

# The Skills Development Scotland Co. Ltd

Annual Audit Plan 2021/22



 AUDIT SCOTLAND

Prepared for Skills Development Scotland

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# Introduction

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## Summary of planned audit work

1. This document summarises the work plan for our 2021/22 external audit of Skills Development Scotland (SDS). The main elements of our work include:

- evaluation of the key controls within the main accounting systems
- an audit of the financial statements, and provision of an Independent Auditor's Report
- an audit opinion on regularity and other statutory information published within the annual report and accounts including the Strategic Report, the Governance Statement and the Remuneration Report
- consideration of arrangements in relation to the audit dimensions that frame the wider scope of public sector audit: financial management, financial sustainability, governance and transparency and value for money
- consideration of Best Value arrangements
- review SDS' participation in the National Fraud Initiative.

## Impact of Covid-19

2. The coronavirus disease (Covid-19) pandemic has had a significant impact on public services and public finances, and the effects will be felt well into the future.

3. Audit Scotland continues to assess the risks to public services and finances from Covid-19 across the full range of our audit work, including annual audits and the programme of performance audits. The well-being of audit teams and the delivery of high-quality audits remain paramount. Changes in our approach may be necessary and where this impacts on annual audits, revisions to this audit plan may be required.

## Adding value

4. We aim to add value to SDS through our external audit by being constructive and forward looking, by identifying areas for improvement and by recommending and encouraging good practice. In so doing, we will help SDS promote improved standards of governance, better management and decision-making and more effective use of resources. Additionally, we attend meetings of the Audit and Risk Committee (ARC) and actively participate in discussions.

## Respective responsibilities of the auditor and SDS

5. The [Code of Audit Practice \(2016\)](#) sets out in detail the respective responsibilities of the auditor and the organisations we audit. Key responsibilities are summarised below.

### Auditor responsibilities

6. Our responsibilities as independent auditors are established by the Public Finance and Accountability (Scotland) Act 2000 and the [Code of Audit Practice](#) (including [supplementary guidance](#)) and guided by the Financial Reporting Council's Ethical Standard.

7. Auditors in the public sector give an independent opinion on the financial statements and other information within the annual report and financial statements. We also review and report on the arrangements within the audited body to manage its performance, regularity and use of resources. In doing this, we aim to support improvement and accountability.

### SDS responsibilities

8. SDS is responsible for maintaining accounting records and preparing financial statements that give a true and fair view.

9. Also, SDS has the primary responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance, propriety and regularity that enable SDS to deliver its objectives.

## Managing the transition to 2022/23 audits

10. Audit appointments are usually for five years but were extended to six years due to Covid-19. 2021/22 is the final year of the current appointment and we will work closely with our successors to ensure a well-managed transition.

# Financial statements audit planning

## Materiality

**11.** Materiality is an expression of the relative significance of a matter in the context of the financial statements as a whole. We are required to plan our audit to determine with reasonable confidence whether the financial statements are free from material misstatement. The assessment of what is material is a matter of professional judgement over both the amount and the nature of the matter arising.

### Materiality levels for the 2021/22 audit

**12.** We assess materiality at different levels as described in [Exhibit 1](#). The materiality values for SDS are set out in [Exhibit 1](#).

## Exhibit 1 2021/22 Materiality levels for SDS

Materiality	Amount
<b>Planning materiality</b> – This is the figure we calculate to assess the overall impact of audit adjustments on the financial statements. It has been set at 1 per cent of gross expenditure for the year ended 31 March 2022, based on the latest financial statements for the year.	£2.6 million
<b>Performance materiality</b> – This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality, this would indicate that further audit procedures should be considered. Using our professional judgement, we have assessed performance materiality at 60 per cent of planning materiality.	£1.5 million
<b>Reporting threshold (i.e. clearly trivial)</b> – We are required to report to those charged with governance on all unadjusted misstatements more than the 'reporting threshold' amount.	£0.10 million

Source: Audit Scotland

## Significant risks of material misstatement to the financial statements

**13.** Our risk assessment draws on our cumulative knowledge of SDS, its major transaction streams, key systems of internal control and risk management

processes. Also, it is informed by our discussions with management, meetings with internal audit, attendance at committees and a review of supporting information.

**14.** Based on our risk assessment process, we identified the following significant risks of material misstatement to the financial statements. These are risks which have the greatest impact on our planned audit procedures. [Exhibit 2](#) summarises the nature of the risk, the sources of assurance from management arrangements and the further audit procedures we plan to perform to gain assurance over the risk.

## Exhibit 2

### 2021/22 Significant risks of material misstatement to the financial statements

Significant risk of material misstatement	Sources of assurance	Planned audit response
<p><b>1.</b> Risk of material misstatement due to fraud caused by the management override of controls</p> <p>As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.</p>	<p>Owing to the nature of this risk, assurances from management are not applicable in this instance</p>	<ul style="list-style-type: none"> <li>• Assess the design and implementation of controls over journal entry processing.</li> <li>• Make inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments.</li> <li>• Test journals at the year-end and post-closing entries and focus on significant risk areas.</li> <li>• Consider the need to test journal entries and other adjustments during the period.</li> <li>• Evaluate significant transactions outside the normal course of business.</li> <li>• Assess the adequacy of controls in place for identifying and disclosing related party relationship and transactions in the financial statements.</li> <li>• Assess any changes to the methods and underlying assumptions used to prepare accounting estimates compared to the prior year.</li> <li>• Substantive testing of income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year.</li> </ul>

Significant risk of material misstatement	Sources of assurance	Planned audit response
<p><b>2. Estimates and judgements – European funding</b></p> <p>SDS receives significant funding from the European Social Fund (ESF) which is administered by the European Commission (EC) and managed by the Scottish Government (SG). The programme was placed in 'full suspension' in November 2019 with payments paused since February 2019. As a result, SDS' 2020/21 financial statements included an income accrual of £58 million in respect of ESF monies due. SDS forecasts that this will increase to around £62 million by March 2022. SDS allows for uncertainty in its accounting estimate through an 'expected credit loss provision' based on historic claim data.</p> <p>There is a risk that SDS misstates the level of the accrual, generally and through its determination of estimation uncertainty.</p>	<ul style="list-style-type: none"> <li>• Regular engagement with the Managing Authority, including attendance at SDS Audit &amp; Risk Committee meeting.</li> <li>• Low incidence of ineligible expenditure identified in previously paid claims for ESF funding provides assurance around SDS's verification checks which precede claim submission and support the valuation of the year-end accrual.</li> <li>• Expected Credit Loss provision is reviewed annually, taking account of all newly available information.</li> <li>• Brought-forward balances are reviewed annually for appropriateness.</li> </ul>	<ul style="list-style-type: none"> <li>• Focussed testing of accounting accruals and prepayments.</li> <li>• Detailed testing of the ESF income accrual including an assessment of estimation uncertainty and related disclosures.</li> <li>• Review of correspondence in relation to ESF funds.</li> <li>• Ongoing review of budget monitoring presented to Board and committees and discussions with SDS finance about ESF developments.</li> <li>• Review of SDS' ESF claims and its internal verification checks.</li> <li>• Liaison with the auditors of the SG on ESF developments from a national perspective.</li> </ul>
<p><b>3. Estimates and judgements – pensions valuations</b></p> <p>SDS is a member of the local government pension scheme and accounts for it as a</p>	<ul style="list-style-type: none"> <li>• Calculations are prepared by the LGPS fund actuary.</li> <li>• Internal consideration</li> </ul>	<ul style="list-style-type: none"> <li>• Review of information provided by SDS to its actuary.</li> <li>• Completion of 'review of the</li> </ul>

Significant risk of material misstatement	Sources of assurance	Planned audit response
<p>defined benefit scheme in line with IAS 19. The present value of the retirement (pension) obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions.</p> <p>This is a risk that changes to supporting assumptions caused by errors in the information provided to the actuary or late information can result in material misstatements.</p>	<p>of the suitability of the proposed financial assumptions.</p> <ul style="list-style-type: none"> <li>• Verification of inputs where possible (eg: employer &amp; employee contributions).</li> </ul>	<p>work of an expert' in respect of the actuary including a review of actuarial assumptions.</p> <ul style="list-style-type: none"> <li>• Testing of pension disclosures, including data that SDS provides to actuaries</li> </ul>

Source: Audit Scotland

**15.** As set out in International Standard on Auditing (UK) 240: *The auditor's responsibilities relating to fraud in an audit of financial statement*, there is a presumed risk of fraud over the recognition of revenue. There is a risk that revenue may be misstated resulting in a material misstatement in the financial statements. We have rebutted this risk for SDS because its material income streams are low risk. These consist of funding from the Scottish Government, recharges from partnership bodies and European grants which is covered under a separate risk (see [Exhibit 2, item 2](#)).

**16.** In line with Practice Note 10: *Audit of financial statements and regularity of public sector bodies in the United Kingdom*, as most public-sector bodies are net spending bodies, the risk of material misstatement due to fraud related to expenditure recognition may in some cases be greater than the risk relating to revenue recognition. We have rebutted this risk for SDS because most expenditure is directly supported by systems where we have previously confirmed that controls operate as expected. In addition, the type of payments involved are not complex and generally relate to contracts or grant agreements.

**17.** The system used for administering most of the national training programmes (NTP) does not have a comprehensive, real-time check when payments are drawn-down by providers. There are mitigating controls such as the work of the compliance team and automated system verification checks to the individual. Further, these payments are low value and there has been a low incidence of frauds in recent years. In light of these circumstances, we concluded that there is a low risk of material fraud in this area. We will though continue to undertake focused tested on NTP payments.

**18.** We have not, therefore, incorporated specific work into our audit plan in these areas over and above our standard audit procedures.

### **Other areas of audit focus**

**19.** As part of our assessment of audit risks, we have identified other areas where we consider there are also risks of material misstatement to the financial statements. Based on our assessment of the likelihood and magnitude of the risk, we do not consider these to represent significant risks. We will keep these areas under review as our audit progresses. If our assessment of risk changes and we consider these risks to be significant, we will communicate this to management and those charged with governance and revise our planned audit approach accordingly.

**20.** The areas of specific audit focus are:

- Significant accruals – these are by their nature estimates and as such there is an element of uncertainty. Previous audit experience has found that these largely arise from well-established processes and systems. This excludes the income accrual in relation to European grants which has been separately identified as a significant risk.

### **Audit risk assessment process**

**21.** Audit risk assessment is an iterative and dynamic process. Our assessment of risks set out in this plan may change as more information and evidence becomes available during the progress of the audit. Where such changes occur, we will advise management and where relevant, report them to those charged with governance.

# Audit dimensions and Best Value

## Introduction

22. The [Code of Audit Practice](#) sets out the four dimensions that frame the wider scope of public sector audit. The Code of Audit Practice requires auditors to consider the adequacy of the arrangements in place for the audit dimensions in audited bodies.

## Audit dimensions

23. The four dimensions that frame our audit work are shown in [Exhibit 3](#).

### Exhibit 3

#### Audit dimensions



Source: Code of Audit Practice

24. In summary, the four dimensions cover the following:

- **Financial management** – financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.
- **Financial sustainability** – as auditors, we consider the appropriateness of the use of the going concern basis of accounting as part of the annual audit. We will also comment on financial sustainability in the longer term. We define this as medium term (two to five years) and longer term (longer than five years).

- **Governance and transparency** – 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.
- **Value for money** – value for money refers to using resources effectively and continually improving services.

## Duty of Best Value

**25.** [Ministerial Guidance to Accountable Officers](#) for public bodies and the [Scottish Public Finance Manual](#) (SPFM) explain that accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value. We will be carrying out a high-level review to confirm that such arrangements are in place within SDS.

## Audit dimension risks

**26.** We have identified audit risks in the areas set out in [Exhibit 4](#). This exhibit sets out the risks, sources of assurance from management arrangements and the further audit procedures we plan to perform to gain assurances over the risks.

### Exhibit 4

#### 2021/22 Audit dimension risks

Description of risk	Sources of assurance	Planned audit response
<p><b>1. Financial management – 2021/22 outturn</b></p> <p>SDS operates a demand led service which makes year-end financial forecasting complicated. Changing economic conditions following the Covid-19 pandemic and EU withdrawal adds to the complexity.</p> <p>Currently SDS is forecasting to spend £6 million less than its initial budget allocation in 2021/22 which it has identified to the Scottish Government. SDS requires to manage this situation and maintain an appropriate working capital balance, in light of this and other pressures such as the</p>	<p>Regular discussions at Board level and with Scottish Government on programme delivery and affordability.</p> <p>Formal monthly Budget Monitoring submissions to Scottish Government.</p>	<ul style="list-style-type: none"> <li>• Review financial reports provided to the board/committee over the year and compare these with the year-end results in the financial statements.</li> <li>• Ongoing enquiry and discussions with SDS about its financial position.</li> <li>• Review relevant correspondence with the Scottish Government regarding the year-end forecast.</li> </ul>

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delayed payment of  
European grants.

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Source: Audit Scotland

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**27.** In addition to the point raised in [Exhibit 6](#), we also plan to monitor the following areas:

- Financial management – review arrangements within SDS to complete the National Fraud Initiative (NFI) exercise
- Financial sustainability – specifically regarding SDS’ intention to restart its longer-term financial planning
- Skills planning – noting progress made on recommendations from the national report [Planning for Skills](#)
- Cyber security – review developments in this area through updates provided to the ARC and relevant internal audit reports.

# Reporting arrangements, timetable, and audit fee

## Reporting arrangements

**28.** Audit reporting is the visible output for the annual audit. All Annual Audit Plans and the outputs, as detailed in [Exhibit 5](#), and any other outputs on matters of public interest will be published on our website: [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).

**29.** Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft management reports will be issued to the relevant officers to confirm factual accuracy.

**30.** We will provide an independent auditor's report to SDS, the Scottish Parliament and the Auditor General for Scotland setting out our opinions on the annual report and accounts. We will provide the SDS and the Auditor General for Scotland with an annual report on the audit containing observations and recommendations on significant matters which have arisen during the audit.

**31.** [Exhibit 5](#) outlines the target dates for our audit outputs. We acknowledge this will be challenging due to the ongoing pressures and uncertainties caused by Covid-19.

## Exhibit 5 2020/21 Audit outputs

Audit Output	Target date	Audit and Risk Committee Date
Annual Audit Plan	28 February 2022	17 March 2022
Independent Auditor's Report	23 June 2022	30 June 2022
Annual Audit Report	23 June 2022	30 June 2022

Source: Audit Scotland

## Timetable

**32.** To support an efficient audit, it is critical that the timetable for producing the annual report and accounts for audit is achieved. We have included a proposed timetable for the audit at [Exhibit 6](#) that has been discussed with management.

**33.** Covid-19 has had a considerable impact on the conduct and timeliness of the audit. We recognise that it is in the best interests of public accountability to get the reporting of audited accounts back to pre-pandemic timelines. To this end, 2021/22 is a transition year with the reporting targets brought forward by one month relative to the two prior years. We are identifying ways to work more efficiently to expedite the 2021/22 audits whilst maintaining high standards of quality.

**34.** We will continue to work in close partnership with management with clarity over timescales and the requirement for high quality unaudited accounts and supporting working papers. Progress will be discussed with management and finance officers over the course of the audit.

## Exhibit 6 Proposed annual report and accounts timetable

 Key stage	 Provisional Date
Consideration of the unaudited annual report and accounts by those charged with governance and senior management	6 May 2022
Latest submission date for the receipt of the unaudited annual report and accounts with complete working papers package.	9 May 2022
Latest date for final clearance meeting with the Director of Finance (or equivalent)	10 June 2022
Issue of final Letter of Representation and proposed Independent Auditor's Report	23 June 2022
Latest date for agreement of audited and unsigned annual report and accounts	23 June 2022
Issue of final Annual Audit Report to those charged with governance.	23 June 2022
Signed Independent Auditor's Report	TBC

Source: Audit Scotland

## Audit fee

**35.** The proposed audit fee for the 2021/22 audit of SDS is £89,310 (2020/21: £87,630). In determining the audit fee, we have taken account of the risk exposure of the SDS, the planned management assurances in place and the level of reliance we plan to take from the work of internal audit.

**36.** Where our audit cannot proceed as planned through, for example, late receipt of unaudited annual report and accounts, the absence of adequate supporting working papers or being unable to take planned reliance from the work of internal audit, a supplementary fee may be levied. An additional fee may also be required

in relation to any work or other significant exercises out with our planned audit activity.

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# Other matters

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## Internal audit

**37.** International standards on Auditing (UK) 610: *Considering the work of internal audit* requires us to:

- consider the activities of internal audit and their effect on external audit procedures;
- obtain an understanding of internal audit activities to inform our planning and develop an effective audit approach that avoids duplication of effort;
- perform a preliminary assessment of the internal audit function when there is scope for relying on internal audit work which is relevant to our financial statements' responsibilities; and
- evaluate and test the work of internal audit, where use is made of that work for our financial statements responsibilities to confirm its adequacy for our purposes.

**38.** From our initial review of the internal audit plans, we do not plan to place formal reliance on internal audit's work for our financial statements' responsibilities. We do plan to consider the findings of Internal Audit across a range of work including:

- Training Provider Compliance
- Financial Management
- Strategic Engagement
- IT Partnership Audit – Cyber Security
- IT Partnership Audit – Governance and Strategy

## Independence and objectivity

**39.** Auditors appointed by the Auditor General for Scotland or Accounts Commission must comply with the [Code of Audit Practice](#) and relevant supporting guidance. When auditing the financial statements, auditors must also comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies. These standards impose stringent rules to ensure the independence and objectivity of auditors. Audit Scotland has robust arrangements in place to ensure compliance with these standards including an annual *'fit and proper'* declaration for all members of staff. The arrangements are overseen by the Director of Audit Services, who serves as Audit Scotland's Ethics Partner.

**40.** The engagement lead (i.e. appointed auditor) for SDS is currently Gordon Smail, Audit Director. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. We are not aware of any such relationships pertaining to the audit of SDS.

## Quality control

**41.** International Standard on Quality Control (UK) 1 (ISQC1) requires a system of quality control to be established, as part of financial audit procedures, to provide reasonable assurance that professional standards and regulatory and legal requirements are being complied with and that the independent auditor's report or opinion is appropriate in the circumstances.

**42.** The foundation of our quality framework is our Audit Guide, which incorporates the application of professional auditing, quality and ethical standards and the [Code of Audit Practice](#) (and supporting guidance) issued by Audit Scotland and approved by the Auditor General for Scotland. To ensure that we achieve the required quality standards, Audit Scotland conducts peer reviews and internal quality reviews. Additionally, the Institute of Chartered Accountants of Scotland (ICAS) have been commissioned to carry out external quality reviews.

**43.** As part of our commitment to quality and continuous improvement, Audit Scotland will periodically seek your views on the quality of our service provision. We welcome feedback at any time, and this may be directed to the engagement lead.

# The Skills Development Scotland Co. Limited

## Annual Audit Plan 2021/22

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[www.audit-scotland.gov.uk/accessibility](http://www.audit-scotland.gov.uk/accessibility)

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