

# The Skills Development Scotland Co. Limited

2023/24 Annual Audit Report



 AUDIT SCOTLAND

Prepared for Skills Development Scotland and the Auditor General for Scotland

July 2024

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# Key messages

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## 2023/24 annual report and financial statements

- 1 Audit opinions on the annual report and financial statements are unmodified.
- 2 The financial statements have been prepared to a high standard and are supported by a comprehensive set of working papers.

## Financial management

- 3 Skills Development Scotland has effective and appropriate arrangements to secure sound financial management, with regular budget monitoring reports provided to the Board.
- 4 In 2023/24, Skills Development Scotland operated within its overall resource and capital budget, reporting an underspend of £0.5 million.
- 5 Skills Development Scotland received a £13.2 million settlement of European Social Fund grant funding in the year, enabling it to repay the equivalent advance funding received from the Scottish Government.
- 6 Financial controls and arrangements for the prevention and detection of fraud remain appropriate.

## Financial sustainability

- 7 Skills Development Scotland has developed financial planning over the medium term reflecting a range of scenarios and financial assumptions. This will support the effective delivery of services going forward.
- 8 The 2024/25 budget includes a working deficit of £2.7 million which needs to be managed in year and options are being considered to achieve this.
- 9 Transform 27 has informed budget modelling and financial scenario planning, with forward planning on service delivery in alignment with the Strategic Plan 2022-27.

## Vision, leadership, and governance

- 10 Skills Development Scotland has a clear vision aligned with the Scottish Government's National Strategy for Economic Transformation, delivered

through the Annual Operating Plan 2023/24 and the Transform 27 programme.

- 11** Governance arrangements are appropriate and support scrutiny of decisions by the Board.
- 12** A simplified organisation structure has been implemented in year to accelerate transformation and enhance collaboration behind Skills Development Scotland's strategic goals.

### **Use of resources to improve outcomes**

- 13** Skills Development Scotland has a performance management framework in place with key performance indicators to measure progress against the corporate goals.
- 14** An overall 'green' rating was reported against four of the five corporate goals in the Strategic Plan 2022-27.
- 15** Anticipated reform of the skills delivery landscape has created significant uncertainty for Skills Development Scotland. SDS recognises the associated risks, both in relation to the delivery of its strategic objectives and the impact on its people.

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# Introduction

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**1.** This report summarises the findings from the 2023/24 audit of Skills Development Scotland (SDS). The scope of the audit was set out in our Annual Audit Plan presented to the 26 March 2024 meeting of the Audit and Risk Committee (ARC). This Annual Audit Report comprises:

- significant matters arising from an audit of SDS' annual report and financial statements
- conclusions on the following wider scope areas that frame public audit as set out in the [Code of Audit Practice 2021](#):
  - Financial Management
  - Financial Sustainability
  - Vision, Leadership, and Governance
  - Use of Resources to Improve Outcomes.

**2.** This report is addressed to the Board of SDS and the Auditor General for Scotland and will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk) in due course.

## Audit appointment

**3.** I, Pauline Gillen, have been appointed by the Auditor General for Scotland as auditor of SDS for the period from 2022/23 until 2026/27.

**4.** My team and I would like to thank Board members, ARC members, executive directors, and other staff, particularly those in finance, for their cooperation and assistance in this year's audit.

## 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. SDS is also responsible for establishing appropriate and effective arrangements for governance, propriety, and regularity.

**6.** My responsibilities as the independent auditor are established by the Public Finance and Accountability (Scotland) Act 2000, the Code of Audit Practice 2021, supplementary guidance and International Standards on Auditing in the UK (ISAs).

**7.** Weaknesses or risks identified are only those which have come to the attention of the audit team during our normal audit work and may not be all that exist. Communicating these does not absolve management of SDS from its responsibility to address the issues I raise and to maintain adequate systems of control.

**8.** This report contains an agreed action plan at [Appendix 1](#). It sets out specific recommendations, the responsible officers, and dates for implementation.

## **Auditor Independence**

**9.** I can confirm that the audit team comply with the Financial Reporting Council's Ethical Standard. I can also confirm that I have not undertaken any non-audit related services and the 2023/24 audit fee is £123,252. The slight reduction from the proposed audit fee reported in our Annual Audit Plan 2023/24 relates to a travel costs rebate for the prior year. I am not aware of any relationships that could compromise our objectivity and independence.

**10.** The annual audit adds value to SDS by:

- identifying and providing insight on significant risks, and making clear and relevant recommendations
- providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, arrangements to ensure the best use of resources and financial sustainability
- sharing intelligence and good practice identified.

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# 1. Audit of 2023/24 annual report and financial statements

Public bodies are required to prepare annual reports and accounts comprising financial statements and other related reports. These are principal means of accounting for the stewardship public funds.

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## Main judgements

Audit opinions on the annual report and financial statements are unmodified.

The financial statements have been prepared to a high standard and are supported by a comprehensive set of working papers.

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## Audit opinions on the annual report and financial statements are unmodified

**11.** The Board approved the annual report and financial statements for SDS for the year ended 31 March 2024 following the ARC meeting on 27 June 2024. As reported in the independent auditor's report, in my opinion as the appointed auditor:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- expenditure and income were in accordance with applicable enactments and guidance issued by Scottish Ministers
- the audited part of the remuneration report was properly prepared in accordance with the financial reporting framework
- the strategic report, directors' report and governance statement were consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

## Overall materiality was assessed as £4.4 million

**12.** Broadly, the concept of materiality is applied by auditors to determine whether misstatements identified during the audit could reasonably be expected to influence the economic decisions of users of the financial statements, and hence impact their opinion set out in the independent auditor's report. Auditors set a monetary threshold when considering materiality, although some issues

may be considered material by their nature. It is ultimately a matter of the auditor's professional judgement.

**13.** Our initial assessment of materiality was carried out during the risk assessment phase of the audit. This was reviewed on receipt of the unaudited annual report and financial statements and is summarised in [Exhibit 1](#).

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## Exhibit 1

### Materiality values

Materiality level	Amount
Overall materiality	£4.4 million
Performance materiality	£2.6 million
Reporting threshold	£220,000

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**14.** The overall materiality threshold was set with reference to gross expenditure which we judged as the figure most relevant to the users of the financial statements.

**15.** Performance materiality is used by auditors when undertaking work on individual areas of the financial statements. It is a lower materiality threshold, set to reduce the probability of aggregated misstatements exceeding overall materiality. Performance materiality was set at 60% of overall materiality, reflecting our risk assessment that confirmed no significant changes in business activities, accounting system and systems of internal control. We also considered the extent of prior year errors and concluded that there is no indication of further systemic error.

**16.** It is my responsibility to request that all misstatements are corrected other than those below the reporting threshold. The final decision on making the correction lies with the Board.

## Significant findings and key audit matters

**17.** Under ISA (UK) 260, I communicate significant findings from the audit to the Board, including my view about the qualitative aspects of the Board's accounting practices.

**18.** The Code of Audit Practice also requires me to highlight key audit matters which are defined in ISA (UK) 701 as those matters judged to be of most significance.

**19.** Significant findings are summarised in [Exhibit 2](#).



## Exhibit 2

### Significant findings and key audit matters from the audit of the annual report and financial statements

Issue	Resolution
<p><b>1. European grant income accrual</b></p> <p>SDS is a delivery partner for two European Social Fund (ESF) strategic initiatives. The Scottish Government (SG) is the Managing Authority for ESF programmes in Scotland. Until 2022 the programmes were in suspension by the European Commission (EC) which resulted in a pause in payments to delivery partners. As a result of this delay in funding, SDS' accounts presented for audit showed £21.0 million of accrued income (£32.6 million in 22/23) based on underlying expenditure. This is an accounting estimate which includes a provision for credit losses of £1.5 million to allow for estimation uncertainty.</p> <p>The final claim for ESF funding was submitted by SDS in December 2023 and a deadline of June 2024 was set by the EC for the SG to complete the verification of all ESF claims.</p> <p>The EC can continue to audit any delivery partners until the ESF programme is formally closed (estimated to be the end of 2025 at earliest). Therefore there is a high likelihood of future Article 127 of the EC Common Provisions Regulation 1303/2013 audits of historic claims and certified expenditure, which presents an ongoing risk of ESF funds being recovered by the EC.</p>	<p>The ESF risk and mitigation plan was reviewed and maintained by SDS, SG Sponsor Team and SG Managing Authority throughout 2023/24 and early 2024/25.</p> <p>SDS received a final payment of ESF funding of £21 million in June 2024 from the SG, following completion of its verification of the final ESF claim submitted by SDS.</p> <p>ESF risk and mitigation meetings will continue to be held on a monthly basis in 2024/25 to reflect the possibility of future audits of historic ESF claims and certified expenditure by the SG, which presents the risk of ESF funds being recovered by the EC.</p> <p>It was concluded that no monies had to be repaid as a result of the ESF 'Article 127' audit held in December 2023.</p> <p><b>Recommendation 1</b> (Refer <a href="#">Appendix 1</a>, action plan)</p>
<p><b>2. Accounting for retirement benefits</b></p> <p>SDS accounts for its retirement benefit obligations on a defined benefit basis under IAS 19 Employee Benefits, with a pension asset or liability disclosed in the Statement of Financial Position. The present value of the assets and obligations depends on factors that are determined on an actuarial basis using assumptions and estimations made by the fund's actuary. Part of this involves measuring the rate of return on assets held by the pension fund.</p> <p>As in prior years, due to early timing the actuary's report used by SDS to prepare the unaudited</p>	<p>Management obtained a revised and enhanced IAS 19 schedule of results from Hymans Robertson in June 2024. Note 9, retirement benefits assets and obligations, has been amended to reflect the actual rate of return on assets shown in the revised results. The primary financial statements have not changed because the application of the asset ceiling in accordance with IAS 19 and IFRIC 14 means that the net funded pension asset is still nil.</p>

Issue	Resolution
<p>financial statements included an estimated rate of return on assets. The actuary confirmed in June 2024 that the actual rate of return on assets was lower than estimated and this reduced the net asset position by £3.1 million.</p>	
<p><b>3. Interest on the effect of the pension asset ceiling</b></p> <p>The application of the asset ceiling in 2022/23 in accordance with IFRIC 14 has an impact on the figures in 2023/24. In particular the net interest income recognised in the surplus/deficit on ordinary activities is reduced by an amount linked to the interest cost on the restriction. Any change in the size of the restriction over the year is recognised through other comprehensive income.</p> <p>The IAS 19 schedule of results provided to SDS by Hymans Robertson in April 2024 did not include the impact of the asset ceiling adjustment applied in 2022/23. Therefore, the ‘interest on the effect of the asset ceiling’ was not accounted for in the unaudited statement of comprehensive income.</p>	<p>Management obtained a revised and enhanced IAS 19 schedule of results from Hymans Robertson in June 2024. This included details of the impact of the asset ceiling adjustment on the ‘Balance Sheet, P&amp;L and OCI disclosures at 31 March 2024’. The financial statements and related notes have been amended to reflect the impact of the asset ceiling adjustment. This includes a £4.982 million reduction in ‘finance income’ recognised in the statement of comprehensive income and an equivalent increase in the ‘other comprehensive income’ recognised in the year. The impact is a reduction in the surplus on ordinary activities after tax from £4.590 million to a £0.392 million deficit but there is no impact on the total comprehensive expenditure for the year. Removing the effect of actuarial pension adjustments still results in an operating expense of £0.4 million for the year.</p>
<p><b>4. Prior year accounting treatment of unfunded pension liability</b></p> <p>In 2022/23, an asset ceiling was applied to the pension fund asset in line with IFRIC 14. This was applied to the net funded and unfunded pension asset/obligation. Guidance emerged after the signing of the 2022/23 annual report and financial statements that clarified, although unfunded liabilities are treated the same way as retirement benefit costs, bodies do not have a right to set off the unfunded liability against a pension asset. Therefore it should have been recognised in full. The total value of the unfunded liability in 2022/23 was £1.028 million and this represents a prior year understatement of ‘Retirement benefit obligations’ on the Statement of Financial Position.</p>	<p>Management chose not to adjust the financial statements and related note as the amount is not considered to be material. This is acceptable under International Accounting Standard 8, as only material prior period errors are required to be corrected retrospectively.</p>

## Audit work responded to the risks of material misstatement we identified in the annual report and financial statements

**20.** We have obtained audit assurances over the identified significant risks of material misstatement in the annual report and financial statements. [Exhibit 3](#) sets out the significant risks of material misstatement to the financial statements identified in the 2023/24 Annual Audit Plan. It also summarises the further audit procedures performed during the year to obtain assurances over these risks and the conclusions from the work completed.

### Exhibit 3

#### Identified significant risks of material misstatement in the annual report and financial statements

Audit risk	Assurance procedure	Results and conclusions
<p><b>1. Risk of material misstatement due to fraud caused by management override of controls</b></p> <p>As stated in ISA (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>	<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.</li> <li>• Test journals at the year-end and post-closing entries, with a focus on significant risk areas.</li> <li>• Evaluate significant transactions outside the normal course of business.</li> <li>• Assess any changes to the methods and underlying assumptions used to prepare accounting estimates compared to the prior year.</li> </ul>	<p>We undertook the assurance procedures as planned and found:</p> <ul style="list-style-type: none"> <li>• The authorisation control over journal entries continues to operate effectively.</li> <li>• Management is not aware of inappropriate or unusual activity.</li> <li>• Detailed testing of journal entries and unusual transactions did not identify any errors.</li> <li>• There were no significant transactions outside the normal course of business.</li> <li>• The methodology used in preparing significant accounting estimates is reasonable and consistent with the previous year.</li> </ul> <p>We did not identify any instances of management override of control.</p>

Audit risk	Assurance procedure	Results and conclusions
<p><b>2. Estimation and judgements – European Funding</b></p> <p>SDS receives funding from the European Social Fund (ESF) which is administered by the European Commission (EC) and managed by the Scottish Government (SG).</p> <p>SDS has recognised a significant income accrual of £21.0 million (2022/23: £32.6 million) as a result of delays to the receipt of ESF monies. SDS allows for uncertainty in this accounting estimate through a ‘expected credit loss provision’ based on historic claim data of £1.5 million (2022/23: £1.6 million).</p> <p>There is a significant amount of estimation uncertainty and judgement applied to this balance.</p>	<ul style="list-style-type: none"> <li>• Review management’s controls over the ESF income accrual reported in the accounts.</li> <li>• Detailed testing of the ESF income accrual including an assessment of estimation uncertainty and related disclosures.</li> <li>• Review of the ESF risk and mitigation plan and related updates.</li> <li>• Review of budget monitoring papers and ongoing engagement with management.</li> <li>• Review of SDS’ ESF claims and internal verification checks.</li> <li>• Review the conclusions of the ‘Article 127’ audit of sample claims and certified expenditure and consider the impact on the audit.</li> </ul>	<p>We undertook the assurance procedures as planned and found:</p> <ul style="list-style-type: none"> <li>• Controls over expenditure relating to ESF claims were found to be operating effectively.</li> <li>• Detailed testing of the ESF income accrual did not identify any errors.</li> <li>• The level of estimation uncertainty was reviewed and confirmed to be low when comparing management estimates to ESF claim outcomes.</li> <li>• The related disclosures were considered appropriate.</li> <li>• Review of ESF papers to the Board and relevant committees, including the risk and mitigation plan confirmed that the assurances provided by Scottish Government in 2021/22 remain valid.</li> <li>• The risk associated with the ‘Article 127’ audit has been factored into the expected credit loss.</li> </ul> <p>We concluded that the ESF income accrual is reported on a reasonable basis.</p>

**21.** In addition, we identified an “area of audit focus” in the 2023/24 Annual Audit Plan where we consider there to be a risk of material misstatement to the financial statements. The area of specific audit focus was:

- **Estimations in the valuation of pension assets and obligations** – SDS is a member of the local government pension scheme (LGPS), which is accounted for as a defined benefit scheme in line with IAS 19. The value

of pension assets and obligations depends on several factors that are determined on an actuarial basis using a number of assumptions. We carried out audit procedures to obtain assurance over the IAS 19 and IFRIC 14 accounting and disclosures. Our findings in this area have been outlined in [Exhibit 2](#).

### **Total adjustments of £8 million were made to the financial statements and supporting notes but the total comprehensive expenditure for the year and statement of financial position were unaffected**

**22.** It is our responsibility to request that all misstatements, other than those below our reporting threshold, are corrected, although the final decision on making corrections lies with those charged with governance. The only unadjusted misstatement relates to the prior year as described in [Exhibit 2](#).

**23.** Adjustments to the financial statements and supporting notes totalled £8 million. These adjustments have been described in [Exhibit 2](#). Adjustments made in the audited annual report and financial statements had no impact on the overall comprehensive expenditure reported in the year or the balances reported in the statement of financial position.

**24.** We have reviewed the nature and cause of these adjustments and have concluded that they arose from issues that have been isolated and identified in their entirety and do not indicate further systemic error.

### **The unaudited annual report and financial statements were received in line with the agreed audit timetable**

**25.** The unaudited annual report and financial statements were received in line with the agreed audit timetable on 6 May 2024. The working papers which accompanied the annual report and financial statements were of a good standard. Regular communication and support from finance staff, including on-site working, helped the audit process run smoothly.

### **Good progress was made on prior year recommendations**

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

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## 2. Financial management

Financial management means having sound budgetary processes, and the ability to understand the financial environment and whether internal controls are operating effectively.

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### Conclusion

Skills Development Scotland has effective and appropriate arrangements to secure sound financial management, with regular budget monitoring reports provided to the Board.

In 2023/24, Skills Development Scotland operated within its overall resource and capital budget, reporting an underspend of £0.5 million.

Skills Development Scotland received a £13.2 million settlement of European Social Fund grant funding in the year, enabling it to repay the equivalent advance funding received from the Scottish Government.

Financial controls and arrangements for the prevention and detection of fraud remain appropriate.

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### SDS operated within its budget in 2023/24

**27.** The main financial objective for SDS is to ensure that financial balance is achieved and funds are utilised in accordance with the annual Letter of Guidance. This includes working within the budget allocated by Scottish Ministers. SDS has reported a total outturn of £204.5 million in 2023/24, with an underspend of £0.5 million (or 0.2 per cent) against the overall resource and capital budget allocation. Unlike the previous year, there were no in year revisions to the resource and capital allocations. The financial performance against fiscal resources is shown in [Exhibit 4](#).

## Exhibit 4

### Performance against fiscal resource in 2023/24

Performance	Initial budget £m	Final budget £m	Outturn £m	Over/(under) spend £m
Resource	203.5	203.5	203.4	(0.1)
Capital	1.5	1.5	1.1	(0.4)
Total	205.0	205.0	204.5	(0.5)

Source: SDS Annual Report and Financial Statements

### Budget processes and reporting were appropriate

**28.** The budget setting and monitoring processes at SDS continued to be effective. The 2023/24 budget was reduced by £4.3 million in comparison to the previous year. The major areas of reduced income and increased expenditure at SDS included:

- a reduction in grant-in-aid (GIA) funding and ESF grant allocations
- an increase in costs relating to national training programmes (NTP)
- the implementation of the 2023/24 pay award linked to cost inflation.

**29.** SDS set a working budget deficit for 2023/24 of £2.5 million in light of reduced funding and increased cost pressures. The working deficit was approved by the Scottish Ministers on the basis that action would be taken in year to achieve financial balance at the year end. This deficit was reduced by SDS in the 2023/24, achieving an underspend of outturn against the budget allocation. This was achieved through vacancy management, reprofiling of digital projects and reductions to forecast expenditure for various NTP initiatives.

**30.** During 2023/24, the SDS Board and the Finance and Operational Performance Committee (FOP) received quarterly financial monitoring reports. The financial position is reported with sufficient accuracy, detail and timeliness to support scrutiny of performance by members on a regular basis. Actual expenditure and income compared to budgeted figures are part of a rolling forecast within the management accounts. A summary of financial performance is reported throughout the year.

## Capital expenditure increased in 2023/24

**31.** Capital expenditure increased slightly in 2023/24 to £0.9 million from £0.7 million in the previous year. This was mainly due to greater capitalised expenditure on computer equipment compared to the previous year. Part of this increase was offset by a reduction in expenditure on the refurbishment of the lease held estate.

## SDS received settlement of £13.2 million of accrued ESF grant funding, enabling it to repay the equivalent advance funding from the Scottish Government

**32.** Following the delay in the receipt of ESF grant funding in previous years, SDS received grant payments totalling £13.2 million during 2023/24 from the SG. This contributed to the fall in the year-end ESF income accrual presented in the annual report and financial statements.

**33.** SDS was able to use these monies in 2023/24 to repay £13.2 million of advance funding from the SG received in previous years. The financial statements at 31 March 2024 recognises an amount payable to the SG of £14.4 million in respect of historic advance funding that is expected to be repaid in 2024/25.

**34.** With the ESF programme coming to an end, SDS submitted its final claim for ESF grant funding in December 2023, ahead of the January 2024 deadline. A deadline of June 2024 was set by the European Commission for the SG to complete the verification of all ESF claims. SDS received a final payment of ESF funding of £21.0 million in June 2024 from the SG, which enabled the remaining £14.4 million of historic advance funding to be repaid by SDS in July 2024.

## SDS has appropriate financial control arrangements in place

**35.** From a review of the design and implementation of systems of internal control during 2023/24 (including those relating to IT) relevant to our audit approach, we did not identify any significant financial control weaknesses 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.

## Internal audit confirmed a satisfactory level of assurance on the framework of internal controls

**36.** The internal audit function for SDS 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. Internal audit completed their 2023/24 audit work and presented their annual report to the June 2024 meeting of the ARC. The internal audit opinion provided in



2023/24 concluded that there is an overall satisfactory level of assurance on SDS' framework of governance, risk management and control.

**37.** Internal audit also submitted a report on its review of financial management at SDS to the March 2024 meeting of the ARC, noting no concerns in this area in 2023/24. It concluded that the overall control environment was well managed but noted the importance of ensuring that this is effectively maintained against a backdrop of potential future pressures.

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

**38.** In the public sector there are specific fraud risks, including those relating to tax receipts, welfare benefits, grants and other claims made by individuals and organisations. Public sector bodies are responsible for implementing effective systems of internal control, including internal audit, which safeguard public assets and prevent and detect fraud, error and irregularities, bribery and corruption.

**39.** SDS has adequate arrangements in place for the prevention and detection of fraud, errors or other irregularities. This was based upon a review of its fraud and irregularity policy and response plan, as well as its whistleblowing policy and procedure.

**40.** We have also reviewed the arrangements in place to maintain standards of conduct including the codes of conduct for staff and Board members. There are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.

### **National Fraud Initiative**

**41.** The National Fraud Initiative (NFI) is a counter-fraud exercise across the UK public sector which aims to prevent and detect fraud. SDS participated in this biennial exercise. The 2022/23 exercise concluded during the 2023/24 financial year and the final report is due to be published in Summer 2024.

**42.** We reported last year that 1,068 NFI data matches were identified for SDS as part of the 2022/23 exercise. SDS concluded its investigation of these matches by the deadline of 30 September 2023 and reported the outcomes of this exercise to the Board in December 2023. No instances of fraud were identified following analysis of the NFI data matches by management. There was a good level of engagement in the 2022/23 exercise by SDS. Sample sizes were concluded to be reasonable and there was sufficient follow-up investigation of identified data matches.

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# 3. Financial sustainability

Financial sustainability means being able to meet the needs of the present without compromising the ability of future generations to meet their own needs.

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## Conclusion

Skills Development Scotland has developed financial planning over the medium term reflecting a range of scenarios and financial assumptions. This will support the effective delivery of services going forward.

The 2024/25 budget includes a working deficit of £2.7 million which needs to be managed in year and options are being considered to achieve this.

Transform 27 has informed budget modelling and financial scenario planning, with forward planning on service delivery in alignment with the Strategic Plan 2022-27.

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## SDS is planning effectively so it can continue to deliver services in the medium term

**43.** In our 2022/23 Annual Audit Report we concluded that medium to long-term financial planning continued to be developed at SDS. We recommended that financial planning aligns with the Transform 27 programme and includes a range of scenarios to reflect the uncertainties that exist for SDS.

**44.** SDS developed its medium-term financial planning work in 2023/24. A range of budget scenarios between 2024/25 to 2027/28 have been mapped out using key assumptions, including:

- year-on-year GIA funding reductions
- annual staff Pay Award cost increases
- projected increases in Modern Apprenticeships and Foundation Apprenticeships cost commitments
- forecast savings over various expenditure areas.

**45.** We reviewed workings by the Financial Planning and Analysis Team supporting these budget scenarios. Overall, we concluded that the financial scenario planning over the medium-term is appropriate. It reflects a range of uncertainties and incorporates anticipated savings from Transform 27 initiatives ([paragraph 49](#)). It was noted that some expenditure areas are forecast without

the application of general inflation increases, which impacts the rising budget deficit position year-on-year.

**46.** Financial scenario planning over the medium term will support SDS in the identification of its priorities to ensure that it can remain effective in the delivery of services going forward. The medium term financial plan is being revised to reflect the most up-to-date information, financial assumptions and underlying forecast deficit positions. An integrated planning process is being developed across the different areas of the business as part of this.

### **The 2024/25 budget includes a working deficit of £2.7 million which needs to be managed in year**

**47.** The original 2024/25 budget for SDS was approved by the Board in February 2024 and included a budget deficit of £1.7 million. There was a £3.5 million (or 1.7 per cent) reduction in GIA funding in comparison to the previous year. A revised budget was endorsed by the Board in May 2024 and this reflected an increase in the budget deficit to £2.7 million. The increase in the budget deficit arose due to a further reduction in GIA (£1.5 million) offset by a reduction in projected costs relating to Foundation Apprenticeship travel and a reduction in the projected Modern Apprenticeship costs. The SG approved the 2024/25 budget with the expectation that the SDS Board will ensure that sufficient action is taken to reach a balanced budget position by the year-end.

### **SDS performed effective financial modelling for the 2024/25 budget submission**

**48.** Effective financial modelling was performed for 2024/25 in the development of its proposed budget submission to the SG. The overall GIA funding reduction of 2 per cent for 2024/25 was within the parameters of the budget scenarios planned for by SDS. This included scenario planning for a flat GIA budget, a 5 per cent reduction and a 10 per cent reduction in budget respectively. These draft budget projections were predicated on SDS maximising all cost reductions under Transform 27.

### **Transform 27 has informed budget modelling and financial scenario planning at SDS, with forward planning on service delivery in alignment with the Strategic Plan 2022-27**

**49.** The transformation programme, Transform 27, was established to enable the delivery of the strategic aims of the Strategic Plan 2022-27 by moving the organisation to a more sustainable operating model in the context of constrained funding. SDS has implemented a number of initiatives through Transform 27 to offset increased financial pressures as part of the budget setting process, resulting in ongoing savings that will help reduce the working budget deficit in 2024/25 and beyond.

**50.** Transform 27 was progressed in 2023/24 with specific focus on staff headcount management and transitioning the estates portfolio to a new

community-based model. Specific actions from Transform 27 that are ongoing to deliver efficiencies include:

- **Workforce:** anticipated recurring savings of £4.4 million from 2024/25 as a result of the 2023/24 voluntary severance and early retirement scheme. In 2023/24, ninety-four staff applications were approved by SDS under this scheme, at a cost of £3 million managed within the existing budget.
- **Estates and facilities:** the revised estates strategy is projected to deliver a reduction in estates and facilities costs of £1 million in 2024/25, further to the £1 million savings achieved in 2023/24. These savings follow a review of the effective use of Public Access Centres and office space which resulted in a move to Local Employability Partnership Hubs. The key priority for SDS following the migration to these community-based hubs is to ensure there is no impact to the continued delivery of services to customers, while achieving cost savings in future years following the closure of a number of leased sites.
- **Employer pension contributions:** as a result of the recent triennial valuation, the level of employer contributions required over the three years from 1 April 2024 have decreased (with no detriment to pension scheme members), resulting in forecast savings of £6 million.

**51.** A new Transformation Portfolio and Programme Team was created in 2023/24 to plan, design and support the transformation of SDS as part of Transform 27. Going forward, the programme approach focuses on three 'Horizons' – immediate, transition and transform. This aims to create a renewed focus on service redesign to continue meeting customer needs, managing changes to the workforce profile and enabling sustainable service delivery.

**52.** An integrated planning approach is being progressed across SDS in 2024/25, with a focus on the continued need for transformation. SDS is developing four integrated service plans for careers, apprenticeships, 'enabling the system' and 'enabling our organisation'. These integrated service plans will include:

- **Transitional changes** – significant changes that have been identified for current service delivery as part of transformation by 2027.
- **Bridgehead activity or 'The Bridgeheads'** – key 'Horizon' activities which have been identified as being fundamental to achieving the transformation of core services, with a primary focus on transforming what will be delivered to customers in future.
- **Day-to-day operational delivery priorities.**

**53.** There is evidence of forward planning over the medium term through the Transform 27 programme, which is aligned with the Strategic Plan 2022-27. Actions and proposals identified within Transform 27 have informed budget modelling and financial scenario planning.

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# 4. Vision, leadership and governance

Public sector bodies must have a clear vision and strategy and set priorities for improvement within this vision and strategy. They work together with partners and communities to improve outcomes and foster a culture of innovation.

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## Conclusion

Skills Development Scotland has a clear vision aligned with the Scottish Government's National Strategy for Economic Transformation, delivered through the Annual Operating Plan 2023/24 and the Transform 27 programme.

Governance arrangements are appropriate and support scrutiny of decisions by the Board.

A simplified organisation structure has been implemented in year to accelerate transformation and enhance collaboration behind Skills Development Scotland's strategic goals.

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## SDS has a clear vision aligned with the Scottish Government's National Strategy for Economic Transformation

**54.** In 2022, SDS published its Strategic Plan 2022-27, Skills for a Changing World. This sets out a clear vision supported by five corporate goals aligned to the Scottish Government's National Strategy for Economic Transformation and National Performance Framework. Each corporate goal has its own key performance indicators (KPIs) to measure progress. SDS continued to work towards delivery of the strategic goals during the year, through the Annual Operating Plan 2023/24 and Transform 27, SDS' transformation programme ([paragraph 49](#)).

**55.** Progress against the corporate goals was monitored and reported regularly to the Audit and Risk Committee (ARC) and Finance and Operational Performance Committee (FOP) throughout 2023/24. Performance for the year was also reported in the performance overview section of the strategic report (within the 2023/24 annual report and financial statements). Our audit review of the strategic report did not identify any material inconsistencies or omissions.

## **Governance arrangements are appropriate and support scrutiny of decisions made by the SDS Board**

**56.** SDS' governance arrangements have been set out in the directors' report and governance statement in its annual report and financial statements. We have reviewed these arrangements and concluded that they are appropriate.

**57.** The SDS Board is supported by committees, including the ARC and the FOP. As part of our role as external audit we have attended the ARC meetings that took place throughout 2023/24 and have reviewed papers and minutes of other meetings. SDS' executive and non-executive directors have demonstrated effective leadership and scrutiny of SDS' activity and performance in 2023/24.

**58.** There is still some scope to strengthen SDS' approach to openness and transparency by making the budget and performance monitoring reports, as well as committee minutes, available on SDS' website. While we recognise that it is for each organisation to determine what papers are made available to the public, this would assist stakeholders' understanding of the challenges facing SDS in its current environment.

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## **Recommendation 2**

Board and committee papers should be made available to the public where appropriate.

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## **SDS has implemented a simplified organisation structure to support collaboration and accelerate transformation**

**59.** Towards the end of 2023/24, SDS implemented a streamlined organisation structure to create greater collaboration and cohesion behind the SDS strategic goals and accelerate transformation. The new structure consists of three interdependent portfolios - governance, delivery and transformation. Three governance groups within each of the new portfolios replace fourteen governance groups that existed previously. The membership and remit of the new governance groups has been set out clearly in terms of reference, summarised below:

- Executive Governance Board: chaired by the Chief Executive, the role of the Executive Governance Board is to provide strategic executive direction to the ambitions of the SDS Board as set out in the Strategic Plan 2022-27. It provides oversight for the annual operational performance via the Performance Board, and oversight of organisational change and service development through the Transformation Board.
- Performance Board: chaired by the Senior Director (Delivery) and has responsibility for the monitoring and stewardship of operational performance of service delivery activities. The Performance Board

reports to the Executive Governance Board and the Finance and Operational Performance Committee.

- Transformation Board: chaired by the newly appointed Senior Director (Transformation) and has responsibility for the development and implementation of SDS' transition to a sustainable, target operating model. The Transformation Board reports to the Executive Governance Board and the Service Development Committee.

**60.** The structural changes are recent, with the first meeting of the Executive Governance Board held in March 2024. It is too early to conclude on the impact of the revised structure.

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# 5. Use of resources to improve outcomes

Public sector bodies need to make best use of their resources to meet stated outcomes and improvement objectives, through effective planning and working with strategic partners and communities.

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## Conclusions

Skills Development Scotland has a performance management framework in place with key performance indicators to measure progress against the corporate goals.

An overall 'green' rating was reported against four of the five corporate goals in the Strategic Plan 2022-27.

Anticipated reform of the skills delivery landscape has created significant uncertainty for Skills Development Scotland. SDS recognises the associated risks, both in relation to the delivery of its strategic objectives and the impact on its people.

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## Skills Development Scotland has a performance management framework in place with key performance indicators to measure progress against the corporate goals

**61.** [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 characteristics of best value and states that compliance with the duty of best value requires public bodies to take a systematic approach to self-evaluation and continuous improvement.

**62.** We consider whether Accountable Officers have put in place appropriate arrangements to satisfy their corresponding duty of best value. We may also undertake local work in this area where our risk assessment requires it. We did not undertake any specific work in 2023/24.

**63.** SDS continued to monitor key performance indicators (KPIs) throughout the year with performance reported to the Board and committees on a regular basis, through the provision of quarterly performance reports. As covered in part 4 of our Annual Audit Report, the Strategic Plan 2022-27 sets out five corporate goals aligned to the Scottish Government's National Strategy for Economic



Transformation and National Performance Framework. Each corporate goal has its own KPIs to measure progress throughout the year against the commitments of the Annual Operating Plan.

**64.** We reviewed the end of year Performance Report 2023/24 prepared for the Board and noted that performance levels in most service delivery areas were in line or above the previous year's figures. The performance overview section of the strategic report in the 2023/24 annual report and financial statements shows clear linkages between the five corporate goals of the Strategic Plan 2022/27 and the ten KPIs underpinning these themes. A more detailed performance report is prepared and used to track performance at an operational level, including reporting against targets. There is scope for SDS to enhance the performance information that is available publicly. This would enable stakeholders to make a better assessment of overall performance in year.

### **In 2023/24, an overall 'green' rating was reported against four of the five corporate goals**

**65.** Quarterly performance reports to the Board include a summary of performance highlights, risk and opportunities relating to each corporate goal, as well as some key delivery metrics over three years. A target or minimum expectation is included against some of the key delivery metrics. The end-of-year Performance Report 2023/24 against the Annual Operating Plan 2023/24 highlighted that four of the five corporate goals had an overall 'green' rating, meaning that they performed with no concerns.

**66.** The number of Modern Apprenticeship starts had marginally decreased in 2023/24 compared to 2022/23 (0.3 per cent). The minimum expectation of 25,500 starts in 2023/24 was narrowly missed following delays in awarding contracts to these new starts. The percentage of Modern Apprenticeship starts in 2023/24 increased across the majority of equality groups, meaning that SDS was meeting the equality targets set by Developing the Young Workforce (DYW), which is the Scottish Government's Youth Employment Strategy to better prepare young people for the world of work. The number of approved Individual Training Account (ITA) scheme applications reduced in year to 3,263 (14,822 in 22/23). The ITA scheme will close in 2024/25 as there is no funding for this in the SDS budget allocation from SG.

**67.** One corporate goal ('Inclusive Talent Pool') had an overall 'amber rating', meaning there were 'minor concerns' with performance. The Broad General Education service offer for S1 to S3 pupils receiving group engagement activity in the 2023/24 academic year had a minimum expectation of 85 per cent but this had not been achieved as at 31 March 2024. This measure follows the academic year which extends beyond the 2023/24 financial year. The primary reason given for this performance metric not being achieved was due to higher school absentee rates.

**68.** A greater number of employers were supported through SDS' PACE (Partnership Action for Continuing Employment) services in 2023/24 compared to the previous year (a 12.6 per cent increase). The number of 'Skills for Growth' review engagements delivered by SDS with employers decreased in

2023/24. A new delivery approach for these reviews has been introduced by SDS for the 2024/25 financial year.

**69.** As part of its progression towards its 'Intelligence-led System' corporate goal, SDS progressed its Climate Emergency Skills Action Plan 2020-2025 and Digital Economy Skills Action Plan 2023-28 respectively. This work included the publication of relevant reports and completing priority actions in 2023/24 as part of the ongoing collaboration between SDS and employers to better understand the skills needs of Scotland's businesses.

**70.** As covered in part 3 of our Annual Audit Report, the development of medium-term financial planning and the implementation of Transform 27 management actions in 2023/24 helped SDS to respond to budget challenges. These actions helped SDS contribute to the 'Impactful Organisation' corporate goal in 2023/24, where SDS 'maximises return on investment, collaborating to deliver better outcomes and experiences for our customers, colleagues, and the economy'.

### **Anticipated reform of the skills delivery landscape has created significant uncertainty for SDS**

**71.** In June 2023, the [Independent Review of the Skills Delivery Landscape](#) reported on how the public body landscape should be adapted to achieve the ambitions for a skilled workforce set out in the [National Strategy for Economic Transformation](#). This was followed by the Scottish Government's own report, [Purpose and Principles for post-school education, research and skills](#), which set out a decision making framework. The programme of reform, signalled through the Purpose and Principles and the Scottish Government's [Initial priorities](#) for implementation outlines the key actions to deliver on the vision and outcomes set for the system.

**72.** The Board has been provided with regular updates from senior management on the SG reform programme throughout 2023/24. The most recent update (May 2024) outlines SDS's understanding of progress on reform of the skills delivery landscape, including: :

- National skills planning: a commitment from Scottish Government to take on responsibility for skills planning at a national level, with a detailed design of new national skills planning processes expected by the end of the year.
- Regional skills planning: work is ongoing to determine how regional skills planning could be more effective.
- Funding for apprenticeship provision: a strategic business case is in development as part of the intention to bring the funding provision for apprenticeships into one place.
- Future development of apprenticeships: a review of the model of apprenticeship delivery and establishment of a Graduate

Apprenticeship Enhancement Group and Foundation Apprenticeship Enhancement Group to identify improvements.

- Careers service: an immediate focus on developing a clearer, coherent offer for learners and also looking to build clearer pathways for employers to support and be involved in shaping the support available.

**73.** SDS recognises significant risks relating to the continued uncertainty around the Scottish Government reform agenda, both in relation to the delivery of its strategic objectives and the impact on its people. A risk action plan is in place to manage these risks. Some of these actions include ongoing engagement with Ministers and Scottish Government to help shape future changes, the communication and implementation of Transform 27 and, a refresh of the employee Wellbeing Strategy.

**74.** A 'Reform Pulse Survey' was recently conducted on a sample of SDS employees. The aim of the survey was to gain an understanding of the impact of the proposed reform on the people working for SDS who were most likely to be directly affected. The results have been shared with the Scottish Government for consideration and internally to enable action to be taken to improve on the employee experience.

# Appendix 1. Action plan 2023/24

## 2023/24 recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p><b>b/f 1. ESF risk and mitigation plan</b></p> <p>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 or there is a risk that the funds will not be recovered.</p> <p><b>Risk</b> – The risk over recovery of ESF funds will exist until all money has been successfully reclaimed.</p>	<p>SDS should ensure that the risk and mitigation plan for ESF claims continues to be reviewed on an ongoing basis until all monies have been received and the risk of money being recovered through audit is removed.</p> <p><a href="#">Paragraph 32.</a></p>	<p><b>Accepted</b></p> <p>All parties have agreed to continue to regularly review the risk and mitigation plan while there is scope for further audits.</p> <p>Director of Finance, Information Governance, Resilience and Risk</p> <p>March 2025</p>
<p><b>b/f 2. Openness and transparency</b></p> <p>SDS Board meetings and Board/committee papers are not open or readily available to the public, in contrast with some other public bodies.</p> <p><b>Risk</b> – stakeholders are unable to fully understand how the Board is taking decisions and how it is using resources such as money, people and assets.</p>	<p>Board and committee papers should be made available to the public where appropriate.</p> <p><a href="#">Paragraph 58.</a></p>	<p><b>Accepted</b></p> <p>We continue to consider opportunities for expanding the scope of our publication scheme where it will add value. Details about requesting information from SDS is available on the corporate website.</p> <p>Director of Finance, Information Governance, Resilience and Risk</p> <p>March 2025</p>

## Follow-up of prior year recommendations

Issue/risk	Recommendation and Agreed Action	Progress
<p><b>b/f 1. ESF risk and mitigation plan</b></p> <p>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 or there is a risk that the funds will not be recovered.</p> <p><b>Risk</b> – The risk over recovery of ESF funds will exist until all money has been successfully reclaimed.</p>	<p>SDS should ensure that the risk and mitigation plan for ESF claims continues to be reviewed on an ongoing basis.</p> <p>June 2024</p>	<p><b>Ongoing</b></p> <p>The ESF risk and mitigation plan was reviewed and maintained by SDS, the SG Sponsor Team and the SG Managing Authority through monthly meetings held throughout 2023/24 and early 2024/25.</p> <p>SDS received a final payment of ESF funding of £21.0 million in June 2024 from the SG, following completion of its verification of the final ESF claim submitted by SDS in December 2023.</p> <p>ESF risk and mitigation meetings will continue to be held in 2024/25 to reflect the possibility of future audits of historic sample ESF claims and certified expenditure by the SG, which presents the risk of ESF funds being recovered by the EC.</p>
<p><b>b/f 2. IFRS 16 Leases</b></p> <p>SDS has adopted the cost model to measure right-of-use assets on the basis that higher value leases are subject to five yearly rent reviews. Management have also been advised by Graham &amp; Sibbald that recent rent reviews have not resulted in an uplift. Management consider that these factors confirm that cost is an appropriate proxy for fair value.</p> <p><b>Risk</b> – there is a risk that the value of right-of-use assets is</p>	<p>Management should re-evaluate the value of right-of-use assets year on year and consult an expert where appropriate to ensure that right-of-use assets are not materially misstated.</p> <p>March 2024</p>	<p><b>Implemented</b></p> <p>SDS remeasured the values of right-of-use assets at 2023/24 year-end to reflect the exercise of break clauses for property leases or to reflect the extension of property leases. We concluded that the leases subject to a revision in 2023/24 have been accounted for appropriately.</p> <p>SDS received advice from Graham &amp; Sibbald regarding the planned rent review of its highest value property lease. A change in rent costs is not</p>

Issue/risk	Recommendation and Agreed Action	Progress
<p>incorrectly reported in the intervening period between rent reviews.</p>		<p>anticipated as a result of this review in late 2024, indicating that the values of the underlying right-of-use assets at 2023/24 year-end are not currently subject to significant fluctuations in market prices.</p> <p>Based on the above consideration, we are satisfied that cost remains an appropriate proxy for fair value at 2023/24 year-end.</p>
<p><b>b/f 3. Medium to long term financial planning</b></p> <p>SDS has identified a grant-in-aid reduction of £19.8 million (or 9 per cent) between 2020/21 and 2023/24. This is coupled with a projected increase in the Modern Apprenticeships commitments of £9 million in 2023/24.</p> <p><b>Risk</b> – SDS is unable to respond effectively to financial pressures, compromising services and the delivery of corporate goals.</p>	<p>Ensure that medium to long term financial planning includes a range of scenarios to reflect the uncertainties that exist. This should be closely aligned with the Transform 27 programme.</p> <p>December 2023</p>	<p><b>Implemented</b></p> <p>SDS developed its medium-term financial planning work in 2023/24. A range of budget scenarios between 2024/25 to 2027/28 were mapped out using key assumptions over annual funding reductions, cost increases and forecast savings over various expenditure areas.</p> <p>We concluded that these financial planning arrangements were appropriate to ensure that SDS is reflecting the uncertainties that exist.</p>
<p><b>b/f 4. Openness and transparency</b></p> <p>SDS Board meetings and Board/committee papers are not open or available to the public, in contrast to other public bodies.</p> <p><b>Risk</b> – stakeholders are unable to fully understand how the Board is taking decisions and how it is using resources such as money, people and assets.</p>	<p>Board and committee papers should be made available to the public where appropriate.</p> <p>March 2024</p>	<p><b>Ongoing</b></p> <p>There is still scope to strengthen SDS' approach to openness and transparency by making the budget and performance monitoring reports, as well as committee minutes, available on SDS' website. This would assist stakeholders' understanding of the challenges facing SDS in its current environment.</p>

# The Skills Development Scotland Co. Limited

## 2023/24 Annual Audit Report

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