation of a group of related purchases which have an aggregate cost of at least £100,000. SDS did not capitalise the £335,000, contrary to its accounting policy.</p>	<p>SDS confirmed that this payment was not capitalised because it did not have a capital budget allocation from the Scottish Government.</p> <p>SDS has accepted this as an unadjusted misstatement.</p> <p> <a href="#">Recommendation 1</a> (refer appendix 1, action plan) <a href="#">Appendix 1</a></p>
<p><b>3. Pension fund liabilities</b></p> <p>Retirement benefits obligations include estimates of SDS's share of the returns on assets of the Local Government Pension Schemes in which it participates. The actuary reported that using the actual investment returns at the yearend would have resulted in a reduction in the asset value, and consequently an increase in the deficit, by around £350,000. This is a timing issue affecting many admitted bodies of Local Government Pension Schemes.</p>	<p>SDS has accepted this as an unadjusted misstatement.</p>
<p><b>4. Pension liabilities following McCloud judgement</b></p> <p>A legal ruling has been made regarding age discrimination arising from public sector pension scheme transition arrangements (referred to as the 'McCloud case'). A final judgement in late June 2019 significantly increased the probability of future liabilities for public bodies that participate in the Local Government Pension Scheme, including SDS. Prior to the conclusion of the case, SDS disclosed an unquantified contingent liability. As a consequence of the judgement, SDS reassessed the position, the related accounting treatment and the impact on its financial statements.</p>	<p>SDS concluded that the final judgement in the McCloud case required it to include an accounting provision in its accounts. The provision (titled 'McCloud') of £4.9 million was determined by SDS using a high-level estimate provided by its actuary.</p> <p>We are content with the accounting treatment.</p> <p>The provision was reported under the Annually Managed Expenditure (AME) budget allocation resulting in an AME overspend £6.03 million. This has no impact on the Departmental Expenditure Limit (DEL) resource position as reflected in <a href="#">Exhibit 4</a>.</p>

Source: Audit Scotland

## Other findings from the audit of the financial statements

**26.** There is one additional significant matter which has the potential to affect SDS's pension liabilities in future years. The courts have ruled that UK defined benefit pension schemes must compensate members for differences attributable to guaranteed minimum pensions (GMPs). SDS's actuary's general expectation is

that a 'trigger event' is yet to occur. SDS has added an unquantified contingent liability to its accounts to explain and disclose this issue.

## How we evaluate misstatements

**27.** There were no material adjustments to the unaudited annual report and accounts arising from our audit.

**28.** It is our responsibility to request that all misstatements, other than those below the reporting threshold, are corrected although the final decision on making the correction lies with those charged with governance considering advice from senior officers and materiality. If corrected the net effect would increase total net liabilities on the group statement of financial position by approximately £15,000. Management does not propose to adjust for the items included in [Exhibit 3](#) above as the amounts are not considered material in the context of the financial statements.

## Follow up of prior year recommendations

**29.** SDS has made reasonable progress in implementing our prior year audit recommendations, but two actions remain to be fully actioned (see [Appendix 1](#)). One of these outstanding actions (2016/17 (5)) concerns SDS's policy for publishing board/committee papers (see [paragraphs 66 and 67](#) for more details). The other outstanding action (2016/17 (1)) relates to further improvements to the performance report in light of changes to the FReM (see [paragraphs 68 to 70](#)).

# Part 2

## Financial management



### Main judgements

**SDS has effective arrangements for financial management which ensured that it operated within its resource allocation in 2018/19.**

**We found that key controls in core financial systems operated as expected. Further sample testing provided us with sufficient assurance concerning the national training programme systems.**

Financial management is about financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

### Financial performance in 2018/19

**30.** The main financial objective for SDS is to ensure that the financial outturn for the year is within the budget allocated by Scottish Ministers.

**31.** SDS has reported an outturn of £209.1 million remaining within its overall budget for 2018/19 with an underspend of £0.7 million. The financial performance against Departmental Expenditure Limits (DEL) is shown in [Exhibit 4](#).

### Exhibit 4 Performance against DEL in 2018/19

Performance	Initial budget £m	Final budget £m	Outturn £m	Over (under) spend £m
Resource DEL	193.3	209.8	209.1	0.7
Capital DEL	0	0	0	0
<b>Total DEL</b>	193.3	209.8	209.1	0.7

Source: SDS Annual Report and Financial Statements for the year ended 31 March 2019

### 2018/19 financial position

**32.** The Statement of Financial Position summarises what is owned and owed by SDS. This shows that SDS has a net liability of £75.3 million. This represents an increase of £41.2 million, largely attributable to a £36.5 million increase in retirement benefit obligations. At the end of the year, these obligations stood at £91.6 million.

## Budgetary processes

**33.** The approved SDS budget for 2018/19 included income and expenditure of £242 million. Similar to previous years, the initial funding allocation from the Scottish Government in April 2018 identified £14 million of adjustments which it anticipated would be addressed through the future autumn and spring budget revisions (ABR/ SBR).

**34.** The report presented to the board when the budget was agreed in March 2018, included £16 million rather than £14 million of ABR/SBR transfers. Management advised that this was due to the Scottish Government agreeing to provide an additional £2 million (for pay pressures) later in the financial year but not formally confirming this until the SBR in February 2019. In our view, this should have been identified as a funding gap until the SBR.

**35.** Otherwise we found that SDS continued to provide regular, timely and up-to-date information on the financial position. This allowed Board members to monitor and question aspects of the body's financial affairs and ultimately helped to ensure that SDS remained within its overall resource allocation for the year.

## Systems of internal control

**36.** 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 confirm that the controls are operating as expected. We found no significant issues from this work.

**37.** We also considered the main processes and controls used in the administration of the national training programmes (NTP). This confirmed that effective controls are in place but, as we have reported previously, there is an inherent control risk in the system for making payments to training providers. Specifically, there is no fully comprehensive, real-time internal check when training providers claim payments.

**38.** Management acknowledges this and is content that other checks mitigate and manage the risk. These checks include the contract procurement process, the legal obligation for providers to declare the accuracy of information when making a claim, and reviews by the skills investment advisors and the compliance/fraud error prevention teams. While we accept these mitigate the risk to some degree, we are required to highlight this matter.

**39.** In line with last year's audit approach, we extended our substantive testing of NTP payments to training providers and found no issues.

## Internal audit

**40.** We reviewed SDS's internal audit arrangements in accordance with International Standard on Auditing (UK) 610 (Using the Work of Internal Auditors) to determine the extent we could use the work of internal audit. While we chose not to place formal reliance on the work of internal audit, we did consider several of its reviews, such as GDPR and financial planning, as part of fulfilling our 2018/19 financial statements and wider dimensions audit responsibilities. A firm of accountants provided internal audit services to SDS in 2018/19. A new arrangement is being developed for 2019/20.

**41.** SDS's ICT services are provided under a shared service arrangement, Enterprise Information Systems (EIS). A firm of accountants provides internal audit services for EIS. In 2018/19 we reviewed how this internal audit arrangement was working to provide us with assurances over IT controls relating to SDS's financial reporting arrangements. We found that the internal audit service complied with auditing standards, allowing us to take assurance from its work.

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

**42.** 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.

**43.** We have reviewed the arrangements in place to maintain standards of conduct including the code of conduct policy for SDS staff and board members' code of conduct. We also reviewed the SDS fraud policy and associated fraud response plan and confirmed that there are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.

**44.** We concluded that SDS 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

**45.** 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.

**46.** NFI activity is summarised in [Exhibit 5](#). The application records a total of 5,821 matches. It is up to individual bodies to decide which, and how many, matches to investigate and the online application identifies high risk cases. In SDS's case the application has identified 151 high risk matches. To date, SDS has investigated 82 matches, 43 of which were high risk. No frauds or errors have been found so far.

### Exhibit 5 NFI activity



5,821

Matches



151

High risk matches



82

Completed/closed  
investigations

Source: NFI secure website: [www.nfi.gov.uk](http://www.nfi.gov.uk)

## Dependency on key suppliers

**47.** The impact of a failure or collapse of a key supplier can be significant to an organisation, potentially resulting in either delays or non-completion of major contracts, or disruption 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.

**48.** SDS carries out robust annual monitoring of all NTP providers, which involves due diligence checks on their financial position. SDS also checks other contracts with a value greater than £150,000 or those which it deems high-risk. This involves SDS remaining in contact with suppliers and discussing emerging issues at planned contract management meetings.

# Part 3

## Financial sustainability



### Main judgements

**SDS has effective financial planning which helps it to respond to changes in resource allocations.**

**SDS faces a potential cashflow issue in 2019/20 due to a delay in receiving grant income from the Scottish Government relating to the European Social Fund.**

**SDS should develop a longer-term capital plan which sets out future spending on areas such as computer hardware and property leases in line with the new policy adopted in 2018/19.**

**SDS has taken reasonable steps in preparation for EU withdrawal.**

Financial sustainability looks forward to the medium and longer-term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

### Financial planning

**49.** SDS agreed its 2019/20 draft budget in February 2019 with a resource allocation of £214.7 million which is £21.4 million (11 per cent) more than the initial 2018/19 budget allocation. This additional funding is to support apprenticeships.

**50.** Subsequently, in response to the Scottish Government's request for efficiency savings of £5 million, SDS revised its budget in May 2019. Additional funding of £2 million for digital initiatives partly off-sets this, giving a net funding reduction of £3 million. SDS has identified savings to re-balance its budget. The Scottish Government has yet to confirm SDS's final allocation for 2019/20.

**51.** The revised financial plans show that SDS expects to receive £28.7 million in cash from the Scottish Government in relation to programmes supported by the European Union, £20.4 million of which was accrued in 2018/19. Should this not transpire, SDS has identified potential cash flow issues later this financial year. SDS continues to liaise with the Scottish Government to resolve this issue and has received supporting correspondence from officials and Ministers.



### Recommendation 1

**SDS should continue to keep its financial plans under close review during 2019/20 so that it is in a position to demonstrate to the Scottish Government the basis for any additional funding or cash flow requirements associated with EU funding programmes.**

## Capital planning

**52.** Earlier in our report, we highlighted that SDS should have capitalised expenditure of £0.3 million in accordance with its new property, plant and equipment accounting policy ([Exhibit 3](#)). SDS informed us that the spend was not capitalised as the Scottish Government did not provide a capital allocation. SDS did not have a capital plan in place for 2018/19 and its new accounting policy only took effect towards the end of the year. As a result, spending on items such as laptop renewal programmes is charged against its revenue resource budget.

**53.** A new accounting standard is being introduced in 2019/20 concerning leases (IFRS 16). Any new lease obligations agreed in-year will have capital spend implications.



### Recommendation 2

**SDS should progress its intention to produce a longer-term capital plan which estimates annual spending on areas such as computer hardware and new lease obligations. This should inform funding discussions with the Scottish Government.**

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## Changing landscape for public financial management and medium to long-term financial planning

**54.** Scottish public finances are fundamentally changing, with significant tax-raising powers, new powers over borrowing and reserves, and responsibility for some social security benefits. This provides the Scottish Government with more policy choices but also means that the Scottish budget is subject to greater uncertainty and complexity.

**55.** The Scottish Parliament has introduced a new budget process which is based on a year-round continuous cycle of budget setting, scrutiny and evaluation. As part of the new budget process, the Scottish Government published an initial five-year Medium-Term Financial Strategy (MTFS) in May 2018. The five-year outlook for the Scottish budget, set out in the MTFS, provides useful context for bodies' financial planning.

**56.** As we have reported previously, SDS prepares a longer-term financial plan which is underpinned by scenario planning and shares these with the Scottish Government. The model enables SDS to cost a range of scenarios, such as different volumes of apprenticeships. This in turn allows SDS to forecast the number of places it can provide, linked to the level of funding available. The MTFS refers to improving skills and employability as one of the Scottish Government's key priorities. The Scottish Government has set a target of 30,000 apprenticeship start places by 2020 which SDS has incorporated within its financial model.

## EU withdrawal

**57.** There remains significant uncertainty surrounding the terms of the UK's withdrawal from the European Union (EU). EU withdrawal will inevitably have implications for devolved government in Scotland and for audited bodies. It is critical that public sector bodies are working to understand, assess and prepare for the impact on their business in three broad areas:

- Workforce – the extent to which potential changes to migration are likely to affect the availability of the people and skills needed to deliver services.
- Funding – the extent to which potential changes to existing EU funding programmes are likely to affect the finances of public bodies and the activity that such funding supports.

- Regulation – the extent to which potential changes to EU regulations are likely to affect the activities of some public bodies.

**58.** SDS has carried out a range of activities in preparation for the UK's withdrawal from the European Union. These included staff communications, employer engagement, ongoing discussions with the Scottish Government (on areas such as funding and procurement) and regular reporting to the board and management. Subsequently, SDS prepared its strategic framework 2019-2022 which includes reference to EU withdrawal.

**59.** There remains great uncertainty regarding future arrangements. In our view, SDS has taken reasonable steps to prepare for the impact of EU withdrawal.

# Part 4

## Governance and transparency



### Main judgements

The governance arrangements at SDS support effective oversight of the organisation's activities and finances.

The performance element in SDS's annual report provides a balanced and comprehensive overview, with some areas for further development.

SDS continues to make publicly available only a limited amount of board papers.

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision-making and transparent reporting of financial and performance information.

### Governance arrangements

**60.** SDS operates with a board which is responsible for the body's strategic direction. The board met seven times during the year and was supported by various committees/groups, including the audit and risk committee (ARC) and the finance and operational performance committee (FOP).

**61.** During the year a new board chair was appointed. At 31 March 2019, the board consisted of the chair plus seven other non-executive directors, five co-opted members and the chief executive. We observed the board's consideration of the budget at its meeting in February 2019 and concluded that the level of information provided to board members supported informed scrutiny of the budget.

### Enterprise and skills strategic board

**62.** In last year's report we referred to the strategic board which was formed following the publication of the Scottish Government's enterprise and skills review. Its membership is drawn from the chairs of each of the enterprise and skills agencies, as well as non-executive members from academic and private-sector bodies. The strategic board first met in December 2017 and has been meeting around every two months since then.

**63.** In October 2018, the strategic board published its strategic plan which sets out its initial priorities (referred to as 'missions'). Each mission aims to maximise the effect of the enterprise and skills system on productivity and inclusive growth, with a focus on 'hard alignment' between the agencies. The strategic plan also identified 14 actions for the agencies and 18 recommendations for the Scottish Government which are set out around the four inter-connected missions.

**64.** Updates on the strategic board are provided to the SDS board. A recent paper identified ongoing discussions with the Scottish Funding Council aimed at aligning both bodies' activities in support of strategic board priorities.

**65.** In May 2019, Audit Scotland produced a briefing titled '[Enterprise and Skills Review: Core areas of audit interest](#)'. This referred to a series of issues relating to governance and performance monitoring. We will continue to monitor

developments as part of our ongoing audit of SDS, and the other enterprise and skills agencies.

## Openness and transparency

**66.** There is an increasing focus on how public money is used and what is achieved from it. In that regard, openness and transparency supports understanding and scrutiny. Transparency means that the public has access to understandable, relevant and timely information about how the board is taking decisions and how it is using its resources.

**67.** As previously reported, in contrast to other public bodies, SDS board meetings are not open to the public. Detailed board minutes are published on the SDS website, but board and committee papers and committee meeting minutes are not available publicly. While it is for each organisation to determine what papers are made available, we continue to hold the view that budget monitoring and performance management reports as well as committee minutes should be published where it is reasonable to do so. This is ultimately a matter for SDS. SDS should keep this area under review and assess periodically whether there are opportunities to make further information available.

## Performance report

**68.** The purpose of a performance report is to provide information on a body, its main objectives and strategies, and the principal risks that it faces. It is required to provide a fair, balanced and understandable analysis of performance. SDS reports its performance in the strategic report in the annual report and financial statements.

**69.** There are a number of characteristics which make for a high-quality performance report. As SDS is required to follow the Companies Act, our testing ensured that the strategic report complied with guidance issued by the Financial Reporting Council. While we were satisfied that the guidance had been met, we suggested some areas for improvement in future years. These concerned the presentation of 'not applicable' targets, particularly for careers information, advice and guidance data, and clearer links to the Scottish Government's national performance framework.

**70.** The FReM's requirements for performance reports suggest additional disclosures such as information on how a body measures performance and an explanation of the relationships and links between different pieces of information, such as risks and performance indicators. While SDS is not required to follow the FReM, these additional disclosures would also improve the performance element of the annual report in future years. We have provided SDS officers with a copy of the Audit Scotland's [Good practice note on improving the quality of central government annual report and accounts: Performance reports](#) to support further development.

## Cyber security

**71.** The Scottish Government issued a Public Sector Action Plan on Cyber Resilience in November 2017. This requires all public sector bodies to carry out a review to ensure their cyber security arrangements are appropriate. Last year we reported that SDS intended to attain cyber essentials accreditation in October 2018. This timescale was extended during 2018/19 and SDS has yet to achieve this accreditation. This is due to SDS developing a new model for delivering its computer services which is due to conclude during 2019.

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# Part 5

## Value for money

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### Main judgements

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**SDS has appropriate performance management arrangements in place with some areas under development.**

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**Performance levels have generally met targets or have improved from previous years.**

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Value for money is concerned with using resources effectively and continually improving services.

### Best value

**72.** *Ministerial guidance to Accountable Officers* for public bodies and the *Scottish Public Finance Manual* (SPFM) sets out the accountable officer's duty to ensure that arrangements are in place to secure best value. We have been informed that SDS will develop a process, in line with the new strategic plan, to provide an annual summary of mapping to the generic and cross-cutting themes of best value.

### Performance management

**73.** We reviewed SDS's performance management processes during 2018/19 and concluded that it has appropriate arrangements in place, with some minor areas for improvement. Details of our findings are presented in our management report. These highlighted that SDS has appropriate arrangements in place for monitoring and reporting performance and Board members are provided with comprehensive information which supports scrutiny.

### National performance audit reports

**74.** Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. Although there were no reports published in 2017/18 which were of direct interest to the SDS, there were others with some wider relevance. These are outlined in [Appendix 4](#).

**75.** Currently SDS does not have a process in place to consider and review national reports at board or committee level.

# Appendix 1

## Action plan 2018/19

No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p><b>Potential cash flow issue</b></p> <p>SDS financial plans for 2019/20 show that it expects to receive £28.7 million in cash from the Scottish Government in relation to programmes supported by the European Union, £20.4 million of which was accrued in 2018/19. Should this not transpire, SDS has identified potential cash flow issues later this financial year.</p> <p><b>Risk</b></p> <p>SDS requires to reduce/delay spending during 2019/20 as a result of a shortage of available cash.</p>	<p>SDS should continue to keep its financial plans under close review during 2019/20 so that it is in a position to demonstrate to the Scottish Government the basis for any additional funding or cash flow requirements associated with EU funding programmes.</p> <p><a href="#">Paragraph 51.</a></p>	
2	<p><b>Capital accounting and planning</b></p> <p>SDS did not capitalise relevant expenditure in 2018/19 although a new accounting policy for property, plant and equipment requires it.</p> <p>SDS did not have a capital plan in place for 2018/19 and its new accounting policy only took effect towards the end of the year. Some of SDS's spend in year (such as the purchase of new laptops) is of a capital nature.</p> <p>The introduction of a new accounting standard in 2019/20 (IFRS 16) will result in some spend</p>	<p>SDS should progress its intention to produce a longer-term capital plan which estimates annual spending on areas such as computer hardware and new lease obligations. This should inform funding discussions and budget allocations.</p> <p><a href="#">Exhibit 3 and paragraphs 52 and 53.</a></p>	<p>SDS will be undertaking development of a long-term capital plan as an enhancement to its 5 year modelling, and intends to seek endorsement through the SDS Board's FOP Committee along with other budgets in November 2019</p> <p>Andrew Livingstone (Finance and Corporate Governance Director)</p> <p>November 2019</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>associated with property leases being capitalised.</p> <p><b>Risk</b></p> <p>Investment in SDS's infrastructure is not separated from running costs in financial plans and annual accounts.</p>		

## Follow up of outstanding prior year recommendations

No.	Issue/risk	Recommendation	Progress
2016/17 (1)	<p><b>Recognised good practice in disclosures</b></p> <p>SDS has prepared its 2016/17 annual report and financial statements in line with the requirements of the Companies Act and the Scottish Public Finance Manual (SPFM) as appropriate. While some disclosures go beyond that required by the Companies Act and therefore also comply with the Financial Reporting Manual (FReM), there are some areas where SDS could provide further disclosures in line with good practice and transparency principles for public bodies.</p> <p><b>Risk</b></p> <p>The SDS annual report and financial statements may not be in line with good practice and transparency principles for public bodies.</p>	<p>SDS should consider providing further disclosures for 2017/18 annual report and financial statements, in line with good practice and transparency principles for public bodies.</p>	<p>Although the annual report has improved and meets with requirements, there are some areas for improvement such as presentation of not applicable targets, particularly for careers information, advice and guidance data, and links to the Scottish Government's national performance framework.</p> <p>Ongoing</p>
2016/17 (5)	<p><b>Transparency</b></p> <p>The SDS board meetings are not open to the public and SDS does not publish board and committee papers and committee meeting minutes on its website. SDS acknowledges that making these publicly available would increase transparency but considers the associated costs would be too high.</p> <p><b>Risk</b></p> <p>The board's commitment to transparency may not be in line with public expectations and good practice principles.</p>	<p>With increasing public expectations for more openness in the conduct of public business, SDS should keep this area under review and consider whether there is scope to enhance transparency. This could include, for example, reviewing the availability of board and committee papers and committee minutes.</p>	<p>This is ultimately a matter for SDS.</p> <p>SDS should keep this area under review and assess periodically whether there are opportunities to make further information available.</p> <p>Ongoing</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 Risk of management override of controls</b></p> <p>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 the risk of management override of controls to change the position disclosed in the financial statements.</p>	<p>Detailed testing of journal entries.</p> <p>Review of accounting estimates.</p> <p>Focused testing of accruals and prepayments.</p> <p>Detailed testing of transactions after the year end to confirm expenditure and income have been accounted for in the correct financial year.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p>	<p>Testing of journal entries, accruals and prepayments was satisfactory.</p> <p>Accounting estimates and key assumptions were reasonable.</p> <p>Testing of post year-end transactions did not find any errors.</p> <p>There were no significant transactions outside the normal course of business.</p> <p>Satisfactory</p>
<p><b>2 Risk of fraud over income</b></p> <p>SDS received around £18 million in income from sources other than government grants in 2017/18. SDS expects this to increase to £33 million in 2018/19 mainly due to expected increases in European funding. The extent and nature of this income means that, in accordance with ISA240, there is an inherent risk of fraud.</p>	<p>Review of SDS's anti-fraud arrangements.</p> <p>Walk-through of controls over receivables.</p> <p>Analytical procedures on income streams.</p> <p>Detailed testing of revenue transactions focusing on the areas of greatest risk such as European income.</p>	<p>Walk-through testing of the receivables system found controls operated as expected.</p> <p>We were provided with satisfactory explanations for any movements/trends found from analytical procedures on income streams.</p> <p>Detailed testing of income transactions found no errors.</p> <p>We reviewed the processes and postings in place regarding European income and were satisfied that these are appropriate.</p> <p>Satisfactory</p>
<p><b>3 Risk of fraud over expenditure</b></p> <p>Most public-sector bodies are net expenditure bodies and</p>	<p>Review of SDS's anti-fraud arrangements.</p> <p>Walk-through of controls over national training programmes,</p>	<p>Walk-through testing of the NTP system (both CTS and FIPS) concluded that there is an inherent control risk over the</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>therefore the risk of fraud is more likely to occur in expenditure. Most of SDS'S operating expenditure is on multi-year national training programmes. The mid-year finance report forecasts spend of £134 million in this area, representing 56 per cent of the total 2018/19 expenditure budget. SDS has a commitment to support them over several years. Due to the nature of SDS expenditure there is an inherent risk of fraud over expenditure.</p>	<p>including the corporate training system (CTS) and funding information and processing system (FIPS).</p> <p>Walk-through of controls over payables.</p> <p>Analytical procedures on expenditure streams.</p> <p>Detailed testing of expenditure transactions focusing on the areas of greatest risk such as apprenticeship expenditure.</p> <p>Consideration of internal audit's review of national training programmes including assurance mapping.</p>	<p>payments to providers as SDS does not hold evidence at that point in time. In a sample test of payments to different providers we did not find any errors.</p> <p>Walkthrough testing over payables did not find any control issues.</p> <p>We carried out analytical procedures in expenditure streams and found suitable explanations for any significant movements/trends.</p> <p>Detailed testing of a sample of expenditure items (over and above NTP payments) found no errors.</p> <p>The walkthrough of NTP processes confirmed that effective controls are in place but, as we have reported previously, there is an inherent control risk in the system for making payments to training providers. We considered management's mitigations.</p> <p>Satisfactory</p>
<p><b>4 Estimation and judgements</b></p> <p>There is a significant degree of subjectivity in the measurement and valuation of the material account areas of pensions and provisions. This subjectivity represents an increased risk of misstatement in the financial statements.</p>	<p>Completion of 'review of the work of an expert' in respect of the actuary including a review of actuarial assumptions.</p> <p>Focused testing of pension disclosures, including data that SDS provides to actuaries.</p> <p>Testing of provisions and related disclosures.</p>	<p>Testing found that pension disclosures and provisions were accounted for satisfactorily.</p> <p>Satisfactory</p>
<p><b>5 Data migration from CTS to FIPS</b></p> <p>SDS is planning to transfer all national training programme data from CTS to FIPS by the end of March 2019. There is a risk that migration of data adversely affects information used to produce the financial statements.</p>	<p>Review of the implementation of the data transfer and controls over data transfer.</p> <p>Focused testing of national training programmes transactions such as modern apprenticeship payments.</p> <p>Consideration of internal audit's review of national training programmes including assurance mapping.</p>	<p>We reviewed the processes in place to verify that CTS data had transferred to FIPS and noted that the data has been fully reconciled by management.</p> <p>Satisfactory</p>

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

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Audit Risk	Assurance procedure	Results and conclusions
<p><b>6 Financial management</b></p> <p>The approved SDS's budget for 2018/19 shows income and expenditure of £242 million. As in previous years, part of the core funding from the Scottish Government (£16 million) was to be confirmed through the Autumn and Spring Budget Revisions. Effective budget monitoring and accurate reporting of SDS's financial position and projected outturn to the board is therefore essential to support effective scrutiny. There is a risk that SDS will not receive sufficient funding to deliver its core services and fails to break even in 2018/19.</p>	<p>We will monitor financial reports provided to board/committee over the year and will compare to year-end result in the financial statements.</p> <p>We will attend an SDS board meeting to observe the scrutiny undertaken with respect to the financial position.</p>	<p>SDS managed its budget within the year and ultimately spent within its resource allocation.</p> <p>SDS did not have a capital plan in place for 2018/19 and its new accounting policy only took effect towards the end of the year. The new accounting standard (IFRS 16) will result in capital spend concerning leases.</p> <p>A recommendation has been raised regarding this point in Appendix 1.</p>
<p><b>7 Financial sustainability</b></p> <p>SDS maintains a five-year financial model to forecast expenditure based on a series of underlying assumptions and variables such as pay awards and volumes of activity in relation to the apprenticeship family. The financial model shows a significant funding gap going forward due to uncertainties over SDS's longer-term funding. This and increasing expectations such as rising apprenticeship targets present risks to the financial sustainability of SDS.</p>	<p>Attendance at the budget-setting board meeting to observe any financial sustainability discussions.</p> <p>Consideration of internal audit's review of financial planning.</p>	<p>SDS faces a cashflow issue in 2019/20 as a result of a delay in receiving grant income from the Scottish Government relating to the European Social Fund. It has received a letter from the Minister providing support for the continuation of the relevant programmes.</p> <p>The 5-year financial model is used by SDS to demonstrate to the Scottish Government the future resource need as a consequence of targets for apprenticeships.</p>
<p><b>8 Openness and transparency</b></p> <p>There is an increasing focus on how public money is used and outcomes achieved. Openness and transparency supports understanding and scrutiny of the use of public money. SDS does not publish board and committee papers and committee meeting minutes on its website and there is scope for SDS to further enhance disclosures in the financial statements. There is a risk that SDS's activities and performance are not transparent to the public, impacting on the public's understanding of how SDS has</p>	<p>Consider SDS's review of the availability of board and committee papers and committee meeting minutes.</p> <p>Review disclosures in the 2018/19 financial statements.</p>	<p>This is ultimately a matter for SDS.</p> <p>SDS should keep this area under review and assess periodically whether there are opportunities to make further information available.</p> <p>Ongoing</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>applied public funds and what has been achieved.</p>		
<p><b>9 Enterprise and skills review - strategic plan</b></p> <p>In October 2018, the enterprise and skills strategic board published its first strategic plan. The plan aims to provide clarity around strategic direction to SDS and other enterprise and skills agencies with the overall aim to increase productivity and drive inclusive and sustainable economic growth in Scotland. The agencies are expected to progress actions set out in the strategic plan through enhanced collaboration and alignment.</p> <p>There is a risk that transitioning to the new enterprise and skills arrangements has an adverse short-term impact on SDS's business and performance.</p>	<p>We will review how SDS is responding to the strategic plan and what impact the new enterprise and skills arrangements are having on SDS'S:</p> <p>governance arrangements regarding clarity over new roles, responsibilities and accountabilities</p> <p>strategic direction and its operations including its capacity to deliver on the existing and new duties and responsibilities and its income and expenditure</p> <p>performance management arrangements, in particular whether appropriate measures are in place to determine and report on the impact of the new arrangements.</p>	<p>Progress regarding the strategic board has been provided to the SDS board by the chief executive or chair. Recent updates have reflected ongoing discussions with the Scottish Funding Council over collaborative working.</p> <p>The new strategic framework and operating plan (both presented to the board in May 2019) include references to the strategic plan and its recommendations.</p> <p>Ongoing</p>
<p><b>10 European Union (EU) withdrawal</b></p> <p>The UK's decision to leave the EU on 29 March 2019 represents a major constitutional change for Scotland. It will affect everyone in Scotland to some degree including SDS. What these effects will be remains uncertain, but they will unfold over both the short and the long term. There is a risk that withdrawal from the EU adversely affects SDS's business.</p>	<p>We will assess SDS's response to EU withdrawal.</p>	<p>Our review found that SDS has taken reasonable steps to assess the possible impact given the level of information available.</p> <p>Ongoing</p>

# Appendix 3

## Summary of uncorrected misstatements

**We report all uncorrected misstatements in the annual report and accounts that are individually greater than our reporting threshold of £24,000 and request they be corrected.**

The table below summarises amendments that would be required to misstatements that were identified during our audit testing and have not been corrected by management. Cumulatively these misstatements are below our performance materiality level as shown in [Exhibit 2](#). We are satisfied that these misstatements do not have a material impact on the financial statements, however we request that they be corrected.

Account areas	Consolidated Statement of Comprehensive Income		Statement of Financial Position	
	Dr £000	Cr £000	Dr £000	Cr £000
<b>1</b> Expenditure		335		
Non-Current Assets			335	
<b>2</b> Retirement benefit obligations				350
Actuarial (losses)/ gains recognised in retirement benefit scheme	350			
<b>Net impact</b>	<b>350</b>	<b>335</b>	<b>335</b>	<b>350</b>

Notes:

Entry 1 relates to expenditure on computer equipment which should have been capitalised. The impact is that non-current assets are understated.

Entry 2 relates to late information received regarding return on assets. The impact is that the pension liability is understated.

Entries posted to the comprehensive income and expenditure account (net effect £15,000) also feed through to Retained Losses in the Statement of Financial Position (through 'Total comprehensive (expense)/ income for the year'), thereby ensuring it remains in balance.

# Appendix 4

## 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

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

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

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

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

# The Skills Development Scotland Co. Limited

## 2018/19 Annual Audit Report

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