

Scottish Funding Council

2019/20 Annual Audit Report



 AUDIT SCOTLAND

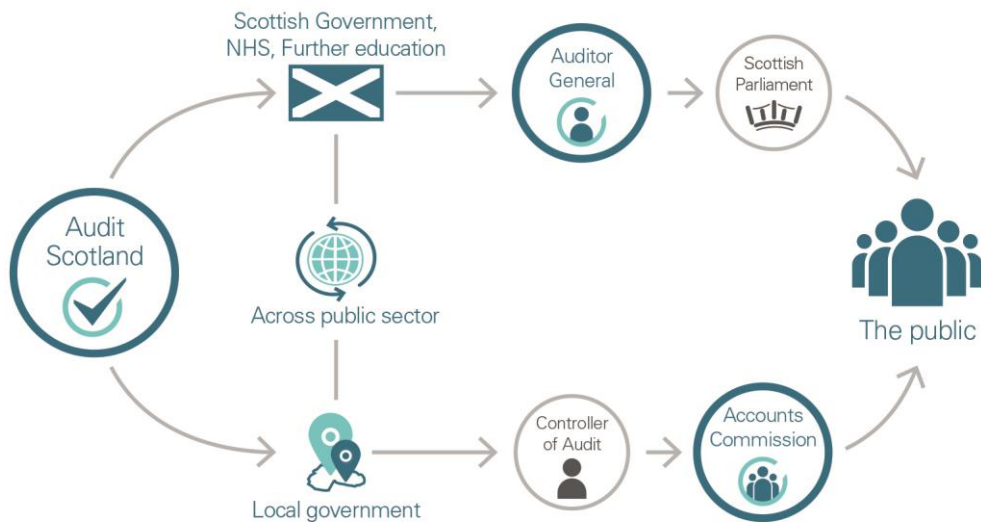
Prepared for the Scottish Funding Council and the Auditor General for Scotland

August 2020

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

2019/20 annual report and accounts

- 1 The financial statements of the Scottish Funding Council (SFC) give a true and fair view of its financial position as at 31 March 2020 and its expenditure and income for 2019/20.
- 2 The other information in the annual report is consistent with the financial statements and prepared in accordance with legal requirements.
- 3 We agreed with SFC to delay our audit by four weeks due to the impact of Covid-19 on the annual accounts process.

Financial management

- 4 SFC has appropriate and effective arrangements for financial management.
- 5 Systems of internal control operated effectively in 2019/20, with scope for improvement in some areas.
- 6 SFC secured additional Scottish Government funding to help colleges and universities respond to immediate risks related to Covid-19.

Financial sustainability

- 7 SFC recognises the significant financial impact of Covid-19 on colleges and universities and is working with the sectors to help them manage the associated risks.
- 8 SFC is building a more detailed picture of the financial position of colleges and universities. It should use this information to inform the development of its own longer-term financial plans.

Governance and transparency

- 9 SFC has effective governance arrangements that support the scrutiny of decisions.
- 10 SFC took effective action to adjust its governance arrangements to take account of the challenges associated with Covid-19.

Value for money

- 11 SFC's Strategic Framework 2019-2022 is aligned with the Enterprise and Skills Strategic Board's strategic plan. SFC has implemented new arrangements to monitor performance.
- 12 SFC has made progress in addressing the recommendations in our *Scotland's Colleges 2019* report and work in other areas is ongoing.

Introduction

1. This report summarises the findings from our 2019/20 audit of the Scottish Funding Council (SFC).
2. The scope of our audit was set out in our Annual Audit Plan presented to the December 2019 meeting of the Audit and Compliance Committee. This report comprises the findings from:
 - an audit of SFC'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](#).

Exhibit 1 Audit dimensions



Source: *Code of Audit Practice 2016*

3. The main elements of our audit work in 2019/20 have been:
 - a review of SFC's key financial systems
 - an audit of SFC's 2019/20 annual report and accounts including the issue of an independent auditor's report setting out my opinions
 - consideration of the four audit dimensions.
4. Since publication of the Annual Audit Plan, in common with all public bodies, SFC has had to respond to the global coronavirus pandemic. This affected the final month of the 2019/20 financial year and will continue to have a significant impact in

2020/21. Covid-19 has significant implications for the financial sustainability of the colleges and universities which SFC funds. SFC has re-prioritised its work programme for the foreseeable future, with an immediate focus on maintaining business continuity and supporting colleges, universities and students.

5. We reviewed our assessment of audit risks and planned audit work in June 2020 and concluded that they remained relevant. We re-issued our Annual Audit Plan in June 2020 to reflect changes to the audit timetable.

Adding value through the audit

6. We add value to SFC through the audit by:

- identifying and providing insight on significant risks, and making clear and relevant recommendations for improvements
- 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.

7. During 2019/20 we provided guidance to SFC on how to improve the structure and content of the performance report section of its annual report and accounts. We will continue to work with SFC to support further improvements in this area.

Responsibilities and reporting

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

9. SFC is also responsible for establishing appropriate and effective arrangements for governance, propriety and regularity that enable the board to successfully deliver its objectives.

10. 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. 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. 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 our audit. 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, the responsible officer(s) and dates for implementation. It also includes any outstanding actions from last year and progress against these.

Auditor Independence

13. Auditors appointed by the Auditor General must comply with the Code of Audit Practice and relevant supporting guidance. When auditing the financial statements

auditors must comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies.

14. 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 2019/20 audit fee of £73,960 as set out in our Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

15. This report is addressed to both SFC and the Auditor General for Scotland and will be published on Audit Scotland's website www.audit-scotland.gov.uk in due course.

16. We would like to thank management and staff for their cooperation and assistance during the audit, particularly given the current challenges presented by the impact of Covid-19.

Part 1

Audit of 2019/20 annual report and accounts



Main judgements

The financial statements of SFC give a true and fair view of its financial position as at 31 March 2020 and its expenditure and income for 2019/20.

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

We agreed with SFC to delay our audit by four weeks due to the impact of Covid-19 on the annual accounts process.

SFC's annual report and accounts are the principal means of accounting for the stewardship of its resources and its performance in the use of those resources.

Our audit opinions on the annual report and accounts are unmodified

17. The annual report and accounts for the year ended 31 March 2020 were approved by the SFC Board on 20 August 2020. We reported within the independent auditor's report that:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- expenditure and income were regular and in accordance with applicable enactments and guidance issued by Scottish Ministers
- the audited part of the Performance Report, the Governance Statement and the Remuneration and Staff report were all consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

18. The working papers provided to support the accounts were of a good standard and the audit team received support from finance staff which helped ensure the final accounts audit process ran smoothly.

The accounting framework was changed due to the Covid-19 pandemic

19. An addendum to the 2019/20 Government Financial Reporting Manual (FReM) was issued in response to the impact of Covid-19 and sets out the minimum requirements. The addendum permits, but does not require, bodies to omit the performance analysis section from the Performance Report. Where relevant performance information has already been published elsewhere, bodies are encouraged to refer to the relevant publication.

20. SFC has used this dispensation and the 2019/20 annual report and accounts does not have a performance analysis section. The performance summary provides a high-level overview of performance throughout the year.

Submission of annual report and accounts for audit

21. Due to the impact of Covid-19, SFC prioritised financial support for colleges, universities and students. We worked with SFC to agree a new audit timetable and received the annual report and accounts for audit on 8 June 2020, four weeks later than originally planned.

22. Officers adapted well to the challenges of being audited remotely. With the support of SFC's finance team we were able to obtain the necessary audit evidence and complete the audit within the revised timetable.

23. Working papers to support the annual report and accounts were provided to the audit team on request through our secure file sharing site. This is the first time SFC has used this system and we recognise the challenges it presented. In future, and to improve the efficiency of the audit, it would be helpful if a full working papers package is available at the start of the audit.

Overall materiality is £18.8 million

24. The assessment of what is material is a matter of professional judgement. It involves considering both the amount and the nature of any misstatement in the financial statements.

25. On receipt of the annual report and accounts for audit we reviewed our materiality calculations and concluded that they remained appropriate as shown in [Exhibit 2](#).

Exhibit 2 Materiality values

Materiality level	Amount
Overall materiality	£18.8 million
Performance materiality	£14.1 million
Reporting threshold	£250,000

Source: Audit Scotland

[Appendix 2](#) identifies the main risks of material misstatement and our audit work to address these

26. [Appendix 2](#) provides our assessment of risks of material misstatement in the annual report and accounts and wider audit dimension risks. These risks influence our overall audit strategy, the allocation of staff resources to the audit and indicate how the efforts of the audit team were directed. [Appendix 2](#) also identifies the work we undertook to address these risks and our conclusions from this work.

27. We have no issues to report from our work on the risks of material misstatement in the accounts. We have reported several points from our wider audit dimension work. These relate to financial sustainability, value for money and workforce capacity and are included in the action plan at [Appendix 1](#).



Significant findings to report on the annual report and accounts

28. 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 SFC's accounting practices. 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>1. Financial Transactions – IFRS 9 accounting adjustments and disclosures</p> <p>The annual report and accounts provided for audit did not reflect the adoption of International Financial Reporting Standard 9, Financial Instruments. IFRS 9 specifies how an entity should classify and measure financial assets and financial liabilities.</p> <p>SFC concluded that the impact of the IFRS 9 adjustments and disclosures is immaterial in the context of its accounts. On this basis, it has not applied IFRS 9 in preparing its accounts.</p>	<p>We have confirmed that accounting for IFRS 9 would not have a material impact on the 2019/20 annual report and accounts. Accounting for IFRS 9 would reduce taxpayers' equity in the Statement of Financial Position by £5.9 million and increase net expenditure in the Statement of Comprehensive Net Expenditure by £5.9 million.</p> <p>Management has agreed to review its accounting policy for Financial Transactions annually and assess whether to apply IFRS 9 in future.</p> <p> Recommendation 1 (refer Appendix 1, action plan)</p>
<p>2. European Social Fund income – accounting treatment</p> <p>SFC is a lead partner for two European Social Fund (ESF) programmes: the Youth Employment Initiative (YEI) and Developing Scotland's Workforce (DSW). SFC provides funding to colleges to support these programmes and claims matched European funding through the Scottish Government. The YEI programme has now ended but claims relating to previous years are still outstanding.</p> <p>SFC's accounts are prepared on an accruals basis but it continues to account for ESF income on a cash basis. This is because of SFC's view of the uncertainty over the timing and receipt of this income. In 2019/20 SFC received £8.4 million of ESF income.</p> <p>In our view, SFC's accounting treatment of ESF income is no longer appropriate due to the increased number of claims approved.</p> <p>In May 2020 SFC received a further £2.3 million in ESF income for a 2016/17 YEI claim. This has not been accrued in the 2019/20 accounts and the income for the year and the Statement of Financial Position is understated by this amount.</p>	<p>We have confirmed that accounting for ESF income on a cash basis does not have a material impact on the 2019/20 annual report and accounts.</p> <p>Management has agreed to carry out an annual assessment of the accounting treatment of ESF funding to ensure it is in accordance with the FReM.</p> <p> Recommendation 2 (refer Appendix 1, action plan)</p>

Source: Audit Scotland

29. There are no material adjustments to the unaudited financial statements arising from our audit. There is one unadjusted error in the accounts that relates to ESF income.

30. 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. Management do not propose to adjust for the item above as the amounts are not considered material in the context of the financial statements.

SFC has made progress on prior year recommendations

31. SFC has made progress in implementing our prior year audit recommendations. For actions not yet implemented, revised responses and timescales have been agreed with management, and are set out in [Appendix 1](#).

Part 2

Financial management



Main judgements

SFC has appropriate and effective arrangements in place for financial management.

Systems of internal control operated effectively in 2019/20, with scope for improvement in some areas.

SFC secured additional Scottish Government funding to help colleges and universities respond to immediate risks related to Covid-19.

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

SFC operated within budget in 2019/20

32. The main financial objective for SFC is to ensure that the financial outturn for the year is within the budget allocated by Scottish Ministers.

33. SFC's budget management process is complex, with the application of a financial year budget to an academic year along with the need to manage budget pressures and commitments. SFC manages its budget through an annual re-profiling exercise to allocate funds among the further education, higher education and running costs budgets.

34. SFC's financial performance against Departmental Expenditure Limits (DEL) is shown in [Exhibit 4](#). SFC underspent its overall budget by £5.3 million. This was mainly due to colleges repaying loans agreed before April 2014 which do not score as resource expenditure and no opportunities were lost to the sectors.

Exhibit 4

Performance against DEL in 2019/20

Performance	Final budget £m	Outturn £m	Over/(under) spend £m
Resource DEL	1,710.6	1,699.6	(11.0)
Capital DEL	116.2	121.7	5.5
Financial transactions	55.5	55.7	0.2
Total DEL	1,882.3	1,877.0	(5.3)

Source: Scottish Funding Council resource return

Budget processes were appropriate, with SFC taking action to provide financial support to colleges, universities and students due to Covid-19

35. We reviewed SFC's budgetary processes and budget monitoring arrangements as part of our interim audit work. From review of budget monitoring reports and committee papers, and attendance at committees we confirmed that senior management and members receive regular, timely and up to date financial information on SFC's financial position. We concluded that SFC has appropriate budget setting and monitoring arrangements.

36. The Covid-19 pandemic did not affect SFC's financial performance for financial year 2019/20. SFC has taken urgent steps to support colleges and universities to mitigate some of the immediate risks. This included bringing forward £2 million of 2020/21 advance funding to support college students on further education courses. This formed part of a £5 million package of emergency financial support to help students.

37. SFC advised the Scottish Government of the financial pressures facing universities at an early stage in the pandemic. As a result of this work the Scottish Government announced a one-off £75 million package to support research in financial year 2020/21. SFC has agreed and announced how this funding will be distributed.

38. Further details on the implications and support for the sectors is set out in Part 3 of this report.

Financial systems of internal control are operating effectively

39. 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 systems of recording and processing transactions provide a sound basis for the preparation of the financial statements.

40. Our management report which was presented to the Audit and Compliance Committee in March 2020 concluded our findings from the review of systems of internal control. Our report identified areas where controls could be strengthened and related management actions. We carried out additional work to gain the assurance we required for the audit of SFC's 2019/20 accounts.

41. SFC staff moved to home working on 24 March 2020. This required changes to some of the internal controls set out in SFC's financial procedures manual. For example, the approval process for payments required authorisation by a signature. Alternative controls have been put in place and guidance on the new arrangements has been provided to staff. SFC should keep this under review and ensure internal controls remain effective during this period of change.

Internal audit

42. SFC's internal audit function in 2019/20 was provided by a firm of accountants. The contract expired on 31 March 2020 and SFC entered into an agreement with the in-house audit team at Scottish Enterprise for the provision of internal audit services with effect from 1 April 2020.

43. We considered the work of internal audit in several areas to inform our wider dimension work including workforce planning and strategic planning. Progress in implementing internal audit recommendations is reported to each meeting of the Audit and Compliance Committee.

Workforce capacity

44. There are increasing demands on SFC's resources. This includes work to support the Enterprise and Skills Strategic Board, preparing for the implications of EU withdrawal and administering European funding to colleges. More recently, the response to the impact of Covid-19 has brought significant, additional pressures to SFC and its staff.

45. We commented on staff capacity in our report last year. In planning our 2019/20 audit we highlighted the risk that SFC may not have adequate resources to carry out its core functions and meet the objectives set out in its strategic plan, the Strategic Framework 2019-2022.

46. Internal capacity and resources continue to be recognised on SFC's risk register and considered at board meetings. SFC has a workforce plan that recognises the need for additional resources and is working to address capacity issues, develop staff in response to new priorities, and to provide SFC with enhanced flexibility. High-level discussions are taking place with the Scottish Government on the optimum resources required to deliver the increasing workload.

47. Internal audit completed a review of workforce planning as part of its 2019/20 plan. We reviewed the findings to inform our wider governance work. The report included two key recommendations:

- SFC should expand the horizon of the workforce plan to consider the medium to longer-term needs of the organisation
- Succession planning is important for SFC to ensure the continuity of its operations on a long-term basis.



Recommendation 3

SFC should continue to develop its workforce plan with a focus on ensuring it has sufficient resources to support its new Strategic Framework and meet its longer-term needs.

Standards of conduct and arrangements for the prevention and detection of fraud and error are appropriate

48. SFC is responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities. Furthermore, the board is responsible for ensuring that its affairs are managed in accordance with proper standards of conduct by putting effective arrangements in place.

49. 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.

50. Appropriate arrangements are in place for the prevention and detection of fraud, error and irregularities. We are not aware of any specific issues that we need to bring to your attention.

51. Audit Scotland issued a new publication in July 2020, [Covid-19 Emerging Fraud Risks](#) that outlines some of the key risks that public sector bodies might be exposed to due to Covid-19.

52. Arrangements for preventing fraud and corruption in the procurement function are appropriate.

53. Our consideration of financial management includes evaluating the arrangements in place for preventing and detecting fraud and corruption. Instances of fraud and corruption can be particularly prevalent in the procurement function. We carried out an assessment of the arrangements at SFC to prevent fraud and corruption in the procurement function. We concluded that management's procedures to address the risk of fraud and corruption in the procurement function are appropriate.

Part 3

Financial sustainability



Main judgements

SFC recognises the significant financial impact of Covid-19 on colleges and universities. It is working closely with the sectors to help them manage the associated risks.

SFC is building a more detailed picture of the financial position of colleges and universities. It should use this information to inform the development of its own longer-term financial plans.

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

SFC is working closely with colleges and universities to help them manage the significant financial impact of Covid-19

54. Covid-19 raises a range of risks and challenges for the public sector. It has significant implications for the finances and operation of Scotland's colleges and universities, placing additional demands on SFC. SFC has re-prioritised its activity for the foreseeable future, with an immediate focus on maintaining business continuity and stabilising funding flows.

55. Colleges and universities were already operating within an increasingly tight financial environment and faced financial pressures and uncertainties. The college sector reported an underlying financial surplus of £12.7 million in 2018/19, although the gap between income and expenditure continued to widen. The operating deficit increased by £16 million to £46 million between 2017/18 and 2018/19. Although the university sector was in good financial health overall, there was significant variation between institutions and more than half of all universities were in deficit in 2017/18.

56. The impact of Covid-19 on the financial sustainability of colleges and universities is significant. The sectors face a loss of income from sources including tuition fees, accommodation, catering and other commercial activity, as well as additional costs to support the move to online teaching and learning.

57. In April 2020, SFC estimated that the academic year 2019/20 adjusted operating position for colleges would move from a near break-even position to a deficit of £25 million, and the overall operating position for universities would reduce by £72 million to a surplus of £166.5 million. SFC expects the financial impact in academic year 2020/21 to be even more severe and is working with the sectors to get a better understanding of the implications for the short to medium term.

58. Colleges and universities are expected to make an important contribution to reviving the Scottish economy. SFC has a central role in supporting the sectors to manage the risks presented by Covid-19 and ensure they remain financially viable. Scottish Ministers have commissioned SFC to review the provision and sustainability of tertiary education and research in Scotland, to address the challenges and opportunities brought by Covid-19. This includes reviewing existing

models of governance, delivery and funding. SFC will provide its initial considerations by the end of August.

59. It is a rapidly changing environment and the longer-term impact on the sectors and the work of SFC are not yet clear. We will continue to monitor the implications for the further and higher education sectors and report on this in due course.

Financial forecast returns help build a comprehensive picture of the financial position of the sectors

60. Last year we recommended that SFC should work to complete medium to longer-term financial plans which measure the likely impact of major developments affecting the higher and further education sectors. This will now need also to reflect the financial impact of Covid-19 on colleges and universities.

61. Financial forecast returns (FFRs) are more important than ever in helping SFC to build a comprehensive picture of the financial position of the sectors, to underpin its own financial plans and allow it to support colleges and universities effectively.

62. SFC is working with colleges and their boards to improve financial forecasting. It issued revised guidance on FFRs to colleges in June 2019, requiring colleges to submit financial forecasts based on achieving a balanced budget each year for the five years to 2023/24. SFC asked colleges to provide a full description of their financial plans and invited them to develop additional forecasts based on alternative planning scenarios where appropriate. Based on this information, SFC reported in February 2020 that the college sector was projecting an underlying deficit of £5 million by 2023/24.

63. SFC extended the deadline for colleges to submit mid-year review returns due to Covid-19 and requested an additional update in May 2020 to capture the latest financial position of the sector. SFC's most recent guidance on FFRs, issued in June 2020, requires colleges to submit financial forecasts for the three years to 2022/23. Reducing the forecast period from five to three years aligns college and university reporting timeframes. Colleges are required to present a balanced budget for 2020/21 and/or a deliverable plan to reach a balanced budget over the forecast period. SFC's February 2020 report, *The Financial Sustainability of Colleges and Universities in Scotland*, presents a helpful overview of the financial challenges faced by colleges. SFC could further improve its reporting on the sector's financial position by including additional information on the level of savings needed to achieve financial sustainability.

64. SFC responded to the recommendation in our report on [Finances of Scottish Universities](#) to improve reporting on university finances. In April and June 2020, SFC asked universities to submit updated financial forecasts for 2019/20 and 2020/21 to identify the immediate and anticipated financial impact of Covid-19. The shorter reporting timeframe reflects the ongoing uncertainties around the medium-term financial impact. SFC asked universities to provide a commentary on the mitigating actions being taken to address the financial effects. SFC anticipates issuing a request for financial forecasts up to 2022/23 in the autumn, once the position on 2020/21 student recruitment becomes clearer.

65. SFC published a briefing note on the impact of Covid-19 on the financial sustainability of colleges and universities in April 2020. It is anticipated that an update will be published in August based on a review of the colleges and universities 2018/19 financial statements.



Recommendation 4

SFC should use its more detailed picture of the financial position of colleges and universities to inform the development of its own medium to longer-term financial plans.

Part 4

Governance and transparency



Main judgements

SFC has effective governance arrangements that support the scrutiny of decisions.

SFC took effective action to adjust its governance arrangements to take account of the challenges associated with Covid-19.

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.

Overall governance and transparency arrangements were appropriate

66. The corporate governance framework within SFC is centred around the board, supported in its role by seven committees including the Audit and Compliance Committee and the Finance Committee.

67. There were changes to the board membership during 2019/20 with four members leaving and seven new members taking up post. As at 31 March 2020 board membership consisted of the Chair, the Chief Executive and 14 non-executive members.

68. Actions taken by SFC in response to the impact of Covid-19 are set out in the 2019/20 annual report and accounts. SFC has made appropriate adjustments to its governance arrangements to respond to the Covid-19 pandemic. Recent board and committee meetings have been conducted virtually with a re-focus of work priorities on business continuity and stabilising funding flows.

69. In assessing governance and transparency arrangements we consider:

- board and committee structure and conduct
- overall arrangements and standards of conduct including those for the prevention and detection of fraud, error, bribery and corruption. This includes action in response to the National Fraud Initiative
- openness of board and committees
- public access to information via websites
- reporting of performance and whether this is fair, balanced and understandable.

70. A short-life committee, the Aberdeen University Review Committee, was established in June 2019 for the purposes of conducting a review into the University of Aberdeen's compliance with SFC's terms and conditions of grant in relation to a payment to its former Principal. This review is now complete. The

university has made an agreed repayment to SFC and is seeking recovery of this amount from the former Principal.

71. We concluded that SFC has effective governance, decision-making and scrutiny arrangements in place which support good governance and accountability.

Covid-19 had an impact on performance reporting in 2019/20

72. In addition to the opinion on the performance report covered in Part 1 of our Annual Audit Report, we also consider the qualitative aspects of the SFC's performance reporting. The performance report should provide information on SFC's main objectives and the principal risks faced. It should provide a fair, balanced and understandable analysis of SFC's performance as well as helping stakeholders understand the financial statements.

73. As noted earlier in this report, an addendum to the 2019/20 Government Financial Reporting Manual (FReM) was issued in response to the impact of Covid-19 and allows bodies to omit the performance analysis section from the performance report. SFC has used this dispensation and the 2019/20 annual report and accounts does not have a performance analysis section.

74. The performance summary provides the required level of reporting and includes summarised information on SFC's performance in 2019/20 including details on how funding was spent. The content of the performance report is in line with the revised requirements of the FReM and includes details of the impact of Covid-19 on SFC and the sectors.

75. In 2018/19 we recommended that SFC should consider the content of its 2019/20 performance report to ensure it provides users of the annual report and accounts with a more comprehensive analysis of its performance. SFC should continue to work towards achieving this.

76. FReM guidance requires SFC to identify its key performance measures and explain the link between these measures, risk and uncertainty. The Audit Scotland [*Good practice note on improving the quality of central government annual report and accounts*](#) is a useful tool to help enhance performance report disclosures.



Recommendation 5

SFC should maintain its focus on making improvements to the performance report to ensure it provides users of the annual report and accounts with a more comprehensive analysis of its performance.

Part 5

Value for money



Main judgements

SFC's Strategic Framework 2019-2022 is aligned with the Enterprise and Skills Strategic Board's strategic plan. SFC has implemented new arrangements to monitor performance.

SFC has made progress in addressing the recommendations in our *Scotland's Colleges 2019* report and work in other areas is ongoing.

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

SFC is proactive in ensuring it has appropriate arrangements for securing Best Value

77. *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. The guidance sets out the key principles of Best Value and the requirement to have a systematic approach to self-evaluation and continuous improvement.

78. SFC assesses its compliance with the principles of Best Value by carrying out periodic self-assessment exercises. The self-assessment measures SFC against the Best Value characteristics an organisation should be able to demonstrate, as identified by the Scottish Government. The last exercise was carried out in 2017 and the next exercise was planned for 2020. SFC decided to postpone this to 2020/21 due to the disruption and uncertainty resulting from Covid-19.

79. SFC will report progress against its Best Value improvement plan actions to the Audit and Compliance Committee in August 2020 and provide evidence of activities carried out during 2019/20 to support Best Value.

SFC has aligned its objectives with the Strategic Board's strategic plan

80. The Enterprise and Skills Strategic Board (ESSB) is designed to align and coordinate the activities of Scotland's enterprise and skills agencies, including SFC, Scottish Enterprise, Skills Development Scotland, and Highlands and Islands Enterprise.

81. In October 2018, the ESSB published a strategic plan, which contained common policy missions that the enterprise and skills agencies are required to work towards. It also contained a high-level performance framework, against which the ESSB can assess the bodies' progress to achieving these missions.

82. The SFC Strategic Framework 2019-2022 was published in June 2019 and sets out its core objectives as well as the operating plan for the financial year. The framework and operating plan are set within the context of Scotland's National Performance Framework and the framework has been built on the foundations of

the Enterprise and Skills Strategic Board's vision. The framework also links SFC's work and performance to the Strategic Board's four missions.

83. The Scottish Government has established an Analytical Unit to support the Strategic Board in its decision-making and assessment of the agencies' performance.

84. To support the ESSB and coordinate collaboration between the agencies, the Strategic Plan Joint Working Group (SPJWG) was formed. Membership of the SPJWG is drawn from each of the agencies along with the sponsor division and the Analytical Unit. The initial focus of the SPJWG was to support the ESSB in developing its strategic plan and ensuring that each agency's own strategic plan aligned. Following publication of the ESSB's strategic plan in October 2018, and the aligned agency plans in April 2019, the group is now focusing on further developing the aligned agency plans and developing the performance framework which was included in the ESSB's strategic plan.

85. SFC is continuing to work collaboratively with other enterprise and skills agencies to develop new forms of decision making. This includes working with Skills Development Scotland to make joint decisions on learning provision and progress delivery of the five-stage skills alignment model. A joint Director of Skills Alignment post has been appointed to enable an integrated approach and is funded equally by SFC and Skills Development Scotland.

SFC has implemented new performance reporting arrangements

86. SFC has changed its performance reporting arrangements in response to its new strategic framework and the performance targets this has set. A performance report is presented at most board meetings setting out SFC's progress against the planned activities in the operating plan. This focusses on the performance of SFC rather than the sectors. No operating plan has been set for 2020/21 due to the impact of Covid-19 however short-term priorities have been set by the senior management team.

87. An annual performance report will be provided to the board which summarises the performance of colleges, universities and the sectors using the performance measures set out in the strategic framework document. This report was due to be presented at the August board meeting however it has been postponed to later in the year due to Covid-19.

88. SFC should ensure it continues to monitor and report progress against its performance targets. It should review the effectiveness of its new performance management arrangements.

National performance audit reports

89. We deliver a national performance audit programme on behalf of the Auditor General for Scotland and the Accounts Commission. Audit Scotland published [Scotland's Colleges 2019](#) in June 2019 and [Finances of Scottish Universities](#) in September 2019. Both reports included specific recommendations for SFC.

90. *Scotland's Colleges 2019* highlighted that while colleges continue to meet SFC targets for learning activity, they also face financial challenges. It reported that SFC needs to work with colleges and their boards to improve financial planning and to achieve greater transparency in the sector's financial position. We highlighted scope for SFC to improve its performance reporting on colleges and ensure that the performance targets set for colleges are realistic.

91. We assessed SFC's progress towards the recommendations included in the *Scotland's Colleges 2019* report. SFC has made progress in addressing some of the report's recommendations and work in other areas is ongoing as shown in Exhibit 5.

Exhibit 5

Progress against 'Scotland's colleges 2019' recommendations

Recommendation	Progress
SFC should work with colleges to agree their underlying financial position prior to finalising their accounts.	SFC implemented this recommendation in its accounts direction for colleges for 2018/19, which was issued in July 2019. Colleges are required to submit their adjusted operating position calculation, together with draft accounts, to SFC for review prior to the accounts being signed off. This has improved transparency and consistency in financial reporting.
SFC should require colleges to submit medium-term financial plans (MTFPs) to support financial forecast returns (FFRs) in assessing financial sustainability across the sector.	<p>SFC issued a call for information in June 2019, asking colleges to submit an FFR for the six years from 2018/19 to 2023/24. It noted that the financial information and additional commentary requested should address the recommendation about MTFPs. SFC asked colleges to take the necessary actions to balance their operating position and to reflect these actions and provide a full description of their financial plans in their FFRs. SFC invited colleges to develop additional forecasts based on alternative planning scenarios where appropriate. Colleges' FFRs included cost reduction actions to mitigate forecast deficits and achieve a balanced budget position. SFC could further improve its reporting on the financial position of the sector by using the information in the FFRs to report on the level of savings needed across the sector to achieve financial sustainability.</p> <p>In June 2020, SFC requested colleges to submit FFRs covering the four years from 2019/20 to 2022/23. The move to a shorter forecasting period aligns reporting timeframes for colleges and universities.</p>
SFC should publish college region performance against all outcome agreement measures.	SFC publishes performance data against indicators and outcome agreement measures, but it does not publish regional college performance alongside targets for all outcome agreement measures. This makes it difficult to assess whether colleges are meeting their agreed targets. As part of work to consider how to improve success rates in colleges, SFC will consider the effect of publishing the data differently.
SFC should publish good-quality student satisfaction data for every college.	<p>SFC published the results of the Student Satisfaction and Engagement Survey 2018/19 in October 2019. This included student satisfaction data for full-time students at individual college level for the first time. Satisfaction rates for part-time students are still reported at a sector level. Overall response rates have continued to rise but there remains a wide variation across colleges. SFC is working with Student Partnerships in Quality Scotland and colleges to improve response rates and develop the survey further.</p> <p>The survey for 2019/20 has been cancelled as the survey period (March/April 2020) coincided with the Covid-19 lockdown period.</p>
SFC and Scottish Government should agree and publish a medium-term capital investment strategy that sets out sector-wide priorities.	The Programme for Government 2019/20, published in September 2019, included a commitment for SFC to work with the Scottish Government to develop a medium-term estate strategy for the college sector, which would set out the main priorities for college capital investment over the next five to ten years. SFC intended to publish the strategy by summer 2020 but has had to reprioritise its work due to Covid-19. The changes in the delivery of college learning brought about by Covid-19 will significantly impact on capital investment priorities, such as digital infrastructure, which SFC will need to reflect in the strategy.
SFC and Scottish Government should review whether targets for college provision and student outcomes, including for	SFC reviews the targets and measures in its guidance on outcome agreements each year. It reconsidered the target for students from the most deprived areas, but the overall sector-level credit target and FTE targets remain the same. SFC considers that the current targets are stretching for many institutions and have therefore decided to maintain

students from deprived areas, remain relevant and realistic, based on current performance trends.	the current targets and support colleges to make progress towards them rather than revise the targets. During 2020, SFC has applied flexibility around credit targets due to the impact of Covid-19. Scottish Ministers have commissioned SFC to review governance, delivery and funding models for colleges and universities in light of Covid-19. We would encourage SFC to work with colleges and the Scottish Government to review the longer-term position of targets, in response to Covid-19 and the recommendations in the Cumberland-Little report.
SFC and Scottish Government should work with colleges to deliver the necessary improvements in performance to meet agreed outcome agreement targets.	SFC's work to support colleges has been refocused in light of Covid-19. SFC has committed to not recovering funds for shortfalls against core targets if these are related to Covid-19 for 2019/20 and 2020/21. It has also revised the outcome agreement (OA) arrangements for 2020/21 and will not ask College Boards to sign off the OAs as the commitments do not account for the impact of Covid-19. SFC is engaging with the sector to agree refocused commitments and priorities linked to core funding for 2020/21 and will provide an update on this in August 2020.

Source: Audit Scotland

92. *Finances of Scottish Universities* highlighted the financial pressures and uncertainties facing the sector, including pension and estate costs and EU withdrawal. It noted the diversity of the sector and the variation in financial positions between individual institutions. We reported that SFC has a good understanding of the issues affecting both the sector and individual universities, though there is scope for it to improve its monitoring and reporting on universities' finances. We also highlighted that SFC had not set out specific actions to mitigate risks to the sector's ability to deliver the Scottish Government's priorities. The report recommended that SFC should:

- specify targets for all outcome agreement measures for each university, where possible and appropriate
- further develop its annual progress and ambitions report to include individual university performance against outcome agreement measures, together with the action taken where a target was not achieved
- improve its approach to analysing universities' financial health and sustainability by:
 - reviewing universities' long-term financial strategies
 - specifying the criteria and examples in its internal guidance that would lead to increased engagement with individual universities
- publish a more detailed summary of its financial analysis, similar to that published by the Office for Students in England
- build on the commitments in its recent Strategic Framework and set out more specific proposals on mitigating risks to the delivery of Scottish Government priorities
- reflect any changes in its outcome agreement process, once the Scottish Government has agreed which National Performance Framework outcomes it expects universities to contribute to.

93. SFC is taking action to address our recommendations, as set out in a letter to the Scottish Parliament's public audit committee, dated 21 February 2020.

94. Officers present regular updates on progress made against the recommendations in our performance audit reports to the Audit and Compliance Committee. We will continue to monitor progress, whilst recognising the impact of Covid-19 on SFC's priorities and activity, to implement our recommendations.

95. The national performance audit reports that were published in 2019/20 and are of direct interest to SFC are outlined in [Appendix 3](#).

Appendix 1

Action plan 2019/20



No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p>IFRS 9 adjustments</p> <p>The annual report and accounts provided for audit did not reflect the adoption of International Financial Reporting Standard 9. IFRS 9 specifies how an entity should classify and measure financial assets and financial liabilities.</p> <p>SFC concluded that the impact of the IFRS 9 adjustments and disclosures is immaterial in the context of its accounts. On this basis, it has not applied IFRS 9 in preparing its accounts.</p> <p>Risk</p> <p>SFC will receive higher levels of financial transactions funding in 2020/21. This may result in its accounting treatment no longer being appropriate.</p>	<p>Officers should review the accounting treatment of financial assets and liabilities annually to ensure it remains appropriate.</p> <p>Exhibit 3</p>	<p>Agreed</p> <p>Assistant Director, Finance</p> <p>February 2021</p>
2	<p>ESF income accounting treatment</p> <p>SFC's accounts are prepared on an accruals basis but it continues to account for ESF income on a cash basis. This is because of SFC's view of the uncertainty over the timing and receipt of this income. In 2019/20 SFC received £8.4 million of ESF income.</p> <p>In our view, SFC's accounting treatment of ESF income is no longer appropriate due to the increased number of claims approved.</p> <p>In May 2020 SFC received a further £2.3 million in ESF income for a 2016/17 YEI claim. This has not been accrued in the 2019/20</p>	<p>Management should carry out an annual assessment of the accounting treatment of ESF funding to ensure it is in accordance with the FReM.</p> <p>Exhibit 3</p>	<p>Agreed</p> <p>Assistant Director, Finance</p> <p>February 2021</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>accounts and the income for the year and the Statement of Financial Position is understated by this amount.</p> <p>Risk</p> <p>There is a risk that the income figure in the annual accounts is understated.</p>		
3	<p>Workforce capacity</p> <p>There are increasing demands on SFC's resources. This includes work to support the Enterprise and Skills Strategic Board, preparing for the implications of EU withdrawal and administering European funding to colleges. More recently, the response to the impact of Covid-19 has brought significant, additional pressures to SFC and its staff.</p> <p>SFC is continuing to develop its workforce plan and high-level discussions are taking place with the Scottish Government on the optimum resources required to deliver its increasing workload.</p> <p>Risk</p> <p>Workforce decisions are not coordinated leading to decisions in one area having unintended consequences in another.</p>	<p>SFC should continue to develop its workforce plan with a focus on ensuring it has sufficient resources to support its new Strategic Framework.</p> <p>Paragraphs 44-47</p>	<p>Agreed</p> <p>Chief Operating Officer</p> <p>December 2020</p>
4	<p>Financial sustainability</p> <p>Covid-19 has significant implications for the finances and operation of Scotland's colleges and universities, placing additional demands on SFC. There are ongoing uncertainties around the medium to longer-term financial impact of Covid-19.</p> <p>Risk</p> <p>SFC does not have sufficient information to support a longer-term view of its financial position, and that of the</p>	<p>SFC should use its more detailed picture of the financial position of colleges and universities to inform the development of its own medium to longer-term financial plans.</p> <p>Paragraphs 63-65</p>	<p>Agreed. To be informed by the outcome of the Review of Coherent Provision and Sustainability.</p> <p>Director of Finance</p> <p>July 2021</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	sectors, and its options for future funding.		
5	<p>Performance Report</p> <p>In 2018/19 we recommended that SFC should consider the content of its 2019/20 performance report to ensure it provides users of the annual report and accounts with a more comprehensive analysis of its performance.</p> <p>In line with revised reporting requirements for 2019/20 SFC's annual report and accounts does not have a performance analysis section. This means that SFC has not been able to demonstrate improvement in this area.</p> <p>Risk</p> <p>SFC does not provide users of the annual report and accounts with a clear analysis of its performance.</p>	<p>SFC should maintain its focus on making improvements to the performance report to ensure it provides users of the annual report and accounts with a more comprehensive analysis of its performance.</p> <p>Paragraphs 74-76</p>	<p>Agreed</p> <p>Assistant Director, Strategy</p> <p>December 2020</p>

Follow up of prior year recommendations

b/f 1	<p>Submission of financial statements for audit</p> <p>We received the unaudited annual report and accounts on 3 May 2019 in line with our agreed audit timetable but these and the working papers were incomplete. Significant outstanding items included:</p> <ul style="list-style-type: none"> • a complete and FReM compliant performance report • working papers to support SFC's treatment of adjustments required under International Financial Reporting Standard 9 Financial Instruments • evidence to support SFC's judgement on its accounting treatment of European Social Fund income. <p>This information was provided after the deadline for</p>	<p>SFC should review its timetable and arrangements for preparation, submission to audit and approval of its annual report and accounts to ensure they are achievable.</p>	<p>Ongoing</p> <p>We received the unaudited annual report and accounts in line with the revised audit timetable. To improve the efficiency of the audit, it would be helpful if a full working papers package is available at the start of our audit.</p> <p>Paragraphs 21-23</p>
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No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>submission of Audit and Compliance Committee papers which delayed the completion of our audit work and meant we could not meet the timetable for the audit set out in our Annual Audit Plan.</p> <p>Risk</p> <p>SFC is unable to approve its annual report and accounts in accordance with its agreed timetable.</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 to our wider responsibility under the [Code of Audit Practice 2016](#).

Risk	Assurance procedure	Results and conclusions
Risks of material misstatement in the financial statements		
<p>1 Risk of material misstatement caused by management override of controls</p> <p>Auditing Standards required that audits are planned to consider the risk of material misstatement caused by fraud, which is presumed to be a significant risk in any audit. This included the risk of management override of controls that results in fraudulent financial statements.</p>	<p>Reviewed the appropriateness of journal entries and other adjustments recorded in the general ledger and financial statements.</p> <p>Reviewed accounting estimates for bias.</p> <p>Evaluated significant transactions that are outside the normal course of business.</p> <p>Focused testing of the regularity and cut-off assertions during the financial statements audit.</p>	<p>We concluded from our audit testing that all 2019/20 journal entries, accounting estimates and judgements, and significant transactions we reviewed were appropriate.</p> <p>We found no issues from our testing of regularity and cut-off assertions.</p>
<p>2 Risk of material misstatement caused by fraud in expenditure</p> <p>Auditing Standards refer to the presumed risk of fraud. As most public-sector bodies are net spending bodies, the risk of fraud is more likely to occur in expenditure. There is a risk that expenditure may be misstated resulting in a material misstatement in the financial statements.</p> <p>The risk of fraud over expenditure exists in SFC due to the complexity and extent of expenditure incurred in carrying out its functions.</p>	<p>Detailed testing of expenditure transactions focusing on the areas of greatest risk.</p> <p>Review actions taken in respect of NFI data matches.</p>	<p>We found no significant issues from our detailed testing of expenditure.</p> <p>SFC has been pro-active in investigating NFI matches.</p>
<p>3 Grant payments to colleges and universities</p> <p>The main activity of SFC is the award and payment of grants to colleges and universities.</p>	<p>Detailed testing of grant funding controls.</p> <p>Substantive testing of formula-based grant awards to individual bodies.</p>	<p>We found no issues from our testing of grant funding controls.</p> <p>We found no misstatements of grant payments to institutions from our sample testing of in year</p>

Due to the complexities around different year end dates and re-profiling of budgets, there is a risk that grants paid to institutions are incorrectly recorded in the financial statements.

Sample testing of grant commitments at the year end.

Substantive cut-off testing of grant payments to ensure they are recognised in the correct financial year.

grant payments and commitments relating to the remainder of the academic year 2019/20.

We found no significant issues from our cut-off testing of grant payments.

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

4 Financial sustainability

SFC and the colleges and universities it funds face financial pressures including increasing pay and pension costs.

SFC has provided colleges and universities with financial planning assumptions covering a six and four-year period respectively, but its own financial plans for its sector budgets continue to cover a one-year period.

There is a risk that SFC does not have the information available to support a longer-term view of its financial position and its options for future funding.

We reviewed SFC's progress in preparing medium to long-term financial plans for the further and higher education sectors.

We considered SFC's arrangements for monitoring and reporting on the financial health of institutions.

SFC is continuing to develop its own medium to long-term financial plans for the sectors.

SFC is working closely with colleges and universities to help them understand and manage the significant financial impact of Covid-19.

SFC should use its more detailed picture of the financial position of colleges and universities to inform the development of its own medium to longer-term financial plans.

See Appendix 1, action plan point 4

5 Value for money

We reported last year that there is scope for SFC to tell a clearer story about how it spends its money and what it achieves in the performance report section of its annual report and accounts. This includes its use of financial transactions funding.

Since then, the 'Finances of Scottish universities' report identified scope for SFC to improve its reporting on universities finances. In addition, the Enterprise and Skills Strategic Board 'missions' represent a change in SFC's operating environment, with implications for performance reporting.

There is a risk that SFC does not have appropriate disclosures and is not reporting fully and transparently on key performance measures.

We reviewed SFC's performance report.

We reviewed SFC's progress in addressing the recommendations in the 'Finances of Scottish universities' report.

We reviewed progress in performance reporting and alignment with the Strategic Board's 'missions'.

Due to reduced reporting requirements in 2019/20 SFC did not include a performance analysis within the performance report. This means that SFC has not been able to demonstrate improvement in this area.

SFC is taking action to address the recommendations, as set out in a letter to the Scottish Parliament's public audit committee dated 21 February 2020.

SFC's Strategic Framework 2019-2022 links SFC's work and performance to the Strategic Board's four missions.

See Appendix 1, action plan point 5

6 Workforce capacity

There are increasing demands on SFC's resources. This includes work to support the Enterprise and Skills Strategic Board, preparing for the implications of EU withdrawal and administering ESF funding to colleges.

There is a risk that SFC does not have adequate resources to carry out its core functions and meet the objectives set out in its strategic plan, the Strategic Framework 2019-2022.

Monitored SFC's progress in implementing its workforce plan.

Internal audit completed a review of workforce planning as part of its 2019/20 plan. We reviewed the findings of this report to inform our wider governance work.

The report included two key recommendations:

- SFC should expand the horizon of the workforce plan to consider the medium to longer term needs of the organisation.
- Succession planning is important for SFC to ensure the continuity of its operations on a long-term basis.

See Appendix 1, action plan point 3

Appendix 3

Summary of national performance reports 2019/20

		 2019/20 Reports	
		Apr	
Social security: Implementing the devolved powers		May	
Scotland's colleges 2019		Jun	 Enabling digital government
		Jul	
NHS workforce planning - part 2		Aug	
Finances of Scottish universities		Sept	
NHS in Scotland 2019		Oct	
		Nov	
Local government in Scotland: Financial overview 2018/19		Dec	
Scotland's City Region and Growth Deals		Jan	 Privately financed infrastructure investment: The Non-Profit Distributing (NPD) and hub models
		Feb	
		Mar	 Early learning and childcare: follow-up

The following reports may be particularly relevant to SFC:

[Scotland's colleges 2019](#) – June 2019

[Enabling digital government](#) – June 2019

[Finances of Scottish universities](#) – September 2019

Scottish Funding Council

2019/20 Annual Audit Report

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