AUDIT SCOTLAND

Education Scotland

2015/16 Annual audit report to Members and the Auditor General for Scotland

June 2016

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Mark Ferris**,** Senior Audit Manager, Audit Scotland is the appointed external auditor of Education Scotland for the period 2014/15 to 2015/16.

This report has been prepared for the use of Education Scotland and no responsibility to any member or officer in their individual capacity or any third party is accepted.

The information in it may be used by the Auditor General in support of her wider responsibilities, including reporting to the Scottish Parliament.

Contents

Key messages

Audit of financial statements	• Unqualified independent auditor's report on the 2015/16 financial statements.
Financial management and sustainability	• Education Scotland reported an underspend of £0.2 million, against a budget of £36.6 million. • There was a revenue underspend of £0.5 million and a capital overspend of £0.3 million. • There were 9 misstatements identified totalling £507,836. The total value of misstatements exceeded our overall performance materiality level of £288,000. ES corrected 7 misstatements with a gross value of £402,297. • Education Scotland has received assurance from the Scottish Government that future liabilities will be met as they arise. • The initial 2016/17 budget resource allocation has reduced by £1.5 million.
Governance and transparency	• Financial control systems operated satisfactorily during 2015/16. • There is scope for Education Scotland to improve their governance arrangements. • The Management Board and the Audit and Risk committee did not meet in line with their terms of reference. At one meeting the Audit and Risk Committee was not quorate. • The internal audit function did not present any formal outputs to the ARC prior to June 2016. • A review of risk management has been delayed. • Education Scotland does not have a digital strategy in place.
Value for money	• Education Scotland will publish an Annual Review document outlining performance against the strategic objectives in August 2016. • Education Scotland should continue to develop how they generate and report on publically available performance measurements in order to demonstrate best value in the delivery of outcomes. • A new performance management approach is due to be implemented in 2016/17.

Introduction

1. This report is a summary of our findings arising from the 2015/16 audit of Education Scotland (ES).

2. The management of ES is responsible for:
   - preparing financial statements which give a true and fair view in accordance with the relevant financial reporting framework
   - ensuring the regularity of transactions by putting in place systems of internal control
   - maintaining proper accounting records
   - publishing with their financial statements an annual governance statement and a remuneration report
   - preparing a Scottish Government consolidation pack.

3. Our responsibility, as the external auditor, is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.

4. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements prepared by management with the oversight of those charged with governance. This does not relieve management of their responsibility for the preparation of financial statements.

5. A number of reports, both local and national, have been issued by Audit Scotland during the course of the year. These reports are summarised at appendix II and reports relevant to ES at appendix III.

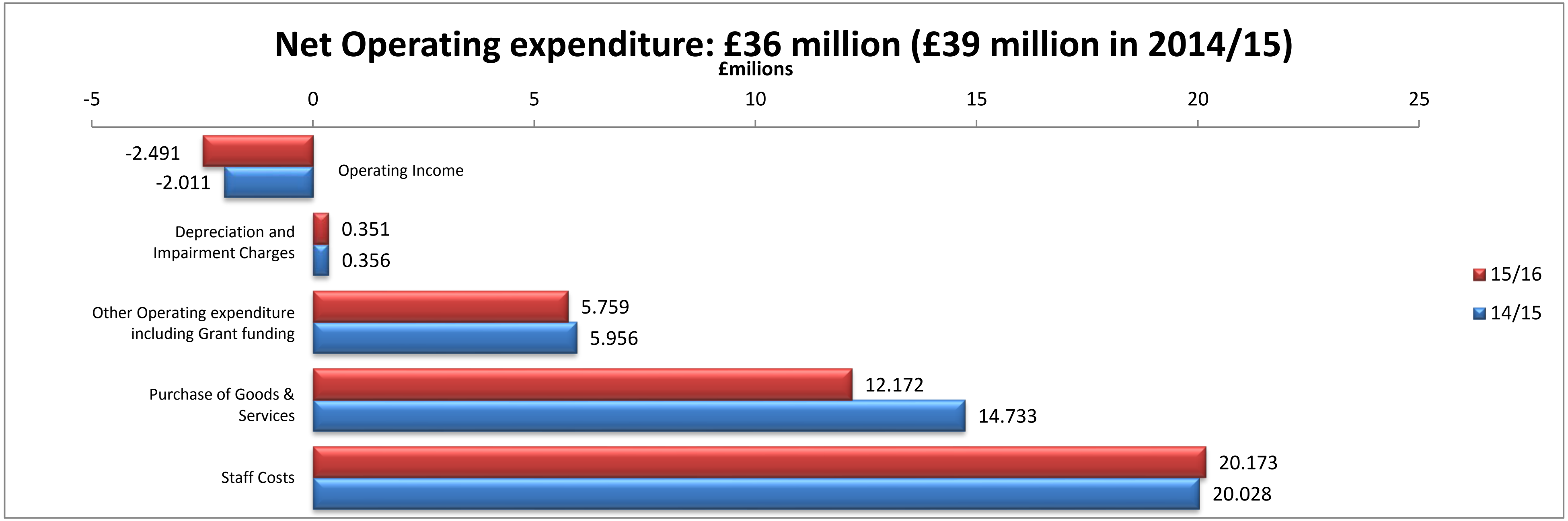
6. Appendix IV is an action plan setting out our recommendations to address the risks we have identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response". We recognise that not all risks can be eliminated or even minimised. What is important is that the Agency understands its risks and has arrangements in place to manage them. The Audit and Risk committee (ARC) should ensure that they are satisfied with proposed action and have a mechanism in place to assess progress and monitor outcomes.

7. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures; consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.

8. The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged.

9. 2015/16 is the final year of the current five year audit appointment. From 2016/17 onwards the auditor of ES will continue to be Audit Scotland. In accordance with agreed protocols and International Standards on Auditing we will be liaising with the incoming auditors as part of this transition.

Audit of the 2015/16 financial statements



10. The statement of comprehensive net expenditure shows that Education Scotland's net expenditure for 2015/16 has fallen to £35.96 million (2014/15 £39.06 million), an overall reduction of £3.1 million. Total operating expenditure has reduced by £2.62 million which is largely attributed to one off installation costs incurred in 2014/15 for the Scottish Wide Area Network (SWAN). Total operating income has increased by £0.48 million mainly as a result of higher levels of grant funding received from other public bodies.

11. The statement of financial position remained relatively static when comparing 2015/16 to 2014/15. As at 31 March 2016, ES had net liabilities of £5.53 million, an increase from £5.31 million in 2014/15. The net liabilities position is as a result of the requirement to account for activities on an accruals basis, whilst recording funding from the Scottish Government on a cash basis. Capital expenditure in year was £0.48 million which was largely offset by a depreciation charge of £0.35 million, resulting in an increase in total non current assets of £0.13 million. Current assets increased by £0.03 million while total liabilities increased by £0.38 million due to a rise in accrued expenditure.

Audit opinions

Financial Statements	• The financial statements of Education Scotland for 2015/16 give a true and fair view of the state of the body's affairs and of its net expenditure for the year. • We confirm that the financial statements have been properly prepared in accordance with the 2015/16 FReM and the requirements of the Public Finance and Accountability (Scotland) Act 2000 and directions.
Regularity	• In all material respects, the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance. • The sums paid out of the Scottish Consolidated Fund were applied in accordance with section 65 of the Scotland Act 1998.
Other prescribed matters	• The part of the Remuneration and Staff Report to be audited has been properly prepared in accordance with the Public Finance and Accountability (Scotland) Act 2000 and directions made thereunder by the Scottish Ministers. • The information given in the Performance Report is consistent with the financial statements.

Submission of financial statements for audit

12. We received the unaudited financial statements on 15 April 2016 in accordance with the agreed timetable. The working papers were of a good standard and staff provided support to the audit team which enabled us to complete our on-site fieldwork on 6 May 2016.

Overview of the scope of the audit of the financial statements

13. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan presented to the ARC on 5 April 2016.

14. As part of the requirement to provide full and fair disclosure of matters relating to our independence, we can confirm that we have not undertaken any non-audit related services. The 2015/16 agreed notional fee for the audit was £34,400 and, as we did not carry out any work additional to our planned audit activity, the notional fee remains unchanged.

15. The concept of audit risk is of central importance to our audit approach. During the planning stage of our audit we identified a number of key audit risks which had the greatest effect on the audit strategy, resources and effort. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance.

16. Appendix I sets out the audit risks identified at the planning stage and how we addressed each risk in arriving at our opinion on the financial statements.

17. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

Materiality

18. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit procedures. We assess the materiality of uncorrected misstatements, both individually and collectively.

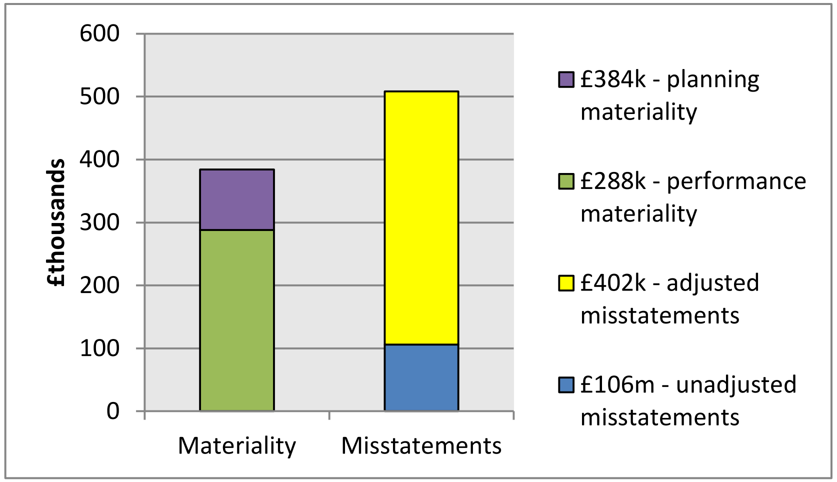
19. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

20. We summarised our approach to materiality in our Annual Audit Plan. On receipt of the unaudited accounts, we maintained our planning materiality at £384,000 (1% of total operating expenditure).

21. We also set a lower level, known as performance materiality, when defining our audit procedures. This is determined to ensure that uncorrected and undetected audit differences do not exceed our materiality level. Performance materiality was set at £288,000.

22. We report all misstatements greater than £5,000.

Exhibit 1: Overall materiality misstatements



Source: 2015/16 Annual Audit Plan

Evaluation of misstatements

23. We have identified 9 misstatements in the unaudited financial statements totalling £507,836. Seven of these, with a gross value of £402,297 were adjusted by the finance staff and are reflected in the revised annual accounts.

24. Two of these with a gross value of £105,539 are unadjusted. If these errors had been corrected then the overall affect on the accounts would have been to decrease net comprehensive expenditure by £45,237 and increase net liabilities by £15,065.

25. The total value of misstatements exceeded our overall performance materiality level of £288,000. Further audit procedures were performed to provide assurance that the errors identified were isolated in nature and not pervasive to either the account area or the financial statements as a whole.

26. We requested that all errors be corrected, although the final decision on this matter rests with those charged with governance taking into account advice from officers.

Significant findings from the audit

27. International Standard on Auditing 260 (ISA 260) requires us to communicate to you significant findings from the audit as detailed below:

- the auditor’s views about significant qualitative aspects of the entity’s accounting practices, including accounting policies, accounting estimates and disclosures
- significant difficulties encountered during the audit
- significant matters arising from the audit that were discussed, or subject to correspondence with management
- written representations requested by the auditor
- other matters which in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

28. The following table details those issues or audit judgements that, in our view, require to be communicated to those charged with governance in accordance with ISA 260.

Table 1: Significant findings from the audit

Significant findings from the audit in accordance with ISA260
Going Concern 29. The balance of taxpayers' equity at 31 March 2016 is reported as £5.5 million (31 March 2015 £5.3 million). The financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the entity has neither the intention nor the need to liquidate or curtail materially the scale of its operations. This may be called into doubt if there are significant net liabilities in the statement of financial position. The current net liability has increased from prior years and as such, ES will wish to consider any consequences should the negative balance of taxpayers' equity increase in future years. **Resolution**: The net liabilities position is as a result of the requirement to account for activities on an accruals basis, whilst recording funding from the Scottish Government on a cash basis. ES has received assurances from the Education and Lifelong Learning portfolio of the Scottish Government that future net current liabilities with be funded as they arise. We have had discussions with finance staff and undertaken a review of management's assessment and the assurances provided to them by the Scottish Government. We are content that ES will continue to operate on a going concern basis. An explanation of the adoption of the going concern basis is included in the annual accounts and assurance is to be provided in the letter of representation that the negative balance on taxpayers' equity will not impact on the continuing operation of ES.

Revaluation of Leasehold Improvements

30. ES was formed in 2011 as a result of a merger between Her Majesty's Inspectorate for Education (HMIE) and Learning Teaching Scotland (LTS). The agency continues to maintain two separate asset registers, one managed by ES and one of which is partly managed by the Scottish Government Finance department (SGFD). Leasehold improvements (NBV of £213,454) held on the SGFD register are annually indexed to inflation rates, a revaluation policy usually applied to owned land and buildings or other assets held at Depreciated Replacement Cost (DRC). Leasehold improvements held on the ES asset register are not subject to revaluation and depreciated over the term of the lease. Applying two separate revaluations policies to the same asset class represents a deviation from accounting standards, and we would not expect leasehold improvement assets to be subject to indexation. Applying this policy has resulted in leasehold improvements being overstated in the accounts by £60,302.

Resolution: The indexation adjustments are applied by Scottish Government on behalf of ES and while ES finance staff have challenged this treatment they have taken the decision to leave the accounts unadjusted and will continue to apply indexation until the current leases expire in 2019. As auditors we have accepted this matter as an unadjusted error and as the amount is below our materiality threshold it has had no impact on our audit opinion. We recommend that ES continue to review their non-current asset policies and continue to consider adopting a consistent and appropriate approach to revaluation.

Appendix IV – Action Plan No. 1

VAT Provision Adjustment

31. ES created a £970,000 provision in 2014/15 providing for estimated costs that could be incurred following an HMRC investigation into the charging of VAT by local authorities for staff seconded to ES. The Scottish Government (ES operate under SG's VAT registration) are challenging HMRC judgements on this issue and the dispute is still on-going. In 2015/16 HMRC accepted that staff seconded to ES to perform school inspections would be classed as providing educational services and VAT did not need to be charged. ES has continued to provide £45,237 in relation to seconded inspectors.

Resolution: To comply with accounting standards the £45,237 should be removed from the total provision. The ES finance team has decided not to adjust the provision. As auditors we have accepted this matter as an unadjusted error and as the amount is below our materiality threshold it has had no impact on our audit opinion.

Deferred Income Adjustment

32. ES received income from Skills Development Scotland (SDS) to cover the cost of two Skills Development Officers over a multi year period. We identified an error in the calculation for the amount which required to be deferred until future years resulting in deferred income being overstated by £50,420.

Resolution: This was agreed with finance staff and an adjustment has been processed in the accounts. Our audit testing provided assurance that there were no similar errors within the overall balance.

Classification of staff costs

33. The accounting standards and the FReM require public bodies to classify expenditure by type, splitting the amounts in the Statement of Comprehensive Net Expenditure between staff and non-staff costs. Where a public body uses a recruitment agency to resource programmes and deliver services, these are normally accounted for as staff costs. During our audit work we identified payments totalling £235,162 to recruitment agencies which had been classified as non-staff costs and included in the Purchase of Goods and Services total.

Resolution: ES has reviewed the list of agency payments not reflected in staff costs and confirmed that the costs related to agency staff and not contractors. The correction was agreed with finance staff and an adjustment has been processed in the accounts.

Appendix IV – Action Plan No. 2

Payroll Overpayment

34. Following an analytical review of staff costs transactions we identified an unusual monthly salary payment made to an employee. An investigation by the Scottish Government (SG) payroll department confirmed the employee had been overpaid by £6,496 following a promotion. While the error was made by SG, a key control is a review of the monthly payroll by the ES finance team. This identified a variance which ES queried with SG payroll. ES accepted the explanation for this variance.

Resolution: Steps are being taken to recover the overpayment. The correction was agreed with finance staff and an adjustment has been processed in the accounts. We undertook further analytical testing and reviewed the payroll records for employees promoted in year and did not identify any additional errors.

Appendix IV – Action Plan No. 3

Video Conferencing Equipment

35. During 2015/16 ES purchased a suite of video conferencing equipment for installation across their office estate with a view to reducing travel costs and the time for staff attending meetings. As the most significant capital addition for the year we substantively tested the purchase and identified three items that had not been accounted for correctly. An integral part of the package was a software licence costing £29,314 which is required for the system to operate and as such should have been capitalised. ES also purchased 12 month maintenance and support contracts at a total cost of £33,860. The contracts cover the period 21 March 2016 to 20 March 2017 and should be accounted for as a prepayment.

Resolution: The correction was agreed with finance staff and adjustments have been processed in the accounts to capitalise the licence and recognise the contracts as a prepayment.

Trade Receivables Balance

36. Our review of trade receivables identified a £12,747 balance that had been outstanding for over more than 1 year. An investigation confirmed the balance had been paid in 2013 however the payment was not matched to the original invoice.

Resolution: The correction was agreed with finance staff and an adjustment has been processed in the accounts.

Inventory write off

37. ES held an inventory of physical educational materials for sale to schools. During 2015/16 £438 of sales were made leaving the inventory value of £37,120 largely unchanged at the year end. We confirmed a high proportion of the resources were now distributed online for free and some stock was out of date. We considered the stock may be overvalued and requested that the value shown in the accounts was reviewed.

Resolution: Following a full review finance staff decided to write off the inventory in full. We have reviewed this and are satisfied that this write off is appropriate.

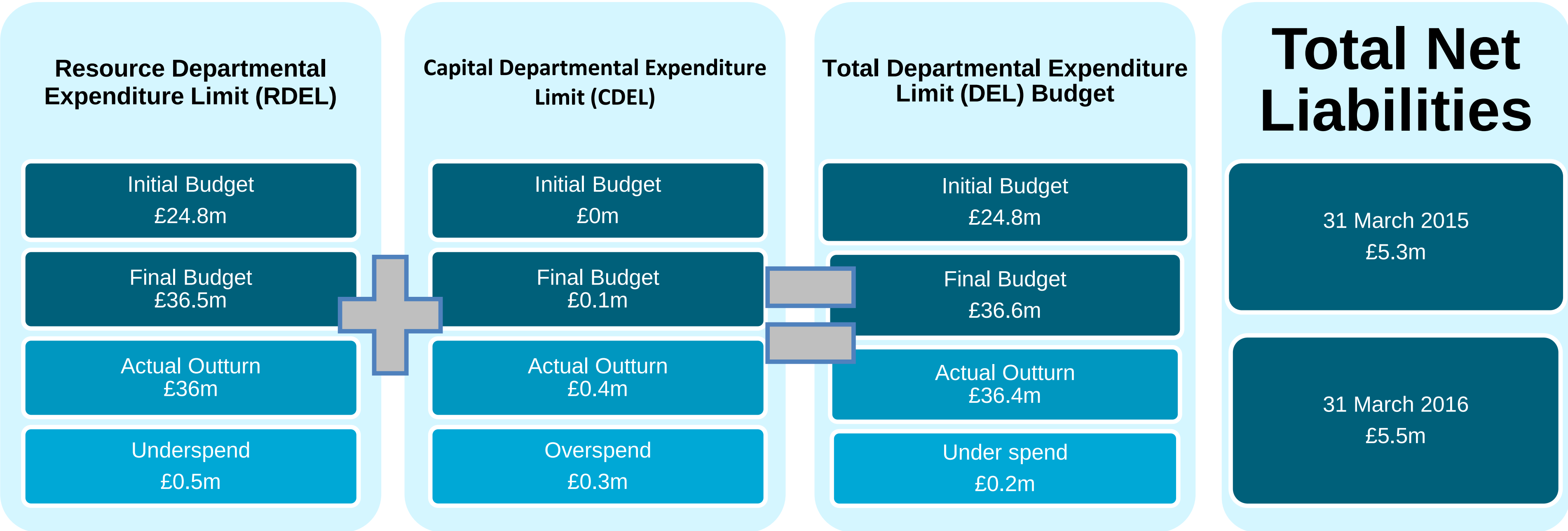
Future accounting and auditing developments

38. No changes have been made to the 2016/17 FReM since the publication of the revised 2015/16 FReM.

39. A new Code of Audit Practice applies to public sector audits for financial years starting on or after 1 April 2016. It replaces the Code issued in May 2011. It outlines the objectives and principles to be followed by auditors. It is part of the overall framework for the conduct of public audit in Scotland.

40. The new Code increases the transparency of our work by making more audit outputs available on Audit Scotland's website. In addition to publishing all annual audit reports, annual audit plans and other significant audit outputs will be put on the website for all audited bodies. This is irrespective of whether the body meets in public or makes documents such as audit committee papers routinely available on its own website.

Financial management and sustainability



2015/16 financial position

41. Education Scotland, as an executive agency of the Scottish Government, receives almost all of its funding directly from the Scottish Government. Its main financial objective is to ensure that the financial outturn for the year is within the budget allocated by Scottish Ministers.

42. Its initial budget was set out in the 2015/16 Draft Budget published in October 2014. The agency received additional allocations totalling £11.8 million during the budget revision process, with a final figure of £36.6 million set by the Spring Budget Revision in January 2016. The additional funding was provided to deliver several specific programmes of work.

43. This budget allocation process has been in place for a number of years, and while the final budget allocation is finalised late in the financial year, the agency is made aware of its indicative budget earlier to aid their budget monitoring and financial management decisions.

44. ES has reported an outturn of £36.4 million, successfully remaining within its overall budget for 2015/16 with an underspend of £0.2 million.

45. Like all other public bodies, the ES budget is split into revenue and capital budgets. Their overall underspend is a net position made up of a £0.5 million underspend on their resource budget and a £0.3 million overspend on their capital budget.

46. In comparison to other public bodies, ES has limited capital investment requirements and so a capital provision is not normally included in its initial budget. If ES identifies areas of capital expenditure it will request approval to move its budget from resource to capital through discussions with the Education & Lifelong Learning (ELL) Finance Business Partner in the Scottish Government.

47. The 2015/16 capital over spend occurred because of the decision to invest in video conferencing equipment. ES Resources Board gave approval for the purchase in January 2016. The SG were notified when there was confirmation the equipment could be delivered within the financial year and additional capital budget was required. ELL business partner confirmed they were able to accommodate this as part of their wider management of the ELL budget.

Appendix IV – Action Plan No. 4

Financial Planning

48. As funding from the Scottish Government is ES's primary source of income there is greater certainty over future funding streams than for some other public sector organisations who are involved in income generating activities. The main focus for ES is achieving a balanced financial plan to remain within their annual allocation.

49. The Scottish Government published its 2016/17 draft budget in December 2015 with a resource allocation of £23.3 million which is £1.5 million (6%) less than the initial 2015/16 budget allocation.

50. ES has undertaken a detailed business planning exercise in order to identify the resource requirements needed to deliver priority programmes as set by Ministerial decisions. This has identified a shortfall based on the reduction in the indicative annual budget. As a consequence senior management has agreed a series of efficiency savings and reductions to some non-priority programmes.

51. The current forecast plans are for a £0.34 million overspend; a decrease from the figure of £0.45m which has been reported to the Scottish Government. This position is based on a number of savings assumptions and there is a risk that these will not materialise as anticipated.

52. Following the 2016 Scottish Parliament elections it is likely the new Scottish Government will publish a multi-year spending review. ES should ensure their business plans consider how resources are to be utilised over the medium and long term.

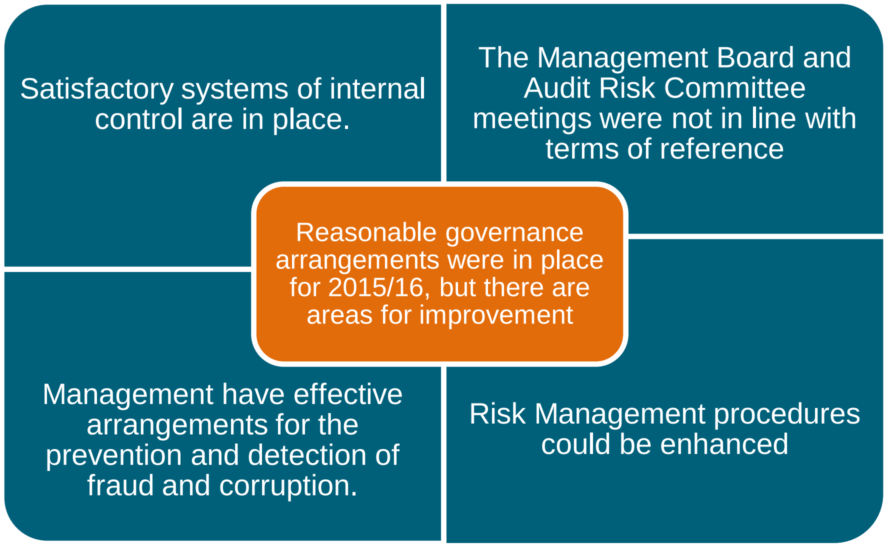
Appendix IV – Action Plan No. 5

Financial management

53. As auditors we need to consider whether bodies have established adequate financial management arrangements. We do this by considering a number of factors, including whether:
    - the Corporate Services director has sufficient status to be able to deliver good financial management
    - standing financial instructions and standing orders are comprehensive, current and promoted within the body
    - reports monitoring performance against budgets are accurate and provided regularly to budget holders
    - monitoring reports contain financial data which is clearly linked to performance information
    - ARC members provide a good level of challenge and question significant variances.

54. Based on our accumulated knowledge, our review of board papers and through our attendance at the ARC we conclude that ES has reasonable financial management arrangements in place. Financial management arrangements could be improved through an increase in the degree of financial scrutiny applied by ARC members.

Governance and transparency



Corporate governance

55. Education Scotland is headed by a Chief Executive who is responsible to Scottish Ministers, within the terms of the framework document, for its management, performance and future development. The Chief Executive has responsibility for all operational matters as delegated by the Director-General Learning and Justice.

56. The Chief Executive has a responsibility to ensure the Agency effectively delivers ministerial policies and is supported in this by the Management Board (MB). The Chief Executive chairs the MB, which comprises three Strategic Directors and the Chief Operating Officer who form the Corporate Management Group (CMG), and 4 Non-Executive Directors appointed by the Chief Executive.

57. The MB is supported in its role by a number of standing committees as illustrated in exhibit 3 below:

Exhibit 2: Education Scotland Governance Structure 2015/16

58. The current terms of reference for both the ES MB and ARC require them to meet on a quarterly basis. During 2015/16 the MB met on one occasion with one meeting replaced with a “risk workshop” and another was postponed until April 2016. The ARC met on three occasions, their fourth meeting was also postponed until April 2016. The April meeting was not attended by the minimum number of non executive directors and was therefore not quorate. There is a risk that the MB and the ARC are not fulfilling their duties as outlined within their respective terms of reference.

Appendix IV – Action Plan No. 6

59. All 4 non executive directors sit on the MB and also on the ARC. Three of the 4 non-executive director’s terms expire in June 2016. Plans are in place to extend these for an additional year while a recruitment exercise is undertaken.

60. ES should put appropriate succession arrangements in place to ensure continuity of experience within the non-executive cohort. There is also an opportunity to review how best to utilise the skills of the non-executive directors attending the MB and ARC respectively.

Appendix IV – Action Plan No. 7

Transparency

61. The Scottish Government’s On Board guidance (http://www.gov.scot/Publications/2015/04/9736/0) for board members of public bodies was updated and reissued in April 2015. On Board states that boards should demonstrate high standards of corporate governance at all times including openness and transparency in decision making. It recommends boards should consider:

- holding an annual open meeting
- holding board meetings in public unless there is a good reason not to
- publishing summary reports and/or minutes of meetings
- inviting evidence from members of the public in relation to matters of public concern
- consulting stakeholders and users on a wide range of issues
- making corporate plans and the annual report widely available.

62. Audit Scotland also believes in transparency of financial reporting within the Annual Accounts including:

- a clear reconciliation between expenditure and the outturn against Scottish Government Resource budgets.
- identification and explanation of any significant movements in budget during the year.

63. We recommend ES reviews their level of openness and transparency by implementing fully the recommendations made in the Scottish Government’s On Board guidance applicable to executive agencies.

Appendix IV – Action Plan No. 8

Risk Management

64. ES planned to undertake a review of their risk management process and strategy during 2015/16. This review began in October 2015, and an updated draft risk management approach including strategy and policy was prepared. This was aligned closely with the Scottish Government risk management approach.

65. Before this review was completed and the revised strategy implemented, the "Improving Our Organisation" programme was launched. ES determined that the corporate priority should be improving and introducing a new approach to business planning to be aligned with the next corporate plan covering the period 2016/19. It was therefore decided to put the risk management review on hold and risk management was to be considered as a work stream of this programme.

Appendix IV – Action Plan No. 9

Internal control

66. No material weaknesses in the accounting and internal control systems were identified during the 2015/16 audit which could adversely affect the organisation's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

Internal audit

67. Internal audit provides the ARC and Accountable Officer with independent assurance on the overall risk management, internal control and corporate governance processes. We are required by international auditing standards to make an assessment of internal audit to determine the extent to which we can place reliance on its work. To avoid duplication, we place reliance on internal audit work where possible.

68. As part of our risk assessment and planning process our Scottish Government audit team assessed the Scottish Government Internal Audit Division (SGIAD), ES's internal auditors, and concluded that they operate in accordance with the Public Sector Internal Audit Standards (PSIAS).

69. During 2015/16 staffing issues within the SGIAD has resulted in slippage in the delivery of their annual audit plan for ES. No internal audit reports have been presented to the ARC during the year.

70. At the September 2015 ARC internal audit reported that a meeting had been held between the Chief Operating Officer and the Assistant Director. As a consequence of these discussions it was felt that there was an opportunity to re-focus the internal audit programme and it should focus on

- Certificates of Assurance (indicative reporting to ARC in December 2015)
- Organisational Development (indicative reporting to ARC in March 2016).

71. **Certificates of assurance:** The December 2015 progress report advised that the work was in progress with fieldwork commencing on 7 December, ending on 26 February with a draft report issued 18

March 2016 and a final report issued on 15 April. The April 2016 progress report confirmed fieldwork was on track however the draft report was not available at that time.

72. **Organisational Development:** The December progress report noted that this work had not yet started. The April 2016 progress report provided an update that internal audit would have membership on the Programme Board which was due to meet for the first time on 23 March 2016. Thereafter support would be provided through a post implementation review of the revised Business Planning process.

73. **Follow up of prior year reviews:** The December progress report noted that this work had not yet started. The April 2016 progress report advised the follow up of the two 2014/15 reports were in progress.

74. The results of the review of the Certificate of Assurance process and follow up reviews on Grant Funding and Governance are now scheduled to be presented to the ARC June meeting. The annual assurance report was not available at the time of completing our final accounts audit.

75. A strategic review of SGIAD was completed in year and steps are being taken to increase the division's resources. A new business partner for ES has been appointed and the 2016/17 Internal Audit Plan will be issued in June 2016, covering the period until March 2017, as part of a decision to realign the internal audit year to the financial year.

76. It is recommended that the plan includes clear delivery timescales for planned work and steps are taken to ensure that all work including the annual assurance report is provided to ES prior to the preparation of their annual report.

Appendix IV – Action Plan No. 10

Performance Management

77. Following previous audits we have reported on ES's approach to measuring their performance. Their own performance is assessed on an annual basis and communicated to stakeholders through the ES Annual Review published in addition to their annual accounts. The majority of their reporting focuses on outputs produced during the year and not the outcomes they have contributed to creating. There are limited numerical key performance indicators to allow year on year comparison of performance.

78. ES continue to work on developing their performance management and reporting with a view to focusing on outcomes as well as outputs. This is one of the work streams within the "Improving our Organisation" with a view to introducing a revised performance management framework to coincide with their 2016-2019 Corporate Plan.

79. A summarised account of their 2015/16 performance is included in the Performance Report of the annual accounts. This is the first year of revised FReM guidance on the format and content of the Performance Report. Going forward reported information contained

in the Performance report should be enhanced once the improvements outlined above are implemented.

Appendix IV – Action Plan No. 11

ICT

Digital Strategy

80. Digital Services play a critical role in both the day to day running of ES and the projects and policies that it helps to deliver. In our 2014/15 AAR we reported our concerns that ES did not have an organisational Digital Strategy. Management assurances were provided that this would be a priority with a target date of March 2016. The Digital Strategy is not yet in place.

81. We have been advised that the lack of experienced business analysts within the Digital Services team has impacted on the planned delivery date. Approval has been granted to appoint a contractor for six months to address this capability issue.

Appendix IV – Action Plan No. 12

Digital Services Organisation

82. The migration of ES's corporate systems onto the SCOTS platform, managed by the Scottish Government's ISIS team, has removed the requirement for a local IT support team. Digital Services has been re-organised to reflect this change, with responsibilities now separated into two areas:

- digital engagement, supporting the development and delivery of the strategy
- web development, developing and maintaining ES's public internet presence.

83. This change in focus has highlighted a lack of senior ICT capability within the Digital Services team. To deliver this organisational change it was necessary to appoint senior, specialist ICT temporary members of staff to lead these teams on an interim basis. There is a risk that this does not provide a robust platform to support the continuing development and delivery of the Digital Services necessary to support the corporate plan.

Appendix IV – Action Plan No. 13

Public web-site presence

84. To support the delivery of the National Improvement Hub (NIH) a new server infrastructure to support all aspects of ES's public internet presence has been implemented. This is located within the Scottish Government data centres as an element of ES's shared services agreement which covers all aspects of security, backup and resilience for this new infrastructure.

85. In addition to supporting new initiatives (e.g. the NIH), it is the intention to migrate all of ES's legacy internet content (e.g. National Qualifications on Line, Parentzone and the main corporate web-site) to this new platform.

86. Under the leadership of the Head of Web Strategy Development, a plan has been developed to migrate this legacy content on to the new platform before the end of November 2016, when the current

third-party website hosting contract is due to end. This will migrate ES's public internet presence on to the "gov.scot" domain.

87. We noted in our annual audit plan that under the terms of the current third-party website, hosting contract backup and resilience arrangements were not well defined. This continues to be the case, with the risk that the access to the information provided via this web-site could be compromised in the event of an incident (e.g. a hardware failure or a cyber attack).

Appendix IV – Action Plan No. 14

Arrangements for the prevention and detection of fraud

88. ES is responsible for establishing arrangements to prevent and detect fraud and other irregularity. We reviewed and reported on these arrangements and have concluded that there are effective arrangements for the prevention and detection of fraud.

National Fraud Initiative in Scotland

89. ES participates in the National Fraud Initiative (NFI) through the Scottish Government Payroll and Financial Services Division. The NFI uses electronic data analysis techniques to compare information held on individuals by different public sector bodies and different financial systems, to identify data matches that might indicate the existence of fraud or error.

90. As the Scottish Government does not hold a separate record of data matches relating specifically to ES we have not been able to establish the number of data matches identified for investigation. However, the Agency has not been notified of any issues by the Scottish Government in relation to their matches.

Arrangements for maintaining standards of conduct and the prevention and detection of corruption

91. Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and have proper arrangements in place for implementing and monitoring compliance with standards and codes of conduct, standing orders and financial instructions. We consider whether bodies have adequate arrangements in place and have concluded that appropriate arrangements exist within ES.

Value for money

Arrangements for securing Best Value

93. Accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value. Audited bodies are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily.

94. The Auditor General may require that we consider whether accountable officers have put in place appropriate arrangements to satisfy their corresponding duty of best value. Where such requirements are not specified we may, in conjunction with ES agree to undertake local work in this area.

95. We did not undertake any specific work in this area during 2015/16.

Local performance audit reports

Workforce Planning Arrangements

96. During 2015/16 auditors of all public bodies were asked to undertake audit work reviewing the workforce planning arrangements in place.

97. As part of the "Improving our Organisation" programme ES are developing their workforce planning arrangements. A detailed business planning process has been completed to allocate resources across delivery programmes for the 2016/17 financial year. Further work is planned under the "Optimising Our People" work stream include reviewing staff skills, identifying skills gaps and developing a "staffing model" that is aligned to their strategic objectives.

98. ES should continue to develop workforce plans which cover the whole organisation over the medium and long term.

Appendix IV – Action Plan No. 15

National performance audit reports

99. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2015/16, a number of reports were issued as outlined in Appendix III.

Appendix I: Significant audit risks

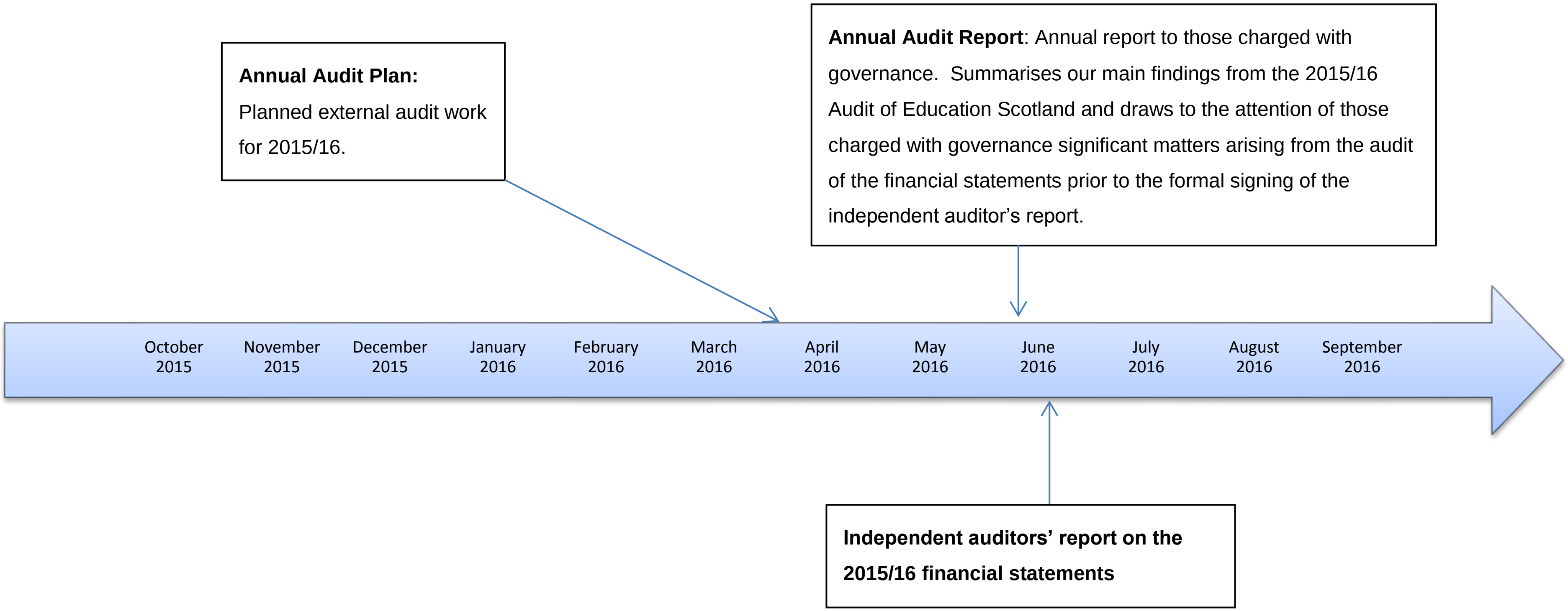
The table below sets out the audit risks we identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

Audit Risk	Assurance procedure	Results and conclusions
Risk of material misstatement		
Financial planning ES continue to operate in a challenging economic environment. They are under pressure to deliver a quality service whilst remaining within a budget which has decreased in real terms. As of October 2015 a projected budget underspend has been reported. This is based on an assumption that ES will receive budget transfers from the SG as part of the SBR process.	We reviewed budget monitoring documents submitted to the ARC and CMG meetings, and the published Spring Budget Revision. We discussed budget monitoring and budget planning arrangements with finance and corporate services staff. Our substantive audit work on capital and revenue expenditure has provided assurance on the final outturn figure	ES received the anticipated budget transfers as part of the Spring Budget Revision and their 2015/16 and have reported a £0.2 million underspend against their final combined revenue and capital budget of £36.6 million. Their capital budget was overspent by £0.3 million and their revenue budget was underspent by £0.5 million. This has been examined in more detail in the main body of our report under Financial Management and Sustainability.
SWAN The complex nature of the SWAN contract increases the risk that ES cannot match the income and expenditure for SWAN with the SWAN contract.	We undertook substantive testing of SWAN related income and expenditure as part of our audit work	ES recorded £0.2 million of SWAN related income in 2015/16 made up of 9 transactions. We have tested 85% of this total and were able to match this to the corresponding expenditure costs. No issues were identified.

Audit Risk	Assurance procedure	Results and conclusions
Financial statements – management override of controls ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls in order to change the position disclosed in the financial statements.	Detailed testing of journal entries. Review of accounting estimates for bias. Evaluating significant transactions that are outside the normal course of business. Focused testing of accruals and prepayments.	Our audit procedures did not uncover evidence of management override of controls.
Risks identified from the auditor's wider responsibility under the Code of Audit Practice		
Performance Management The move to a new performance management approach from 2016/17 creates additional risks for ES in their ability to demonstrate delivery of outcomes as defined in the 2015/16 business plan.	Review of ARC and CMG papers Discussions with officers regarding new performance management priority setting Review of performance report within financial statements	We reviewed the performance information included in the Performance Report and recommended changes to enhance the disclosures. There is still scope for ES to improve their performance reporting including linking their performance to outcomes rather than outputs.
Risk Management ES are continuing to develop the way they assess and manage risk. Until this new model becomes embedded there is a risk the corporate risk register does not fully reflect the organisational risk.	Review of ARC and CMG papers Discussions with officers regarding new risk management model Review of corporate risk register Review of work of internal audit	The embedding of the new risk management model has been postponed and will now be completed by the end of 2016. The corporate risk register was updated during the financial year.

Audit Risk	Assurance procedure	Results and conclusions
Digital strategy and cyber risk The use of ICT underpins the successful delivery of strategic objects. ES has not had a formal digital strategy in place in 2015/16. The recent cyber attack on the JANET network highlights the risk of user disruption and reputational risk for ES as they develop their role in the wider SWAN environment.	Review of ARC and CMG minutes Discussions with IT officers Review of back up and resilience arrangements for public website Review of actions taken as a result of the DDOS cyber attack	ES are still developing their digital strategy and have planned for this to be agreed in summer 2016. ES has advised they are taking steps to increase the resilience of their public facing websites including the relocation of the host infrastructure

Appendix II: Summary of local audit reports 2015/16

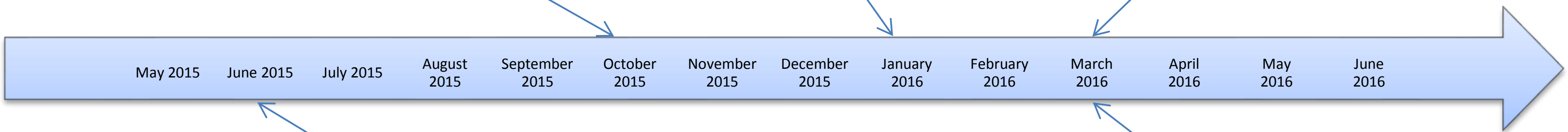


Appendix III: Summary of Audit Scotland national reports 2015/16

The 2014/15 audit of the Scottish Government Consolidated Accounts (October 2015) -
The Auditor General for Scotland, Caroline Gardner, has prepared a report to support the Scottish Parliament's scrutiny of the Scottish Government's 2014/15

Major capital investments in councils: follow-up (January 2016) - Councils need to improve further the way they manage major projects like schools, roads, housing and flood prevention, says the Accounts Commission.

An overview of local government in Scotland (March 2016) – Budget reductions mean starker choices ahead for councils which will not be met simply by continuing to cut staff and services.



Managing ICT contracts in central government: an update (June 2015)
The Scottish Government and central government bodies continue to encounter difficulties in managing Information and Communication Technology (ICT) programmes, though progress is being made to overcome these issues

National scrutiny plan for local government (March 2016) – Provides a summary of strategic scrutiny activity for all councils in 2016/17.

Appendix IV: Action plan

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
1.	30	**Leasehold Improvement Indexation** Indexation is being applied to a number of ES leasehold improvement assets. Indexation should not be applied to this class of asset. As a result we consider NCA to be overvalued by £60,302. **Recommendation** ES should continue to review their accounting policy for leasehold improvements and seek an opportunity to apply an appropriate treatment in future financial years.	This will be reviewed in 2016-17. If the required adjustments are made this will involve a write off against the balance in the revaluation reserve.	Head of Finance and Procurement 31 July 2016

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
2.	33	**Classification of Staff Costs** We identified a number of payments relating to temporary agency staff that had been classified as non-staff costs in the 2015/16 draft accounts. There is a risk that the true picture of the numbers and costs of using temporary staff is not accounted for in accordance with the FReM. **Recommendation** ES should review the classification of staff costs to ensure this is compliant with the FReM. Guidance should be issued to ES staff to ensure the policy is applied on a consistent basis.	The classification of staff costs used during the year reflected the distinction between staff who were engaged to fulfil an ES role and those who were engaged to undertake a specific piece of work- this was exclusively work on IT projects or Glow. This complies with the requirements of the FReM. The classification was applied consistently throughout the year. At the clearance meeting Audit Scotland asked that all staff recruited via a recruitment agency be classified as agency staff regardless of the nature of work that they were doing. This was agreed to on the basis that the coding should reflect the legal and contractual position. ES will review this for 2016-17 and the ES policy on coding issued to relevant staff to ensure consistency of coding. This area might benefit from a wider review as Audit Scotland's own report made several references to "IT contractors" although they had been recruited via an agency. There is potential here for a continuing lack of clarity and misunderstanding.	Head of Finance and Procurement 30 June 2016

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
3.	34	**Payroll Overpayment** A salary overpayment was identified during our audit. A key system control is to review monthly payroll costs. There is a risk that the current control is not operating effectively. **Recommendation** ES should review the operation of their monthly payroll checks to ensure staff provide appropriate challenge.	Monthly payroll checks are currently in place and staff have been trained. The overpayment was identified when the routine monthly reconciliation was undertaken and was queried immediately. SG payroll had assured us that the payments were correct. The response provided by the payroll team provided evidence which confirmed the balance and seemed reasonable and therefore did not merit further investigation. At the time of the audit, when AS checked with a different member of the payroll team he was given a different answer.	Head of Finance and Procurement 30 June 2016
4.	44	**Capital Budget Overspend** ES purchased video conferencing equipment in March 2016. This expenditure was made without sufficient capital budget cover. **Recommendation** Guidance on revenue/capital classification should be issued to staff. Appropriate controls should be put in place to ensure capital spend is authorised by finance prior to being committed.	Education Scotland had no capital budget at the start of the year. In the past we have switched budget from resource to capital as required. The ELL portfolio are aware of this and manage it within their overall budget allocations. The portfolio business manager confirmed that this is how they would manage it during 2015-16. Appropriate controls are already in place.	Head of Finance and Procurement 31 July 2016

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
5.	49	**Financial Planning** ES are operating in a climate of reducing budgets. It is likely that the Scottish Government will publish a multi-year spending review in 2016. Without adequate financial planning ES may not be able to deliver Ministerial policies within their budget allocation. **Recommendation** ES should continue to develop business planning to allocate resources in the medium and long term with a clear connection between planned spending and delivery of outcomes.	Detailed work on financial planning was undertaken throughout 2015-16 and this work is ongoing. The business planning processes already makes a clear connection between spending and outcomes and prioritises work accordingly.	Assistant Director Corporate Services Ongoing

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
6.	55	**MB/ARC Meetings** The terms of reference require the MB and the ARC respectively to meet 4 times within the financial year. In 2015/16 the • MB met on one occasion • ARC met on 3 occasions. **Recommendation** ES should take steps to ensure bodies meet in line with their agreed terms of reference. Non executive directors should review their performance in both their Board and ARC roles respectively to ensure that they have discharged their duties during 2015/16.	Meetings for 2016-17 have already been scheduled.	Head of Governance and Corporate Support 31 May 2016

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
7.	57	**Non-executive Director Recruitment** 3 of the 4 NXD appointments expire in 2016. Adequate succession planning is required to ensure that levels of governance and scrutiny are maintained. **Recommendation** Structured succession planning for Board and ARC members should be introduced, including the use of staggered start/ end dates for contracts.	Our current non-executive directors appointments have been extended and a concurrent recruitment exercise will take place to increase the number of non-executive directors. On completion of this exercise, consideration will be given as to how each non-executive director can best provide the support and challenge within our improving governance structure. This approach provides us with better opportunities to maximise succession planning, followed by improved induction and handover arrangements. Operationally, this approach also aims to have more flexibility within our governance structure and maximises the role of each non-executive director in providing the essential external support and challenge we highly value.	Head of Governance and Corporate Support 30 September 2016
8.	60	**Transparency** ES have not fully implemented the On Board guidance which was issued in April 2015. **Recommendation** ES should review the On Board guidance and take steps to implement the reports recommendations.	See above	Head of Governance and Corporate Support 31 August 2016

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
9.	62	**Risk Management** A review of risk management procedures planned for 2015/16 has been postponed. **Recommendation** ES should ensure improvements to their risk management processes are developed and implemented.	A comprehensive review of the risk management process will take place during 2016-17 to reflect the significant shifts in Education Scotland's operational delivery model.	Assistant Director Strategy, Knowledge and Programme Management Ongoing
10.	73	**Internal Audit** Internal Audit did not complete their planned audit work until the final quarter of the year, and the ARC did not receive any reports until June 2016. **Recommendation** Planned internal audit work should be completed on a timely basis to enable it to support the preparation of the annual report and feed into the annual assurance process.	Representatives from Internal Audit, Audit Scotland and Education Scotland will meet together as soon as practicable to agree the timeline for reporting for 2016-17.	Assistant Director Corporate Services 31 March 2017

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
11.	76	**Performance Management** We reviewed the key performance targets included within the strategic report. The information included in this section focussed on outputs rather than outcomes with limited reference to performance against targets or comparisons with prior years. **Recommendation** ES should ensure that it is reporting performance against published targets that will allow performance to be measured on an ongoing basis. Performance should focus on outcomes as well as outputs delivered during the year.	Work on this area is already underway. The Improving Our Organisation includes a workstream which focuses on evaluating the impact of our work.	Assistant Director Strategy, Knowledge and Programme Management Ongoing
12.	78	**Digital Strategy** There is no agreed organisational Digital Strategy in place. There is a risk that there is no formal statement outlining how digital services are to be developed to support the delivery of the corporate plan. There is also no basis against which the benefits of digital investment can be assessed. **Recommendation** The draft digital strategy should be completed and formally adopted.	A draft digital strategy is already complete and is due to be approved and published by the end of August 2016	Head of Digital Services 31 August 2016

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
13.	80	**Digital Services Organisation** The lack of senior ICT capability means that the key areas within the Digital Services Team are currently led by temporary members of staff. There is a risk that this will impact on the continuing development and delivery of the Digital Services necessary to support the corporate plan. **Recommendation** ES should review the staff capacity and skills required to support the corporate plan.	The structure of the digital team has already been reviewed to ensure that it supports ES business needs. The recruitment process is already underway to fill 2 x C1 posts on permanent basis.	Head of Digital Services 30 September 2016
14.	84	**Public website** The backup and resilience arrangement for the public website are not well-defined. There is risk that the access to the information provided via this web-site could be compromised in the event of an incident (e.g. a hardware failure or a cyber attack). **Recommendation** The migration of content to the new web-site infrastructure should be prioritised to allow implementation.	This has been identified as a key risk and has been prioritised accordingly. Migration has already been scheduled and has a completion date of 31 October 2016.	Head of Digital Services 31 October 2016

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
15.	95	**Workforce Planning** Current ES workforce planning arrangements are focused on allocating single year resources to their non-core priority programmes. **Recommendation** ES should develop their workforce planning to include an over-arching strategic workforce plan covering the whole organisation over the medium and long term.	This comment fails to recognise the spending review periods we are bound to comply with. Business planning does take account of the life cycle of work programmes and recognises longer terms resources needs. However, in the absence of confirmed budgets for future years any further detailed planning would be nugatory.	Assistant Director Corporate Services Ongoing