

The Skills Development Scotland Co. Limited

2021/22 Annual Audit Report



 AUDIT SCOTLAND

Prepared for Skills Development Scotland and the Auditor General for Scotland
November 2022

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Key messages

2021/22 annual report and financial statements

- 1 Our audit opinions on the annual report and financial statements are unmodified.
- 2 Significant concerns arose in relation to the ESF income accrual which required further assurances from the Scottish Government to resolve.

Financial management

- 3 SDS operated within its overall revised fiscal resources while meeting its targets in terms of apprenticeship starts.
- 4 SDS is not provided with a capital funding allocation by the Scottish Government despite SDS making capital spending decisions from its overall allocation. While the Scottish Government was informed of these decisions, accountability and budget management would be improved with separate revenue and capital allocations.
- 5 SDS had appropriate and effective financial management in place and was able to accurately forecast a year-end underspend to the Scottish Government. A further £26 million cash advance was provided to SDS in 2021/22 to off-set the impact of delayed ESF funding, with more likely to be required in 2022/23.

Financial sustainability

- 6 SDS set a budget deficit for 2022/23 in light of reduced funding and increased costs, and is developing mitigation plans to meet further funding reductions.
- 7 SDS has still to restart its longer-term financial planning but has established a team to perform this task.

Governance and transparency

- 8 SDS has had appropriate and effective governance arrangements in place throughout the Covid-19 pandemic.
- 9 The performance report was generally of a good standard but could be made more accessible in line with relevant regulations.

Value for money

- 10** SDS is developing a new strategic plan to set out how it will support the Scottish Government's National Strategy for Economic Transformation.
- 11** SDS has started taking action in light of a national audit report on Planning for Skills, but more will be needed to achieve outcomes.

Introduction

1. This report summarises the findings from our 2021/22 audit of Skills Development Scotland (SDS).
2. The scope of our audit was set out in our Annual Audit Plan presented to the 17 March 2022 meeting of the Audit and Risk Committee (ARC). This report comprises the findings from:
 - an audit of the SDS annual report and financial statements
 - consideration of the four audit dimensions that frame the wider scope of public audit set out in the [Code of Audit Practice 2016](#).
3. The main elements of our audit work in 2021/22 have been:
 - an audit of the SDS' 2021/22 annual report and accounts including the issue of an independent auditor's report setting out our opinions
 - a review of the SDS' key financial systems
 - consideration of the four audit dimensions.

Adding value through the audit

4. We add value to the body 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 2](#)) and good practice guides
 - providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability.

Responsibilities and reporting

5. SDS has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and financial statements that are in accordance with the account's direction from the Scottish Ministers.
6. Also, SDS is responsible for establishing appropriate and effective arrangements for governance, propriety, and regularity.
7. 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.

8. 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.

9. Our annual audit report contains an agreed action plan at [Appendix 1](#). It sets out specific recommendations, the responsible officers, and dates for implementation. It also includes any outstanding actions from last year and progress against these.

Auditor Independence

10. 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.

11. 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 the 2021/22 audit fee of £89,310 as set out in our 2021/22 Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

12. 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.

Audit appointment from 2022/23

13. The Auditor General for Scotland is responsible for the appointment of external auditors to central government bodies. External auditors are usually appointed for a five-year term either from Audit Scotland's Audit Services Group or a private firm of accountants. The current appointment round was due to end in 2020/21 but this was extended for a year so that 2021/22 is the last year of the current appointment round.

14. The procurement process for the new round of audit appointments was completed in May 2022. From financial year 2022/23, Audit Scotland's Audit Services Group will continue to be the appointed auditor for SDS.

15. A new [Code of Audit Practice](#) applies to public sector audits for financial years starting on or after 1 April 2022. It replaces the previous Code issued in May 2016.

16. We would like to thank Board members, ARC members, Executive Directors, and other staff, particularly those in finance for their co-operation and assistance over the last six years.

1. Audit of 2021/22 annual report and financial statements

The principal means of accounting for the stewardship of resources and performance

Main judgements

Our audit opinions on the annual report and financial statements are unmodified.

Significant concerns arose in relation to the ESF income accrual which required further assurances from the Scottish Government to resolve.

Our audit opinions on the annual report and financial statements are unmodified

17. The annual report and financial statements for the year ended 31 March 2022 were approved by the SDS Board following the ARC meeting on 3 November 2022. As reported in the independent auditor's report:

- 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 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 the relevant legislation and directions made by Scottish Ministers.

The annual report and financial statements were submitted in line with our agreed audit timetable

18. The unaudited annual report and financial statements were received on 9 May 2022, in line with our agreed audit timetable. The working papers which accompanied the annual report and financial statements were of a good standard. Regular communication and good support from finance staff helped the final accounts audit process run smoothly.

19. Similar to last year, management reviews of the annual report were not complete at the date the audit began. However, subsequent changes were reduced from the prior year. SDS should continue to develop a timetable for the

production of its accounts that allows for a full suite of management review prior to the start of the audit. The agreed management action for this prior year recommendation is summarised in [Appendix 1](#).

20. The issues arising from the ESF income accrual, as detailed in [Exhibit 2](#), and the protracted time taken to reach a resolution, resulted in significant delays to the original agreed audit timetable.

Overall materiality is £2.78 million

21. Our initial assessment of materiality was carried out during the planning phase of the audit. This was reviewed and recalculated on receipt of the unaudited annual report and accounts and is summarised in [Exhibit 1](#).

Exhibit 1 Materiality values

Materiality level	Amount
Overall materiality	£2.78 million
Performance materiality	£1.67 million
Reporting threshold	£110,000

Source: Audit Scotland

22. In determining performance materiality, we considered the following factors:

- our understanding of SDS, including the extent of estimation and judgements in its financial statements relating to European funding and pensions valuations
- the nature and extent of any misstatements identified in previous audits
- any issues identified during the performance of risk assessment procedures.

23. The overall scope of the audit was adapted to incorporate the significant assessed risks of material misstatement included within [Exhibit 3](#). Assurance procedures were performed to ensure each audit risk was addressed.

Significant findings to report on the annual report and financial statements

24. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the body's accounting practices.

25. The significant findings are summarised in [Exhibit 2](#). Where a finding has resulted in a recommendation to management, a cross-reference to the action plan in [Appendix 1](#) has been included.

Exhibit 2

Significant findings from the audit of financial statements

Issue	Resolution
<p>1. European grant income accrual</p> <p>SDS is a delivery partner for two European Social Fund (ESF) programmes. The Scottish Government (SG) is the Managing Authority for ESF programmes in Scotland. Until recently, the programmes were in suspension by the European Commission (EC) which resulted in a pause in payments to delivery partners.</p> <p>As a result of this delay in funding, SDS' accounts presented for audit showed a £61.9 million income accrual based on underlying expenditure. This is an accounting estimate which includes a provision for credit losses of £2.0 million to allow for estimation uncertainty.</p> <p>As the programmes come to an end, a deadline of June 2024 has been set by the EC for the SG to complete the verification of all ESF claims. Delivery partners have until January 2024 to submit all claims. However the SG indicated to the SDS ARC in March 2022 that this timescale was unlikely to be sufficient to complete verification checks. This verification timescale has since been reduced as a result of changes to the sampling approach.</p> <p>Consequently, there is significant uncertainty that outstanding claims accrued as at 31 March 2022 will be verified by June 2024. Given this, there is a risk that SDS materially misstates the ESF income accrual in its accounts due to unknown future events.</p>	<p>The SG provided a letter of assurance to SDS giving a commitment to reimburse all evidenced claims received by January 2024, to meet the June 2024 deadline.</p> <p>The SG also confirmed an alternative approach has been approved by the audit authority which will reduce the required level of sampling to speed up the verification process. A risk and mitigation plan was also developed jointly by SDS and the SG to manage and monitor the ongoing risks.</p> <p>In addition, SDS made adjustments to its accrual in light of findings from the SG regarding the procurement of foundation apprenticeships. This also involved an adjustment to the expected credit loss provision.</p> <p>The closing accrual is £60.2 million, a reduction of £1.7 million. The expected credit loss provision has increased by £1.0 million to £3.0 million. It now represents 4.9 per cent of the total value of the accrual, previously it represented 3.3 per cent.</p> <p>In our view these adjustments are reasonable and the updated letter from the SG (alongside the risk and mitigation plan) provides greater assurance regarding future claims.</p> <p>Recommendation 1</p> <p>(Refer Appendix 1, action plan)</p>
<p>2. Retirement benefit obligations</p> <p>SDS accounts for its retirement benefit obligations on a defined benefit basis under <i>IAS 19 Employee Benefits</i>, with a pension liability disclosed in the Statement of Financial Position. The present value</p>	<p>SDS updated the financial statements to incorporate the revised figures received from the actuary. As a result, total liabilities in the Statement of Financial Position decreased by £13.0 million and the total comprehensive income in the</p>

Issue	Resolution
<p>of these obligations depends on factors that are determined on an actuarial basis using assumptions applied to information SDS provides to the actuary. Part of this involves measuring the rate of return on assets held by the pension fund.</p> <p>As in prior years, the actuary's report used by SDS to prepare the unaudited accounts included an estimated rate of return on assets, due to early timing. The actuary confirmed in June 2022 that the actual rate of return on assets was higher than estimated and as a result has reduced the net pension liability by £13 million.</p>	<p>Statement of Comprehensive Income increased by the same amount . The retirement benefit obligations Note 7 was also updated along with the related disclosures in the strategic and directors' reports.</p> <p>We are content with the revised financial statements. We are also content that SDS amended its disclosures in the key accounting estimates and judgements Note 2 this year to include the value of the obligation and a sensitivity analysis.</p>

Source: Audit Scotland

26. We have obtained audit assurances over the identified significant risks of material misstatement to the financial statements. [Exhibit 3](#) sets out the significant risks of material misstatement to the financial statements we identified in our 2021/22 Annual Audit Plan. It summarises the further audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

Exhibit 3

Significant risks of material misstatement in the financial statements

Audit risk	Assurance procedure	Results and conclusions
<p>1. 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>Assessed the design and implementation of controls over journal entry processing.</p> <p>Made inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments.</p> <p>Tested journals at the year-end and post-closing entries and focussed on significant risk areas.</p> <p>Considered the need to test journal entries and other</p>	<p>Results & Significant Judgements: Carried out walkthrough testing of the journal authorisation process and found controls operated as expected.</p> <p>Selected a sample of journals (in-year and year-end) through applying risk assessment analysis, no issues were identified.</p> <p>Reviewed significant estimates and judgements and found no issues.</p> <p>Tested related party transactions, including checks to suppliers' data on the payables system and</p>

adjustments during the period.

Evaluated significant transactions outside the normal course of business.

Assessed the adequacy of controls in place for identifying and disclosing related party relationship and transactions in the financial statements.

Assessed any changes to the methods and underlying assumptions used to prepare accounting estimates compared to the prior year.

Substantively tested income and expenditure transactions around the year-end to confirm they were accounted for in the correct financial year.

Focussed testing on accounting accruals and prepayments.

from the register of interests to Companies House records. No issues found.

Sampling of expenditure, income and year-end balances (accrual and prepayments) identifying unusual/ high value transactions, with no issues identified.

Conclusion: Satisfactory – no issues found from our testing.

2. Estimates and judgements – European funding

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

Detailed testing of the ESF income accrual including an assessment of estimation uncertainty and related disclosures.

Reviewed correspondence in relation to ESF funds.

Reviewed budget monitoring presented to the Board and committees and discussed ESF developments with SDS finance.

Reviewed SDS' ESF claims and its internal verification checks.

Liaised with the auditors of the SG on ESF developments from a national perspective.

Results & Significant Judgements:

The working papers supporting the ESF income accrual were agreed to the accounts and to source documents.

The disclosure note on critical accounting estimates and judgements was further improved to differentiate the judgements and to provide a sensitivity analysis.

We concluded that SDS applied the estimation uncertainty based on the best information available and in accordance with the accounting standards.

We were made aware of a potential timing issue with regard to the verification process by the SG. This issue placed greater uncertainty on the income

provision' based on historic claim data.

There is a risk that SDS misstates the level of the accrual, generally and through its determination of estimation uncertainty.

accrual. However the SG was able to provide further assurances and adapted its verification approach. Both of these developments alongside a risk mitigation plan prepared jointly by SDS and the SG, allowed us to conclude that the accrual was reasonable.

Conclusion: Satisfactory – our review found that the income accrual was reasonable.

See also [Appendix 1 action plan, point 1](#).

3. Estimates and judgements – pensions valuations

SDS is a member of the local government pension scheme and accounts for it as a 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.

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.

Reviewed the information provided by SDS to its actuary.

Completed a 'review of the work of an expert' in respect of the actuary including a review of actuarial assumptions.

Tested pension disclosures, including data that SDS provided to actuaries.

Results & Significant Judgements:

As in previous years, the actuary report used by SDS to prepare the accounts included an estimate of the rate of return on assets. The actuary confirmed in June 2022 that the actual rate of return on assets was higher than the estimate resulting in a reduction in the pension liability by a material amount (£13.0 million). The accounts were subsequently amended. Our review of SDS' actuaries did not identify any issues.

SDS also enhanced its disclosure note on critical accounting estimates and judgements to incorporate a sensitivity analysis which demonstrated the potential impact of a change in key variables.

Conclusion: Satisfactory – following amendments made for late information on return on investments.

Other areas of audit focus

27. We identified in our 2021/22 Annual Audit Plan areas where we considered there to be other risks of material misstatement to the financial statements. Based on our assessment of the likelihood and magnitude of the risk, we did not consider these to represent significant risks. The areas of specific audit focus were:

- 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 in [Exhibit 3](#).

28. We kept this area under review throughout our audit. Based on the findings of the audit procedures performed, there are no matters which we need to bring to your attention.

Total misstatements of £15.6 million were adjusted in the accounts

29. We identified three misstatements during the audit totalling £15.6 million, which is above our materiality of £2.78 million. As described at [Exhibit 2](#), this related to the ESF income accrual and the pension liability in the financial statements.

30. We have reviewed the nature and cause of these misstatements and have concluded that they were isolated issues. These arose due to the timing of feedback from the ESF verification process and information available from the actuary. These have been identified in their entirety and do not indicate further systemic error. We did not need to review our planned audit approach.

31. Adjustments made in the audited accounts increased total comprehensive income in the Statement of Comprehensive Income and total equity in the Statement of Financial Position both by £10.4 million.

32. 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 agreed to adjust all identified misstatements above our reporting threshold; there are no unadjusted errors to report.

SDS has made some progress with prior year recommendations but more work is required in three key areas

33. SDS has made some progress in implementing our prior year audit recommendations, with three completed and three in progress. Those in progress relate to:

- Management review of unaudited accounts (see [paragraph 20](#))
- Longer-term financial planning (see [paragraph 60](#))

- Improvements to the strategic report to make it more accessible (see [paragraph 70](#))

34. For actions not yet implemented, revised responses and timescales have been agreed with management, and are set out in [Appendix 1](#).

2. Financial management

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

Main judgements

SDS operated within its overall revised fiscal resources while meeting its targets in terms of apprenticeship starts.

SDS is not provided with a capital funding allocation by the Scottish Government despite SDS making capital spending decisions from its overall allocation. While the Scottish Government was informed of these decisions, accountability and budget management would be improved with separate revenue and capital allocations.

SDS had appropriate and effective financial management in place and was able to accurately forecast a year-end underspend to the Scottish Government.

A further £26 million cash advance was provided to SDS in 2021/22 to off-set the impact of delayed ESF funding, with more likely to be required in 2022/23.

We have obtained audit assurances over the wider audit dimension risks relating to financial management identified in our 2021/22 Annual Audit Plan

35. [Exhibit 4](#) sets out the audit dimension risks relating to financial management we identified in our 2021/22 annual audit plan. It summarises the audit procedures we planned to perform during the year to obtain assurances over these risks and the conclusions from the work completed.

Exhibit 4

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

Audit risk	Assurance procedure	Results and conclusions
<p>4. Financial management – 2021/22 outturn</p> <p>SDS operates a demand led service which makes year-end financial forecasting complicated. Changing</p>	<p>Reviewed the outturn position presented in the strategic report (within the annual report and financial statements) and correspondence between</p>	<p>Results & Significant Judgements: As the Scottish Government does not provide a separate capital funding allocation, capital and resource spend must be</p>

Audit risk	Assurance procedure	Results and conclusions
<p>economic conditions following the Covid-19 pandemic and EU withdrawal adds to the complexity.</p> <p>During the year SDS was 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 delayed payment of European grants.</p>	<p>SDS and the Scottish Government.</p>	<p>looked at together. Combined spend in these areas was £2.6 million more than the allocation, largely due to adjustments relating to European grants outlined in Exhibit 2.</p> <p>The final allocation letter from the Scottish Government confirmed that the forecast £6 million underspend had not been formally adjusted through the spring budget revision. However, the letter did recognise it as surplus Grant-in-Aid and it was subsequently reduced from the final allocation.</p> <p>Conclusion: Satisfactory - SDS demonstrated that it was able to maintain its spend within resource allocations and had clearly communicated its identified surplus Grant-in-Aid to the Scottish Government.</p>

SDS achieved a near break-even position against its revised resource budget for 2021/22

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

37. SDS has reported an outturn of £234.5 million remaining within its overall budget for 2021/22. The financial performance against fiscal resources is shown in [Exhibit 5](#).

Exhibit 5**Performance against fiscal resource in 2021/22**

Performance	Initial budget £m	Final budget £m	Outturn £m	Over/(under) spend £m
Resource	230.0	234.6	234.5	(0.1)
Capital	0	0	2.8	2.8
Total	230.0	234.6	237.3	2.7

Source: SDS Annual Report and Financial Statements

SDS was able to provide more accurate financial forecasts in 2021/22 and shared these with the Scottish Government

38. SDS operates a demand led service in the form of its national training programmes (NTP). The NTPs were particularly affected in 2020/21, which had a significant impact on SDS' finances. This involved significant reductions in volume in traditional programmes such as modern apprenticeships.

39. To offset this, SDS developed Covid initiatives such as the apprenticeship employer grant (AEG) to continue to provide support. However as there was no historical data concerning these types of schemes, it created difficulties for SDS to forecast its year-end financial outturn.

40. In 2021/22, as the pandemic evolved, the level of restrictions reduced. This has seen the volumes of its NTP recover, to some extent. Consequently, this allowed for more accurate financial forecasting allowing SDS to identify a £6 million underspend to the Scottish Government. This was formally recognised by the Scottish Government in its final grant allocation to SDS in April 2022.

41. While NTP volumes were largely around target, the composition of training packages resulted in a lower level of spend. For example, there were a larger number of older participants than had been anticipated. The costs associated with older individuals are lower commensurate with the expected level of training required. This positive management of in-year resources relates to a recommendation from our 2020/21 report (see [Appendix 1](#)).

Spend on Covid initiatives has reduced significantly from the previous year

42. As highlighted previously, SDS developed a range of Covid initiatives in 2020/21 to continue to provide support during the period of heaviest restrictions. We commented on these in our report in 2020/21, highlighting total spend of £24.8 million. Most of this related to AEG which accounted for £19.1 million of spend.

43. In 2021/22 the level of Covid initiatives reduced significantly as the other elements of the NTP recovered. Total spend was £5.3 million. The largest areas of spend were transitional training fund (28 per cent), pathway apprenticeships (19 per cent) and tourism and hospitality (18 per cent). AEG is no longer offered by SDS as this is now provided by local government bodies.

Capital expenditure increased in 2021/22 but SDS does not receive a capital funding allocation

44. Following a change in accounting policy in 2019/20, SDS capitalises spend on items such as computer equipment purchases and refurbishment of lease held estate. During 2021/22 this increased to £2.8 million from £1.5 million the previous year. This was largely due to refurbishment works at SDS' main office at Monteith House in Glasgow. Audit testing confirmed no issues with the treatment of this spend.

45. Despite the change in accounting treatment, SDS is not provided with a capital funding allocation by the Scottish Government. SDS has though outlined its capital spending plans to the Scottish Government. Although SDS has demonstrated its ability to manage its overall allocation, accountability and budget management would be improved with a capital allocation.

Recommendation 2

SDS should request a capital funding allocation in future settlements from the Scottish Government based on its capital plan.

Although SDS received £8 million of ESF grant funding, it still required a further £18 million additional cash

46. SDS continues to be impacted by the suspension of the Scottish Government from the European Social Fund (ESF). Although one claim was paid in 2021/22, SDS continues to require additional support from the Scottish Government to maintain adequate working capital.

47. During 2021/22, SDS indicated to the Scottish Government that it required a further £26 million of funding. However, SDS also received an £8 million payment of grant in relation to ESF grants during the year. This reduced the cash advance required to £18 million. SDS' accounts at 31 March 2022 includes a creditor to the Scottish Government in respect of advance funding of £47 million.

Financial systems of internal control are operating effectively, while focused testing provided assurance on NTP payments

48. We carried out walkthrough testing of the core financial systems during 2021/22. From this we concluded that the controls operated as expected. No significant internal control weaknesses were identified during the audit which could affect SDS' ability to record, process, summarise and report financial and other relevant data to result in a material misstatement in the financial statements.

49. We also carried out a walkthrough test of the NTP process, which utilises the funding information processing system (FIPS). Through this we found that effective controls were in place in most instances. However, we also found an inherent control risk in relation to the process of making payments to some training providers. This is because in some instances there is no comprehensive, real-time internal check prior to paying training providers for the achievement of stated milestones.

50. SDS acknowledges this and believes that other mitigating controls allows it to effectively manage the risk. These include the work of the skills investment advisors and the compliance/ fraud and error protection teams who review training providers arrangements on a regular basis. In addition, there are automated checks within FIPS and training providers annually declare compliance with programme rules and the accuracy of data input to FIPS.

51. While we believe these controls mitigate the inherent risk, we carried out focused substantive testing of NTP payments to provide further assurance. This testing found no issues.

Internal audit confirmed a good level of assurance on SDS' internal controls

52. The internal audit function is carried out by a shared service hosted by Scottish Enterprise. The Public Sector Internal Audit Standards (PSIAS) require the chief internal auditor to provide an annual internal audit opinion and report that can be used to inform the annual governance statement. The opinion provided in 2021/22 is that there is an overall good level of assurance on SDS' framework of governance, risk management and management control.

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

53. SDS is responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery, and corruption. 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.

54. We have reviewed the arrangements in place to maintain standards of conduct including the codes of Conduct for staff and board member. This confirmed that there are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.

55. We concluded that appropriate arrangements are in place for the prevention and detection of fraud, error and irregularities. This was based on reviews of the fraud and irregularity policy and the response plan. We also assessed SDS' arrangements for the completion of the National Fraud Initiative (NFI) and found these to be satisfactory.

3. Financial sustainability

Financial Sustainability looks forward to the medium and long term to consider whether a body is planning effectively to continue to deliver its services

Main judgements

SDS set a budget deficit for 2022/23 in light of reduced funding and increased costs, and is developing mitigation plans to meet further funding reductions.

SDS has still to restart its longer-term financial planning but has established a team to perform this task.

SDS set a budget deficit for 2022/23 in light of reduced funding and increased costs, and is developing mitigation plans to meet further funding reductions

56. The SDS budget for 2022/23 was approved in June 2022, incorporating a deficit of £2.35 million. This is similar to the agreed budget for 2021/22 and has been agreed with the Scottish Government. SDS intends to implement actions to eliminate this deficit.

57. This was based on grant-in-aid from the Scottish Government which at that point had reduced by £13.4 million. This consisted of a £5.8 million reduction plus £7.6 million transfer to No One Left Behind. This represented a reduction of just under 6 per cent from the settlement for 2021/22.

58. In August 2022, the Scottish Government requested that SDS find a further 5 per cent of savings, equating to £11.2 million. This is against increasing costs in areas such as staff pay awards and increasing volume of new apprenticeship starts. SDS estimates that this results in a pressure of up to £24 million and is currently developing mitigating actions in light of this.

SDS has still to restart its longer-term financial planning but has put in place a team to perform this task

59. The financial impact of the pandemic on the Scottish economy is likely to extend across several years. Much of SDS' spend (through the NTP) is demand led. Therefore SDS will need to ensure its longer-term financial planning (including scenario modelling) allows it to adjust to the changing environment.

60. As reported last year, SDS paused the work on its rolling five-year financial plan due to Covid-19. While work on the plan has yet to resume, we understand that a new team (financial planning and analysis) has been put in place. One of the remits of this team is to carry out longer-term financial planning with a commitment to deliver this in 2022/23. As such the recommendation we raised last year remains open (see [Appendix 1](#)).

4. Governance and transparency

The effectiveness of scrutiny and oversight, and transparent reporting of information

Main judgements

SDS has had appropriate and effective governance arrangements in place throughout the Covid-19 pandemic.

The performance report was generally of a good standard but could be made more accessible in line with relevant regulations.

The governance arrangements and controls operating throughout the Covid-19 pandemic have been appropriate

61. We reported in our 2020/21 Annual Audit Report that SDS had appropriate governance arrangements in place. This includes the SDS Board and its supporting committees including the ARC and the finance and operating performance committee (FOP), which met virtually in 2020/21.

62. These arrangements have remained in place during 2021/22, with one meeting of the ARC being in-person in March 2022. We have therefore confirmed that these arrangements have been maintained in 2021/22 and remain appropriate. The ARC also met in November 2022, with a special meeting in June to discuss the ESF income accrual. In addition, the ARC held a joint meeting with the FOP in September to discuss budget pressures.

Openness and transparency

63. Openness and transparency in how a body 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.

64. We have previously highlighted that, 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 are not available publicly.

65. It is for each organisation to determine what papers are made available. We continue to hold the view that budget and performance monitoring reports, and committee minutes should be published where it is reasonable to do so.

66. SDS should continue to keep this under review and periodically assess whether there are opportunities to make further information available. It should also consider the guidance on communication with stakeholders from the Scottish Government's ['On board'](#) publication.

67. Further information could be provided about SDS' finances and the steps it is taking in response to the changing economic conditions. This would assist stakeholders' understanding of the challenges SDS is facing in this environment.

The performance report was generally of a good standard but could be made more accessible in line with regulations

68. In addition to the opinion on the strategic report covered in Part 1 of our Annual Audit Report, we also consider the qualitative aspects here. The strategic report should provide information on SDS such as its main objectives and its principal risks.

69. Additionally, it should provide a fair, balanced and understandable analysis of SDS' performance as well as helping stakeholders understand the financial statements. From review we are satisfied that it met all criteria set out in guidance from the [Financial Reporting Council](#).

70. However, we feel further improvement could be made to ensure the report is more focused. In particular SDS should ensure that it meets with the [Public Sector Accessibility Regulations 2018](#). The recommendation from last year has been updated to reflect this and remains open.

5. Value for money

Using resources effectively and continually improving services

Main judgements

SDS is developing a new strategic plan to set out how it will support the Scottish Government's National Strategy for Economic Transformation.

SDS has started taking action in light of a national audit report on Planning for Skills, but more will be needed to achieve outcomes.

SDS has a key role in delivering the national economic strategy's programme on a skilled workforce

71. The Scottish Government published its [National Strategy for Economic Transformation](#) (NSET) in March 2022. It focuses on five policy programmes, including one on the importance of a 'Skilled Workforce'. The 2022/23 Letter of Guidance to SDS highlights that SDS has a role in programmes targeted towards delivering a skilled population within the NSET.

72. SDS and the Scottish Funding Council (SFC) worked with the Scottish Government to develop a [Shared Outcomes Framework](#) (SOF), published in March 2022. It sets out how SDS and the SFC will monitor and report on collaborative projects that contribute to skills outcomes set by the NSET. In particular the SOF provides:

- Clarity on the areas where both SDS and the SFC are working collaboratively to achieve greater alignment between economic demand and skills provision
- Detail on the impacts and outcomes that individual projects will deliver including clear timescales and milestones
- The basis from which detailed monitoring, reporting and assurance can be provided.

SDS is developing a new strategic plan to allow it to meet these new challenges

73. In line with the other enterprise and skills agencies, SDS is developing a new strategic plan in 2022. This plan will cover the period to 2027 and will set out how it plans to support the NSET. A final draft was submitted for approval to the SDS board in September 2022. It will then be shared with the Minister for Higher Education and Further Education, Youth Employment and Training and formally published thereafter.

A national audit report on Planning for Skills has recommended action by SDS

74. In January 2022, Audit Scotland published a national performance audit about [Planning for skills](#), on behalf of the Auditor General for Scotland (AGS). The report summarised how effectively SDS, the SFC and the Scottish Government work together to ensure that Scotland's skills system responds to individuals' and employers' needs.

75. The report concluded that

- the Scottish Government has not provided the necessary leadership for progress
- current arrangements are unlikely to achieve the ambitions for skills alignment at the pace required
- differences between the Scottish Government, SFC and SDS on the approach to skills alignment have prevented effective joint working.

76. The report recommended that SDS should work with the Scottish Government and the SFC to deliver shared outcomes for skills. It also recommended that SDS should work with the SFC to:

- implement solutions to overcome obstacles to joint working, including collectively using data to inform skills planning
- provide timely, regular reports about their progress on skills alignment to the Scottish Government and others with governance and oversight responsibilities.

SDS has acted on the audit report's recommendations

77. Since the 'Planning for skills' audit report was published, SDS has taken action to implement the recommendations that apply to it. This mainly includes being represented at the Shared Outcomes Agreement Group (SOAG). This involves the Scottish Government Reform Division and SDS and SFC Directors/Deputy Directors amongst others.

78. The main aim of the SOAG is to provide collective and collaborative leadership and assurance regarding the Shared Outcomes Framework. It has started to receive project status reports. Minutes are taken at these meetings and made available on the Scottish Government website.

79. SDS and SFC senior Management teams held a joint workshop recently to discuss wider engagement and ways of working together. From this meeting it was agreed that both chief executives will chair future meetings of the joint executive. These will aim to further support and embed collaborative working across the SFC and SDS.

80. At an operational level information has been shared between SDS and SFC staff using platforms such as MS Teams. In addition, SDS has provided SFC staff with access to its FIPS system which is used to manage the NTP. This

facilitates monitoring of foundation and graduate apprenticeships across both bodies.

81. The SDS board invited Audit Scotland to present the report's findings in February 2022. Following on from that, the shared outcomes framework is now a standing item at meetings of the service development committee.

82. This provides evidence of positive action taken by SDS in recent months which should help address the key points arising from this report. Momentum must be maintained in the coming years to ensure successful delivery.

The Scottish Government plan to review the skills delivery landscape

83. In August 2022, the Minister for Higher Education, Further Education, Youth Employment and Training announced plans for an independent review of the skills delivery landscape. This review will make recommendations about SDS' future functions, remit and status to ensure that it can respond effectively to ambitions set out in the NSET. The findings are due to be reported in spring 2023.

National performance audit reports

84. In 2021/22 a number of other national performance reports were published and may also be of interest to SDS. These are outlined in [Appendix 2](#).

Appendix 1. Action plan 2021/22

2021/22 recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p>1. ESF risk and mitigation plan</p> <p>Alongside the Scottish Government, SDS has developed a risk and mitigation plan regarding ongoing ESF claims. The aim of this plan is to ensure that all ESF claims are raised by the closing date of January 2024.</p> <p>Risk – As a result of ongoing delays in the Scottish Government’s verification process, SDS is unable to submit all ESF claims. Consequently SDS does not receive the full level of funding available to it.</p>	<p>SDS should ensure that the risk and mitigation plan for ESF claims is updated on an ongoing basis over the coming period.</p> <p>Exhibit 2</p>	<p>SDS will continue to collaborate regularly with SG Sponsor Team and SG Managing Authority on the risk and mitigation plan.</p> <p>There is a formal timetable for fortnightly review. SG has indicated a provisional date of December 2022 for payment of the claim which is currently undergoing verification. Attainment of this will open the claims system to submission of all claims, and SDS is working to assist with follow-up documents required.</p> <p>Responsible officer - Director of Finance, Information Governance, Resilience and Risk</p> <p>Agreed date - Ongoing</p>
<p>2. Capital funding allocation</p> <p>Following a change in accounting policy in 2019/20, SDS now capitalises spend on items such as computer equipment and refurbishment of leased office accommodation. Despite this change in accounting policy, SDS does not receive a formal capital funding</p>	<p>SDS should request a capital funding allocation within future settlements from the Scottish Government based on its capital plan.</p> <p>Paragraph 45</p>	<p>SDS will continue to consult on resource and capital budget requirements at monthly budget monitoring meetings with SG. SDS will request a capital budget allocation for 2023/24</p> <p>Responsible officer - Director of Finance, Information Governance, Resilience and Risk</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>allocation from the Scottish Government.</p> <p>Risk – SDS spend is not consistent in nature with its funding allocation.</p>		<p>Agreed date – Ongoing but request in December 2022</p>

Follow-up of prior year recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p>3. Submission of annual report and financial statements for audit (2020/21 AAR)</p> <p>We received the unaudited annual report and financial statements on 7 May 2021 in line with our agreed timetable. Like last year, SDS notified us of changes to its annual report due to the senior management review during the audit. This resulted in additional audit work and delayed completion.</p> <p>Risk – SDS provides unreviewed annual report and financial statements to audit resulting in additional work and delayed completion.</p>	<p>SDS management should complete their review of the 2021/22 annual report and accounts before these are provided to us for audit.</p>	<p>In Progress – management reviews were not all complete at the date the audit began, however subsequent changes were reduced from the prior year.</p> <p>It is recommended that SDS continues to develop a timetable for the production of its accounts that allows for a full suite of management review prior to the start of the audit. See paragraph 19.</p> <p>SDS timelines were affected significantly by the imperative to clarify and agree ESF funding and verification matters</p> <p>Responsible officer - Director of Finance, Information Governance, Resilience and Risk</p> <p>Revised date - Ongoing</p>
<p>4. Retirement benefits obligations (2020/21 AAR)</p> <p>SDS accounts for retired benefit obligations on a defined benefit basis under IAS 19 Employee Benefits. The present value of these obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions applied to actual</p>	<p>We are content with the revised financial statements but SDS should consider enhancing disclosures in the key accounting estimates and judgements note next year to better reflect uncertainty regarding the estimate. This should include the value of the obligation and a sensitivity analysis, currently presented in the retirement benefits obligations Note 7, to</p>	<p>Complete – the disclosure note for critical accounting estimates and judgements has been amended and now includes the value of the net obligation and a sensitivity analysis. See Exhibit 3, item 3.</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>information SDS provides to the actuary where available.</p> <p>Due to timing, the actuary report SDS used to prepare the accounts included an element of estimation in the rate of return on assets. The actuary confirmed in late June 2021 that the actual rate of return on assets would reduce the pension liability by a material amount (£13.0 million). The accounts were subsequently amended.</p> <p>Risk – the retirement benefits obligation could be materially mis-stated.</p>	<p>bring the disclosure in Note 2 in line with good practice.</p>	
<p>5. Budget management (2020/21 AAR)</p> <p>SDS drew down £31 million of grant-in-aid (GiA) in early February. The total draw-down for the year (£214.0 million) at that point exceeded the forecast spending of £212.8 million subsequently provided to the Scottish Government in late February.</p> <p>Risk – SDS draws down cash in advance of need and does not comply with the Scottish Public Finance Manual (SPFM) at year end.</p>	<p>To eliminate the risk of drawing down cash in advance of need, SDS should ensure that that it its cumulative GiA draw-downs do not exceed the remaining spending forecast at all times during the financial year.</p>	<p>Complete – SDS has operated within its resource limits and has not drawn-down excess Grant-in-aid during the year. It clearly identified a forecast underspend of £6 million to the Scottish Government which in turn was reduced from the final allocation in April 2022. SDS ensured that its final draw-down was in cognisance of this identified underspend. See paragraph 41.</p>
<p>6. Additional payment to Strathclyde Pension Fund (2020/21 AAR)</p> <p>SDS opted to make an additional payment of £5 million to Strathclyde Pension Fund (SPF) at the end of March 2021. SPF advised SDS that this would allow its contribution rate to remain at the previous level of 22.3 per cent. SPF calculated that paying this would result in</p>	<p>SDS should take into account the time value of money (in line with HM Treasury’s guidance) in any future VFM calculations and formally report any such ‘invest to save’ proposals to its Board or committee for approval.</p>	<p>Complete – although SDS did not make a similar payment in 2021/22, it did amend its grant-in-aid allocation in light of a forecast £6 million underspend.</p> <p>We have reviewed a budget monitoring paper presented to the finance and operational performance committee (FOP) on 13th January 2022. This paper discussed potential options for a</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>SDS saving around £1 million over the next three years.</p> <p>SDS' VFM calculation prior to payment did not reflect the time value of money in line with HM Treasury's guidance but we were content with the subsequent assessment. The payment proposal was discussed with Board members and the Scottish Government but it was not formally reported to the Board for approval.</p> <p>Risk – The VFM assessment does not meet the SPFM requirements and is not subject to formal approval by the board.</p>		<p>forecast underspend and explained how these were not feasible.</p> <p>Consequently, the FOP approved the executive to complete a budget transfer request with the Scottish Government. This demonstrates how SDS presented a significant change to the budget to members, outlined potential options and sought approval for the proposed action.</p>
<p>7. Longer-term financial planning (2020/21 AAR)</p> <p>In contributing to economic recovery, the Scottish Government expects SDS to continue delivering Covid-19 initiatives whilst also delivering its core services to support wider Scottish Government priorities and ambitions such as maximising apprenticeship starts.</p> <p>SDS will therefore need to keep its budget under close review and consider a range of scenarios such as different volumes of apprenticeships and the associated financial challenges. During 2020/21 SDS paused the work on its rolling five-year financial plan and has yet to evaluate the impact of Covid-19 on its business and finances over the medium to long term.</p>	<p>SDS should continue its longer-term financial planning and scenario planning. This should include an assessment of the continued impact of Covid-19 on its business and finances.</p>	<p>In progress – SDS has implemented a new finance structure which involves a new Financial Planning and Analysis team. One of the main tasks assigned to this team is longer-term financial planning. We therefore recommend that SDS follows through on its commitment to restart the 5-year financial planning model during 2022/23. See paragraph 60.</p> <p>Responsible officer - Director of Finance, Information Governance, Resilience and Risk</p> <p>Revised date - Ongoing</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>Risk – SDS is not well placed to be flexible and responsive to its financial position and the changing demands on its services.</p>		
<p>8. Scope for improvements to the strategic report (2019/20 AAR)</p> <p>SDS’ strategic report within the annual report and financial statements 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>In progress –some improvements were noted in 2020/21 regarding narrative on the impact of Covid-19 on SDS’ performance, risks and finances. This year we noted that there is good balance between positive and negative performance. Further improvement could be made to ensure that the report meets the Public Sector Bodies Accessibility Regulations 2018. More detail is provided at paragraph 70.</p> <p>Responsible officer - Director of Finance, Information Governance, Resilience and Risk</p> <p>Revised date - Ongoing</p>

Appendix 2. Summary of 2021/22 national reports

May

[Local government in Scotland Overview 2021](#)

June

[Covid 19: Personal protective equipment](#)

July

[Community justice: Sustainable alternatives to custody](#)

September

[Covid 19: Vaccination programme](#)

January

[Planning for skills](#)

[Social care briefing](#)

February

[NHS in Scotland 2021](#)

March

[Local government in Scotland: Financial Overview 20/21](#)

[Drug and alcohol: An update](#)

[Scotland's economy: Supporting businesses through the Covid 19 pandemic](#)

The Skills Development Scotland Co. Limited

2021/22 Annual Audit Report

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