

The Skills Development Scotland Co. Limited

2019/20 Annual Audit Report



 AUDIT SCOTLAND

Prepared for Skills Development Scotland and the Auditor General for Scotland

June 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 SDS give a true and fair view of the state of affairs of SDS and its group as at 31 March 2020 and of the group's comprehensive income for 2019/20.
- 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 and operated within its budget in 2019/20. Key controls within core financial systems operated as expected.
- 5 SDS received £19 million advance funding from the Scottish Government in 2019/20 to support cashflows during the suspension of European Social Fund (ESF) programmes. SDS' 2019/20 accounts include £41 million of accrued income, reflecting its estimate of the ESF funding it expects to receive in due course. The ESF position is central to SDS' finances and it will need to keep this under close review during 2020/21.

Financial sustainability

- 6 SDS recognises the need for further budget adjustments to achieve financial balance in 2020/21. It also faces potential cashflow difficulties due to the delays in receiving ESF funding. SDS is in discussion with the Scottish Government which has confirmed its continuing financial support for SDS.
- 7 SDS has yet to evaluate the full impact of the Covid-19 pandemic on its longer-term financial plans and is currently modelling scenarios in discussion with the Scottish Government. SDS has identified key risks to services and will need to be responsive to changing demands.
- 8 SDS has developed a five-year capital plan.

Governance and transparency

- 8 The governance arrangements at SDS support effective oversight of the organisation's activities and finances. SDS has made appropriate adjustments to governance in response to the impact of Covid-19.
- 9 The strategic report in SDS' annual report provides a comprehensive overview of SDS' performance, with scope for further improvement.

Value for money

- 10** The SDS Strategic Plan 2019-2022 is aligned with the Enterprise and Skills Strategic Board's strategic plan. SDS further improved its performance management in 2019/20 and is developing a revised framework with the other enterprise agencies to underpin the Strategic Board's plan.
- 11** SDS demonstrates appropriate arrangements to secure best value, and good practice in promoting equalities.

Introduction

1. This report summarises the findings from our 2019/20 audit of Skills Development Scotland (SDS).

2. The scope of our audit was set out in our annual audit plan, presented to the 12 December 2019 meeting of the Audit and Risk Committee (ARC). This report comprises the findings from:

- our audit of SDS' 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:

- an audit of SDS' 2019/20 annual report and accounts including the issue of an independent auditor's report setting out our audit opinions
- a review of SDS' key financial systems
- consideration of the four audit dimensions.

4. In common with all organisations, SDS has had to respond to the global coronavirus (Covid-19) pandemic. This affected the final month of the 2019/20 financial year and will continue to have significant impact in 2020/21, in particular on the national training programmes (NTP), provision of career information and guidance and other SDS services such as Partnership Action for Continuing Employment (PACE).

5. As we undertook our audit planning work prior to the pandemic, we reviewed our assessment of audit risks and the planned audit work again in May 2020 and concluded that they remained relevant.

Adding value through the audit

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

- identifying and providing insight on significant risks, and making clear and relevant recommendations
- 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 financial sustainability.

7. During 2019/20, we provided additional insight into the timing of the application of a new accounting standard on leasing. More recently, in response to questions from SDS about the application of the going concern basis of accounting, we provided information based on our understanding of the technical issues affecting audit considerations of going concern in the public sector context.

Responsibilities and reporting

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

9. SDS 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, responsible officers and dates for implementation. It also includes any outstanding actions from last year and progress against these.

Auditor Independence

13. Auditors appointed by the Accounts Commission or 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 £85,696 remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

15. 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 in due course.

16. We would like to thank the management and staff who have been involved in our work for their cooperation and assistance during the audit.

Part 1

Audit of 2019/20 annual report and accounts



Main judgements

The financial statements of SDS give a true and fair view of the state of affairs of SDS and its group as at 31 March 2020 and of the group's comprehensive income for 2019/20.

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

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

The annual report and accounts are the principal means of accounting for the stewardship of resources and performance.

Our audit opinions on the annual report and accounts are unmodified

17. SDS board approved the annual report and accounts for the year ended 31 March 2020 on 26 June 2020. 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.

18. The working papers provided with 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 annual report and accounts were signed off within the agreed timescales

19. The unaudited annual report and accounts were received in line with our agreed audit timetable on 5 May 2020. Both SDS and Audit Scotland staff operated remotely but were able to complete the audit within agreed timescales. SDS notified us of changes to its annual report late in the audit which resulted in additional audit work. We would request that in future all management reviews are

complete before the annual report and financial statements are provided to us for audit.

20. Conducting the audit under lockdown presented challenges to the SDS finance team and the Audit Scotland audit team. We are pleased that the approach taken by both teams has enabled completion of the audit in accordance with the timetable set out in the audit plan.

Overall materiality is £2.66 million

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

22. 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 | £2.66 million |
| Performance materiality | £1.60 million |
| Reporting threshold | £50,000 |

Source: Audit Scotland

Appendix 2 identifies the main risks of material misstatement and our audit work to address these

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

24. We undertook our planning work and issued our 2019/20 annual audit plan in December 2019, prior to the Covid-19 pandemic. In line with auditing standards and professional advice, including the [Financial Reporting Council's Covid-19 bulletin](#) published in March 2020, we reviewed our assessment of audit risks and the planned audit work in May 2020 and concluded that they remained relevant. There have not been any changes to audit risks, our audit approach and the timing of our audit.

25. We have reported matters arising from our work on the risks of material misstatements. These relate mainly to the European Social Fund funding and financial management and financial sustainability risks and are included in the action plan at [Appendix 1](#).

Significant findings to report on the annual report and accounts

26. 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. 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

Resolution

1. European grant income accrual

SDS is a delivery partner for two European Social Fund (ESF) programmes. The Scottish Government (the Managing Authority for ESF programmes in Scotland) was placed in pre-suspension in spring 2019 and full suspension in late 2019. This meant that SDS was unable to make claims. It received only minor payments during that time.

In response to ESF audit findings, SDS made changes to the largest of its two programmes, Developing Scotland's Workforce (DSW). These were agreed by the Managing Authority in late May 2020. SDS expects this will allow it to make claims for this programme in the near future.

SDS' claims will be based on its underlying expenditure. Once submitted, they will be verified by the Managing Authority prior to the Scottish Government reimbursing SDS.

SDS recorded a £41 million income accrual in its 2019/20 accounts, of which £32 million relates to the DSW programme and £9 million to the National Third Sector Fund (NTSF). We consider this to be an accounting estimate as the level of income SDS will receive from the Scottish Government will depend on the results of verification.

SDS did not disclose this estimate in the note on critical accounting estimates and judgements as it considered the income accrual to be a calculation rather than an estimate. Additionally, it did not adjust the value of the accrual to allow for the management's estimation uncertainty which it felt would be difficult to define.

After discussion, and based on best information available to it, SDS calculated an estimation uncertainty based on previous experience of the ESF process. It applied the estimation uncertainty to the amount of income accrued in its accounts, in accordance with accounting standards. SDS total comprehensive income therefore decreased and its total liabilities increased by this amount.

SDS also added a disclosure to note 2 (critical accounting estimates and judgements) to reflect that the ESF accrual is an estimate and the work performed to assess the degree of estimation uncertainty.

We concluded that the estimation uncertainty applied to the income accrual and the disclosure in the updated note 2 were appropriate.



[Recommendation 1](#)
(refer [Appendix 1, action plan](#))

2. Governance statement

The Scottish Public Finance Manual requires the governance statement to be supported by signed certificates of assurance from all directors and senior directors. Three forms were outstanding, awaiting the Scottish Government's approval of the changes to the DSW programme as described above. As a result, the governance statement presented for audit required updating to reflect the updated position.

In addition, the governance statement did not adequately disclose the impact of the Covid-19 pandemic and the associated uncertainties.

Upon the Scottish Government's approval of SDS' change request for its DSW programme, the remaining certificates of assurance were signed.

The governance statement was also updated to reflect the current ESF situation and the impact of the Covid-19 pandemic more fully.

We confirmed that the revised governance statement meets the requirements.

Resolution

3. Consolidated statement of cash flows

SDS included the additional cash of £19 million, received from the Scottish Government to support cashflows during the suspension of ESF, within the wrong line in the consolidated statement of cash flows. As a result, the 'total cash received' and 'cash paid to suppliers and employees' were both understated by £19 million. There is no overall impact on the total cash flows from operating activities or on the bottom line.

SDS agreed to amend the disclosure and include the £19 million cash within the total cash received.

We are content that SDS appropriately amended the consolidated statement of cash flows.

Source: Audit Scotland

Other matters noted during the audit of the financial statements

27. There were no misstatements above our reporting thresholds identified from our audit. In paragraphs below we highlight other matters noted during our audit.

28. SDS' subsidiary WBL Scotland was dissolved in November 2019 at which point £5.1 million was transferred to SDS. SDS committed to using this money in accordance with WBL's objectives to improve employability and enterprise skills of the people of Scotland and to increase participation in learning and employment, subject to the availability of resource budget allocation from Scottish Government. We are content that the accounting entries for the transfer of cash were appropriate.

29. Following prior year recommendations, SDS implemented its new capital policy in 2019/20. In particular, it capitalised its spending on office upgrades and the purchase of mobile phones to the cumulative value of £1.2 million. This has further enhanced SDS' financial reporting and financial management.

30. Last year we reported that there was scope for SDS to improve reporting on its performance in the strategic report part of its annual report. While some improvements have been made, we concluded that there is scope for further improvement in the future years as set out in Part 4 of this report.

SDS has made good progress with prior year recommendations

31. SDS has made good progress in implementing our prior year audit recommendations, with both actioned. A revised response and timescale has been agreed with management and are set out in [Appendix 1](#).

Part 2

Financial management



Main judgements

SDS has effective arrangements for financial management operated within its budget in 2019/20. Key controls within core financial systems operated as expected.

SDS received £19 million advance funding from the Scottish Government to support cashflows during the suspension of European Social Fund (ESF) programmes. SDS' 2019/20 accounts include £41 million of accrued income, reflecting its estimate of the ESF funding it expects to receive in due course. The ESF position is central to SDS' finances and it will need to keep this under close review during 2020/21.

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

SDS operated within its budget in 2019/20

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

33. In 2019/20 SDS reported an outturn of £220.3 million, remaining within its overall budget with an underspend of £1.1 million. [Exhibit 4](#) shows its financial performance against Departmental Expenditure Limits (DEL).

Exhibit 4 Performance against DEL in 2019/20

| Performance | Initial budget £m | Final budget £m | Outturn £m | Over (under) spend £m |
|--------------|----------------------|--------------------|---------------|-----------------------------|
| Resource DEL | 220.1 | 219.4 | 219.1 | (0.3) |
| Capital DEL | | 2.0 | 1.2 | (0.8) |
| Total DEL | 220.1 | 221.4 | 220.3 | (1.1) |

Sources: SDS Annual Report and Financial Statements for the year ended 31 March 2020, SDS Budget Allocation and Monitoring letter, May 2019 and SDS Budget Allocation and Monitoring letter, March 2020.

34. The approved SDS budget for 2019/20 included expenditure of £260.9 million. This represented an increase in SDS' resource allocation of around £10 million on

2018/19 as SDS aimed to deliver more apprenticeship places. Similar to previous years, the funding allocation from the Scottish Government identified £10.4 million through the autumn and spring budget revisions. This was subsequently reduced to £5.7 million, largely as a result of the requested efficiency savings of around £5 million. Despite the reduction in its resource DEL, SDS increased the number of apprenticeships to meet the overall new target of 29,000.

35. Following our recommendation in 2018/19, SDS changed its accounting policy in 2019/20 and reported capital spend of £1.2 million as it capitalised its property, plant and equipment for the first time. This represented an underspend of £0.8 million on its capital allocation of £2 million which was a transfer from its resource DEL.

36. SDS continued to provide regular, timely and up-to-date information on the financial position to the board and its committees. This allowed SDS board members to monitor and question aspects of SDS' finances and helped to ensure that SDS remained within its overall resource allocation for the year.

SDS received £19 million advance funding from the Scottish Government to support the continued delivery of national training programmes

37. Last year we reported that SDS identified a risk to its cash flow should it not receive funds due under the European Social Fund (ESF) programmes. With the ESF programmes in suspension, the risk materialised and SDS received only £0.9 million during 2019/20. SDS regularly presented its cash flow position to the board and to the Scottish Government, identifying the need for additional cash towards the end of the 2019/20 financial year.

38. This resulted in the Scottish Government providing SDS with additional cash of £19 million in March 2020 to support the continued delivery of NTP which ensured that SDS' working capital remained at an appropriate level.

Financial systems of internal control are operating as expected

39. As part of our audit we identify and inspect the key internal controls in accounting systems which we regard as significant to produce the financial statements. Our objective is to gain assurance that controls within the core financial systems are operating as expected. We found no significant issues from this work.

40. We also considered the main processes and controls used in the administration of the NTP. In our 2019/20 management report we concluded that effective controls were in place but, as 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.

41. SDS acknowledge this and state that other controls mitigate the risk. These include the work of the skills investment advisors and the compliance/ fraud error protection team, automated checks within the Funding Information and Processing System (FIPS) system and training providers' annual declaration of compliance with programme rules. While we accept these mitigate the risk to some degree, we are required to highlight this matter. In line with previous years' audit approach, we extended our substantive testing of NTP payments to training providers and found no issues.

SDS has a new shared internal audit service

42. In 2019/20, SDS' internal audit function was carried out under a new shared service arrangement managed by Scottish Enterprise which subsequently extended services to the Scottish Funding Council and the South of Scotland Enterprise Agency. We considered the work of internal audit in a number of areas such as its review of controls in key financial systems, Strategic Board alignment

and strategic planning, Skills Alignment, graduate and foundation apprenticeships and EIS partnership review.

43. The Public Sector Internal Audit Standards (PSIAS) require the head of internal audit to provide an annual internal audit opinion and report that can be used to inform the annual governance statement. The opinion provided in 2019/20 concludes an overall good level of assurance on SDS' framework of governance, risk management and management control. This opinion extends to the Enterprise Information Systems (EIS), ICT shared services. A firm of accountants provides internal audit services for EIS, and this is overseen by the new internal audit shared service arrangement.

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

44. SDS 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.

45. We have reviewed the arrangements to maintain standards of conduct through the codes of conduct in place for both staff and board Members. There are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.

46. 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.

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

47. In our 2019/20 management report we concluded that SDS had appropriate arrangements to mitigate the risk of fraud in procurement activities. The report noted that internal audit has not carried out a specific review of procurement since the 2015/16 financial year. The draft internal audit plan for 2020/21 includes a review of procurement.

Part 3

Financial sustainability



Main judgements

SDS recognises the need for further budget adjustments to achieve financial balance in 2020/21. It also faces potential cashflow difficulties due to the delays in receiving ESF funding. It is in discussion with the Scottish Government which has confirmed its continuing financial support for SDS.

SDS has yet to evaluate the full impact of the coronavirus Covid-19 pandemic on its longer-term financial plans and is currently modelling scenarios in discussion with the Scottish Government. SDS has identified key risks to services and will need to be responsive to changing demands.

SDS has developed a five-year capital plan which estimates annual spending in areas such as computer hardware, property refurbishment and new lease obligations.

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.

SDS recognised the need for further work and adjustments to its 2020/21 budget to ensure a balanced financial position in year

48. The 2020/21 SDS budget, approved by the board in March 2020 incorporated £3.4 million of a funding gap. Of this, SDS believes it can manage £1.6 million through efficiency savings but a gap of £1.8 million remains. Additionally, the voluntary severance scheme is likely to result in £0.3 million less savings during 2020/21 than initially planned.

49. In addition to known financial challenges before the Covid-19 pandemic, SDS has yet to evaluate the impact of Covid-19 on SDS' longer-term finances and is currently modelling scenarios in discussion with the Scottish Government. SDS has however identified a number of key risks to its service delivery during 2020/21 and in future years. They include inability to meet demand for Partnership Action for Continuing Employment (PACE) services, the configuration of Career Information, Advice and Guidance (CIAG) services, and training providers' financial hardship compromising the delivery of apprenticeships.

50. These risks are likely to have a significant impact on SDS' spending, for example payments to training providers may be affected where the provider is not delivering agreed service levels.

51. The Scottish Government has requested SDS to put in place a grant scheme to support training providers during the lockdown period. Additionally, SDS is designing innovative options to support individuals and the economic infrastructure. For example, it is leading the 'Keep Scotland Working' initiative, looking at apprenticeships in the current situation. Given the wider economic impact of the pandemic, there is also likely to be greater demand for SDS services such as PACE. SDS will therefore need to keep its budget under close review.

52. The level of uncertainty caused by the pandemic is reflected in the Scottish Government's decision to delay issuing the Strategic Letters of Guidance to all Enterprise and Skills agencies until later in 2020. In the meantime, the Scottish Government has issued an interim letter advising that all but the most critical 'business as usual' activity must be re-evaluated and halted, unless it is clearly contributing to the challenges of the pandemic.

53. The interim letter of guidance requests SDS to be flexible, responsive and to work collaboratively where possible. We have previously highlighted that SDS has an effective longer-term financial plan which is underpinned by scenario planning. This means that SDS is well placed to cost a range of scenarios, such as different volumes of apprenticeships. This ability to plan for different scenarios will be vital to ensure that SDS can be flexible and responsive to its financial position and the changing demands upon its services.

SDS faces further potential cash flow issues in 2020/21 due to a delay in receiving ESF funding

54. As reported in Part 1, SDS' accounts include an ESF income accrual of £41 million (£21 million in 2018/19) due to suspension of ESF programmes. SDS expects that the changes to the DSW programme, recently agreed by the Scottish Government, will allow it to make claims for ESF income in the near future.

55. There is a risk, as a result of the Covid-19 pandemic, that claims processing and verification is delayed, leading to further cash flow issues for SDS later in this financial year. This is another factor which underlines the need for SDS to keep its financial plans under close review during 2020/21. SDS has included this as one of the key risks in its corporate risk register and is in discussion with the Scottish Government which has confirmed its continuing financial support for SDS.



Recommendation 1

SDS should continue to keep its financial plans under close review during 2020/21 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 and response to the Covid-19 pandemic.

SDS has developed a five-year capital plan

56. Last year we recommended that SDS should 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.

57. We are pleased to report that SDS has developed a five-year capital plan. In 2019/10 it received a capital allocation of £2 million and it capitalised £1.2 million of its spending on the upgrade of office accommodation and the purchase of mobile phones. It also plans to spend a further £1.4 million on property refurbishment in 2020/21 although this may change as a result of the pandemic.

Part 4

Governance and transparency



Main judgements

The governance arrangements at SDS continue to support effective oversight of the organisation's activities and finances. SDS has made appropriate adjustments to its governance arrangements as a result of the Covid-19 pandemic.

The strategic report in SDS' annual report provides a comprehensive overview of SDS' performance, with scope for further improvement.

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.

SDS governance arrangements continue to support effective oversight of the organisation's activities and finances

58. SDS has appropriate governance arrangements in place. It 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). Recent meetings have been conducted virtually as a result of the lockdown caused by the Covid-19 pandemic.

SDS has made appropriate adjustments to its governance arrangements as a result of the Covid-19 pandemic

59. SDS has made appropriate adjustments to its governance arrangements as a result of the Covid-19 pandemic. At the start of the lockdown, all SDS employees already had the necessary equipment to allow them to work remotely. SDS established the Senior National Incident Management Team to manage its Covid-19 response, provided regular briefings to the board chair, and arranged for board and committee meetings to take place virtually. This has meant that SDS has been able to continue operating during the lockdown period put in place by the Scottish Government in response to the Covid-19 pandemic.

60. Internal audit reported in June 2020 that SDS' response to Covid-19 was swift and that SDS satisfactorily addressed each of the key risk areas identified by the Business Continuity Institute in its guidance on coronavirus organisational preparedness. This included quick updates to the corporate and departmental risk registers, reallocating staff to respond to increased PACE needs, and timing of ongoing communications with staff and the board. Internal audit also reported that SDS worked with the Scottish Government, training providers and other stakeholders to provide information and support during this fast-moving situation. As highlighted in Part 3 of this report, there are likely to be changing levels of demand upon SDS' services and its staff as a consequence of the economic impact from the pandemic. SDS will therefore need to keep its governance arrangements under ongoing review.

Openness and transparency

61. There continues to be an increasing focus on demonstrating the best use of public money. Openness and transparency in how SDS operates and makes decisions is key to supporting understanding and scrutiny. Transparency means that the public have access to understandable, relevant and timely information about how the board is taking decisions and how it is using resources such as money, people and assets.

62. 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.

63. 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. It may be, for example, that further information about its finances and the steps it is taking in response to the impact of Covid-19 would assist stakeholders' understanding of the challenges SDS is facing, and the basis on which its decisions are made.

The strategic report met the requirements of the Companies Act but there is scope for further improvement

64. In addition to the opinion on the performance report covered in Part 1 of this report, we also consider the qualitative aspects of SDS' performance report. A performance report should provide information on a body, its main objectives and the principal risks it faced. It should provide a fair, balanced and understandable analysis of a body's performance as well as helping stakeholders understand the financial statements.

65. SDS reports its performance in the strategic report part of its annual report. As SDS is required to follow the Companies Act, our testing ensured that the strategic report complied with related guidance. While we were satisfied that the guidance had been met and are pleased to note some improvements on last year, in our view there is scope for further improvement. This might include, for example, clearer articulation of links between risks and uncertainties and performance and use of key performance indicators for reporting performance. More context could also be added around some achievements and the impact of the Covid-19 pandemic could have been made clearer in the unaudited accounts.



Recommendation 2

SDS should consider making further improvements to its strategic report to enhance understanding of its performance. These include the clearer linking of risks and uncertainties to its performance and the use of key performance indicators. More context could also be added around some achievements.

EIS governance arrangements have improved and work is ongoing to strengthen cyber security

66. Information technology services for SDS are mostly managed by the Enterprise Information Services (EIS). The EIS Partnership Board provides the strategic oversight of the EIS partnership (also involving Scottish Enterprise and Highlands

and Islands Enterprise) which has been in place for just over 10 years. From April 2020, the South of Scotland Enterprise Agency has also joined the partnership.

67. The partnership has appointed a specialist internal auditor for EIS. Its September 2019 report on cyber security was graded 4 (the second highest priority for attention) with a recommendation to carry out a cyber maturity assessment. EIS is currently implementing this recommendation with the assessment due to conclude in summer 2020. Going forward, the partnership will need to consider the maturity level it wants to achieve. After any identified gaps are addressed, the partnership may look to achieve Cyber Essentials+ accreditation.

68. Internal audit also assessed EIS governance and strategy at grade 3. We found EIS strengthened its governance arrangements in response to this report:

- The shared services programme board has been introduced which deals with day-to-day management matters
- The security council has been introduced to deal with security matters, including cyber security
- The product council is responsible for creating, discussing and putting in place shared services and products. Its role has changed and is now partner led instead of technology led.

69. All partners agree that EIS is an appropriate delivery vehicle for information technology and that greater convergence of digital provision is desirable. More work is ongoing and we will continue to monitor developments as part of our audits.

Part 5

Value for money



Main judgements

The SDS Strategic Plan 2019-2022 is aligned with the Enterprise and Skills Strategic Board's strategic plan.

SDS made further improvements to its performance management arrangements and is developing a performance management framework with the other enterprise agencies to underpin the Strategic Board's strategic plan.

SDS demonstrates appropriate arrangements to secure best value, and good practice in promoting equalities.

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

SDS is developing a performance framework with the other enterprise agencies to underpin the Strategic Board's strategic plan

70. Last year we referred to the Enterprise and Skills Strategic Board's new strategic plan. The plan set out the Strategic Board's 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 plan also included a high-level performance framework.

71. SDS is currently working to develop a more detailed performance framework to underpin the plan, aligned with its missions and demonstrate contribution to the Scottish Government's national performance framework. It is taking this forward with Scottish Enterprise, Highlands and Islands Enterprise and the Scottish Funding Council. A new framework is expected to be presented to the strategic board in September 2020.

The SDS strategic plan 2019-22 is aligned with the Strategic Board's strategic plan

72. SDS has developed a new strategic plan for 2019-2022 to reflect significant changes in its internal and external operating environments, including the publication of the Enterprise and Skills Strategic Board's strategic plan published in October 2018. Internal audit report on strategic board alignment confirmed that the SDS strategic plan demonstrates clear alignment with the Strategic Board's strategic plan. The internal audit report on strategic planning also confirmed that the SDS strategic plan is appropriately linked to the SDS operating plan for 2019/20.

SDS made further improvements to its performance management arrangements

73. Last year we highlighted that SDS had appropriate performance management arrangements in place, with some minor areas for improvement. Our follow-up work included discussions with SDS staff and review of internal audit's report on strategic planning. In our 2019/20 management report we concluded that SDS has made good progress in addressing the areas we highlighted. This included:

- developing a revised corporate performance framework to support the new SDS strategic plan;
- assigning unique references to performance indicators
- improvements to efficiency and quality of performance data collection.

74. In addition, SDS has also identified 16 key performance indicators with each mapped to the four goals in the SDS strategic plan. More details are contained in our 2019/20 management report which was submitted to the ARC in March 2020.

SDS demonstrates appropriate arrangements to secure Best Value

75. *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.

76. In 2019, SDS prepared a Recognised for Excellence Award submission to Quality Scotland which is the Scottish National Partner Organisation (NPO) of the European Foundation for Quality Management. SDS believes this submission highlighted the organisation's approach to striving for best in class in many best value attributes. The result of Quality Scotland's review of SDS' submission will be announced in June 2020.

77. Our high-level review of the SDS' submission and confirmed that it can be mapped to the seven Best Value characteristics set out by the SPFM. We therefore concluded that SDS has appropriate arrangements in place to secure Best Value.

SDS demonstrates good practice in promoting equalities

78. Fairness and equality are one of the Best Value characteristics listed in the SPFM. We reviewed how SDS demonstrates its compliance with the 2010 Equalities Act, and how it advances equalities within the organisation and in its business activities.

79. Our 2019/20 management report concluded that SDS demonstrates that equalities and diversity have a prominent place at the centre of its business. Furthermore, SDS has achieved a number of significant outcomes in promoting equalities and, in our view, demonstrates good practice in this area.

National performance audit reports

80. 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 2019/20 which were of direct interest to SDS, there were others with some wider relevance. These are outlined in [Appendix 3](#).

81. Currently SDS does not have a process in place to consider and review national reports at board or committee level. We have been advised that it considers them at an operational level.

Appendix 1

Action plan 2019/20



| No. | Issue/risk | Recommendation | Agreed management action/timing |
|-----|---|--|---|
| 1 | <p>ESF income accrual and potential cash flow issue</p> <p>SDS' accounts for 2019/20 contains an income accrual of £41 million in relation to European grant monies. This is based on incurred expenditure extending back over several years and as a result has placed a strain on SDS' cashflow.</p> <p>SDS may also find increased demands on some of its services as a result of the economic impact from the Covid-19 pandemic.</p> <p>Risk – SDS requires to reduce or delay spending during 2020/21 as a result of a shortage of available cash and does not have sufficient funds to meet the potential increased demand for its services due to Covid-19.</p> | <p>SDS should continue to keep its financial plans under close review during 2020/21 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 and response to the Covid-19 pandemic.</p> <p>Paragraphs 48 - 55</p> | <p>SDS has cashflow assurances from Scottish Government. Additionally, SDS has continued its active financial management including regular meetings with SG sponsor team officials. This is supplemented by extensive scenario modelling and the development of initiatives requiring realignment or expansion of current budget. SDS shared some of this information with SG in May and June 2020. It is anticipated that this work will continue throughout the year</p> <p>Responsible Officer – Director of Finance Information Governance Resilience and Risk</p> <p>Agreed date - Ongoing</p> |
| 2 | <p>Scope for improvements to the strategic report</p> <p>SDS' strategic report within the annual report and accounts found complies with the Companies Act requirements but there is scope for further improvement.</p> <p>Risk – The reader may not get a comprehensive picture of the organisation's in-year performance and risks to performance in the future.</p> | <p>SDS should consider making some further improvements to its strategic report, such as increased contextual data around achievements, clearer links between risks and performance and the use of its agreed key performance indicators.</p> <p>Paragraphs 64 - 65</p> | <p>Performance reporting is subject to ongoing and iterative review at executive level and at the FOP Committee</p> <p>Responsible officer – Senior Director Enabling Services</p> <p>Agreed date – Ongoing</p> |



No. Issue/risk

Recommendation

Agreed management action/timing

Follow up of prior year recommendations

| | | | |
|---|---|--|---|
| 1 | <p>Potential cash flow issue</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>Risk</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>Complete/ Ongoing</p> <p>During 2019/20 SDS regularly reported its cash flow position to the board and to the Scottish Government. This resulted in SDS receiving advance funding of £19 million from the Scottish Government to support the continued delivery of the national training programmes in light of suspension of ESF funding.</p> <p>(refer action plan point 1)</p> |
| 2 | <p>Capital accounting and planning</p> <p>SDS did not capitalise relevant expenditure in 2018/19 although a new accounting policy for property, plant and equipment requires it. 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. The introduction of a new accounting standard in 2019/20 (IFRS 16) will result in some spend associated with property leases being capitalised.</p> <p>Risk</p> <p>Investment in SDS's infrastructure is not separated from running costs in financial plans and annual accounts.</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>Complete</p> <p>SDS has prepared a five-year capital plan and included its property, plant and equipment additions in the 2019/20 financial statements.</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](#).

| Audit 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 require 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 includes the risk of management override of controls that results in fraudulent financial statements.</p> | <p>Tested a sample of journal entries.</p> <p>Reviewed the accounting estimates.</p> <p>Tested a sample of accruals and prepayments.</p> <p>Performed cut-off testing, to confirm expenditure and income is accounted for in the correct financial year.</p> <p>Evaluated significant transactions that are outside the normal course of business</p> | <p>Results: Our testing did not identify any issues.</p> <p>Conclusion: Satisfactory.</p> |
| <p>2 Risk of material misstatement caused by fraud in income recognition.</p> <p>As set out in ISA 240, there is a presumed risk of fraud in the recognition of income. There is a risk that income may be misstated resulting in a material misstatement in the financial statements.</p> <p>In 2019/20, SDS expects to receive approximately £38 million of income from sources other than the Scottish Government with £21 million expected from the European Social Fund (ESF). The extent and nature of this income means that, in accordance with ISA 240, there is an inherent risk of fraud.</p> | <p>Reviewed SDS' anti-fraud arrangements.</p> <p>Carried out a walk-through of controls over receivables.</p> <p>Performed analytical procedures on income streams.</p> <p>Carried out detailed testing of revenue transactions focusing on the areas of greatest audit risk such as European income.</p> | <p>Results: We concluded that SDS had appropriate anti-fraud arrangements in place. We also confirmed that key controls over receivables operated as expected and testing of income transactions found no errors. Accounting entries of the ESF income accrual of £41 million, were appropriate. Further findings from our review of the ESF income accrual are provided at risk number 6.</p> <p>Conclusion: Satisfactory.</p> |
| <p>3 Risk of material misstatement in expenditure</p> <p>Most public-sector bodies are net spending bodies and therefore the risk of fraud is</p> | <p>Reviewed SDS' anti-fraud arrangements.</p> <p>Carried out a walk-through of controls over national training programmes, including the</p> | <p>Results: We concluded that SDS had appropriate anti-fraud arrangements in place. We also confirmed that key controls over payables and national training</p> |

| Audit Risk | Assurance procedure | Results and conclusions |
|---|--|--|
| <p>more likely to occur in expenditure.</p> <p>Most of SDS' operating expenditure is on multi-year national training programmes. The mid-year finance report forecasts spending of £138 million in this area, representing 53 per cent of the total 2019/20 expenditure budget. Due to the extent and nature of expenditure there is an inherent risk of fraud.</p> | <p>funding information and processing system (FIPS), and payables.</p> <p>Performed analytical procedures on expenditure streams.</p> <p>Carried out detailed testing of expenditure transactions focusing on the areas of greatest audit risk such as apprenticeship expenditure.</p> <p>Considered internal audit's review of graduate and foundation apprenticeships.</p> | <p>programmes operated as expected with an inherent control risk identified in FIPS. Our testing of expenditure transactions did not identify any significant issues.</p> <p>Conclusion: Satisfactory.</p> |
| <p>4 Estimation and judgements</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>Completed a 'review of the work of an expert' in respect of the actuary including a review of actuarial assumptions.</p> <p>Tested pension disclosures, including data that SDS provides to actuaries.</p> <p>Tested provisions and related disclosures.</p> | <p>Results: Our review of SDS' actuaries did not identify any issues. We concluded that pension and provision disclosures in the accounts were reasonable and appropriate.</p> <p>Conclusion: Satisfactory.</p> <p>(see also European funding below)</p> |
| <p>5 Non-current assets</p> <p>SDS expects to capitalise property development costs and IT upgrades in 2019/20 which will result in the inclusion of tangible non-current assets being disclosed in the financial statements for the first time.</p> <p>As this is a new account area for SDS, there is an inherent risk over completeness and accuracy of these amounts.</p> | <p>Reviewed the new non-current asset register module of SDS' ledger system.</p> <p>Substantively tested non-current assets.</p> | <p>Results: Our review of the asset register and testing of non-current assets did not identify any issues.</p> <p>Conclusion: Satisfactory.</p> |
| <p>6 European funding</p> <p>SDS receives significant amounts of funding from the European Social Fund (ESF). ESF is administered centrally by the European Commission (EC) and managed locally by the Scottish Government, who make payments to lead partners such as SDS. SDS' 2018/19 financial statements included an income accrual of £20.4 million in respect of ESF monies due and SDS forecasts further ESF income of £20.6 million in 2019/20.</p> <p>Due to deficiencies in the arrangements for ESF in Scotland, identified by auditors,</p> | <p>Ongoing review of budget monitoring presented to board and committees.</p> <p>Reviewed correspondence in relation to ESF funds.</p> <p>Ongoing discussions with SDS finance about developments regarding ESF.</p> <p>Reviewed SDS' ESF claims and its internal verification checks.</p> <p>Consider Scottish Government's review of SDS' ESF arrangements, if appropriate.</p> <p>Liaised with the auditors of the Scottish Government to</p> | <p>Results: The working papers supporting ESF expenditure agreed to the accounts and to source documents. On audit recommendation, SDS agreed to allow for the estimation uncertainty by applying error rates from historic ESF claims. We concluded that it applied the estimation uncertainty based on best information available to it and in accordance with accounting standards.</p> <p>Conclusion: Satisfactory.</p> <p>(refer Appendix 1, action plan point 1)</p> |

| Audit Risk | Assurance procedure | Results and conclusions |
|---|--|-------------------------|
| <p>the programme was in 'pre-suspension' and is now suspended until negotiations between the Scottish Government and the EC are concluded. Payments have been suspended since February 2019. This affects all organisations which participate in the ESF programme, including SDS.</p> <p>There is a risk that SDS misstates the ESF income and related accruals in its 2019/20 accounts.</p> | <p>understand developments in this area from a national perspective.</p> | |

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

| | | |
|---|--|--|
| <p>7 Financial management and sustainability</p> <p>There are a range of factors which affect SDS' financial management, including in-year changes to the budget which the Scottish Government allocates to SDS. Elements of SDS' core funding are confirmed through the Autumn and Spring budget revisions. There are also ongoing uncertainties about the amount and timing of ESF funding (see above).</p> <p>There is a risk that financial management and reporting does not keep pace with SDS' changing financial context. There is also a risk that uncertainties about ESF funding affect SDS' cash-flows and operations.</p> | <p>Monitored financial reports provided to the board/committee over the year and compared these with the year-end results in the financial statements.</p> <p>Ongoing discussions with SDS about its financial position, including its working capital levels.</p> | <p>Results: SDS continued to provide regular, timely and up-to-date information on the financial position to the board and its committees. SDS board approved an unbalanced budget for 2020/21 but the impact of the Covid-19 pandemic means that this is expected to be subject to ongoing review over the course of the year.</p> <p>Conclusion: SDS will need to be flexible in its financial planning throughout 2020/21 to manage the impact of Covid-19 pandemic. It will also need to continue to manage an unbalanced budget and the likely cash flow issues as a result of the suspension of ESF programmes. Action plan point 2 at Appendix 1.</p> |
| <p>8 Governance and transparency – cyber security</p> <p>Organisations are increasingly threatened by cyber-attacks. SDS has a shared Enterprise Information Service (EIS) IT arrangement with Scottish Enterprise and (SE) and Highlands and Islands Enterprise (HIE).</p> <p>Internal audit reported on cyber security in September 2019 and identified areas for improvement.</p> | <p>Reviewed progress in addressing the recommendations raised by internal audit.</p> <p>Considered the level of risk in this area at the end of the year when reviewing the governance statement within the annual report and accounts.</p> | <p>Results: Although internal audit noted that SDS made good progress in addressing its recommendations, the remaining recommendations are expected to be addressed once SDS has undertaken a Cyber Maturity Assessment. The draft governance statement presented for audit did not refer to cyber security issues.</p> <p>Conclusion: SDS has made good progress but there is still a risk that a cyber-attack could disrupt SDS' systems. Following an audit recommendation, the governance statement now includes a</p> |

| Audit Risk | Assurance procedure | Results and conclusions |
|--|--|--|
| <p>There is a risk that a cyber-attack could disrupt SDS' systems, including key financial systems.</p> | | <p>reference to cyber security issues.</p> |
| <p>9 Value for money</p> <p>SDS has developed a new Strategic Plan 2019-2022 to reflect significant changes in its internal and external operating environments.</p> <p>There is a risk that the new performance management arrangements are not aligned with the Enterprise and Skills Strategic Board's missions and that, as a result, SDS is unable to demonstrate progress and its contribution to the Scottish Government's National Performance Framework.</p> | <p>Reviewed SDS' strategic plan's alignment with the Enterprise and Skills Strategic Board's missions.</p> <p>Considered the impact of the Strategic Board's strategic plan on SDS' performance management arrangements, in particular whether appropriate measures are in place to report on achievement of its objectives.</p> | <p>Results: We concluded that SDS' strategic plan is clearly aligned to the Strategic Board's plan objectives. SDS made further refinements its performance management arrangements and is planning to submit the new framework to the Strategic Board in September 2020.</p> <p>Conclusion: There is good evidence of progress to embed the Strategic Board's objectives into SDS's strategic plan and SDS is making further refinements to its performance management framework.</p> |

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 |

Reports relevant to SDS:

[Social security: Implementing the devolved powers – May 2019](#)

[Scotland's Colleges – June 2019](#)

[Enabling digital government – June 2019](#)

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

[Scotland's City Region and Growth Deals – October 2019](#)

[Early learning and childcare: follow-up – March 2020](#)

SDS

2019/20 Annual Audit Report

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