

Scottish Qualifications Authority

2016/17 Annual Audit Report



 AUDIT SCOTLAND

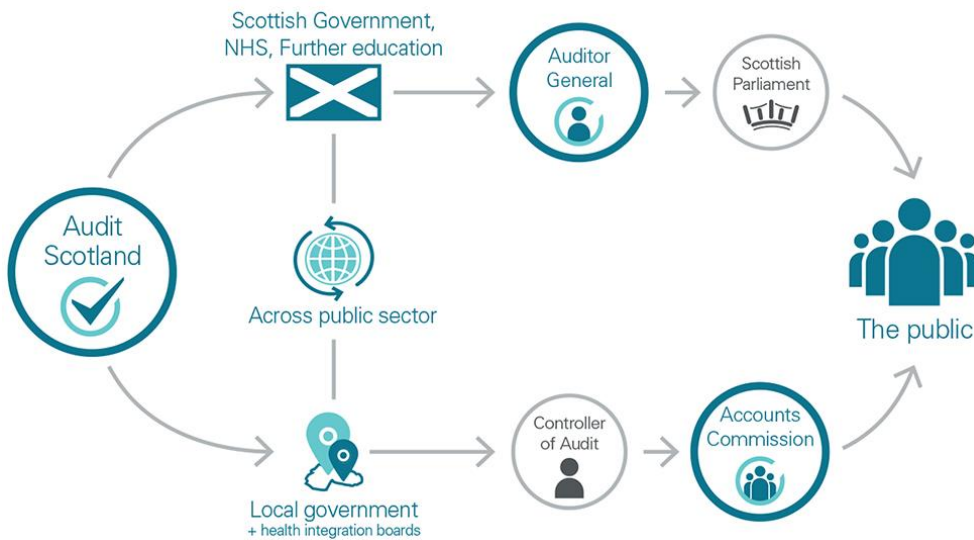
Prepared for the Scottish Qualifications Authority and the Auditor General for Scotland

August 2017

Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



About us

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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Key messages

Audit of the 2016/17 financial statements

- 1 The financial statements of SQA for 2016/17 give a true and fair view of the state of its affairs and of its net expenditure for the year.
- 2 We have issued an unqualified Independent Auditor's Report on the SQA Annual Report and Accounts for 2016/17.
- 3 Management made adjustments for all miscategorisation and omission errors. The overall impact of the corrections made was to increase general reserves by £1.428 million.

Financial management

- 4 SQA effectively managed its 2016/17 budget.
- 5 Systems of internal control operated effectively in 2016/17 with scope for improvements in some areas.

Financial sustainability

- 6 Reliance on direct funding from the Scottish Government will increase as a consequence of the increasing costs of delivering the Scottish qualifications system.
- 7 SQA could do more to develop medium to long term financial plans to bring together risks and opportunities affecting its financial position and financial sustainability.
- 8 The SQA pension liability has increased significantly over the year and this has had a significant effect on the Statement of Financial Position (balance sheet).

Governance and transparency

- 9 SQA has effective governance arrangements in place.
- 10 SQA is open and transparent in the way it conducts its business but improvements could be made to enhance engagement with the wider stakeholder community.
- 11 SQA has appropriate risk management arrangements in place.

Value for money

- 12 SQA should undertake a periodic formal review of its performance against the Scottish Government Best Value framework.
- 13 Key performance indicators, measuring success against strategic goals, should be periodically submitted to the Board of Management.

Introduction

1. The scope of our audit was set out in our Annual Audit Plan presented to the March 2017 meeting of the Audit Committee.
2. This report sets out our findings from:
 - the audit of the Annual Report and Accounts
 - our consideration of the wider dimensions of public sector audit, [Exhibit 1](#), as set out in Audit Scotland's [Code of Audit Practice](#).

Exhibit 1 Audit dimensions



Source: Code of Audit Practice 2016

3. The main elements of our audit work in 2016/17 have been:
 - a review of SQA's main financial systems and governance arrangements
 - a follow up review of the role of boards
 - an audit of the SQA's 2016/17 Annual Report and Accounts
 - a review SQA's arrangements to manage performance, regularity and use of resources.

4. The management of SQA is responsible for, inter alia:

- preparing financial statements which give a true and fair view in accordance with the HM Treasury Financial Reporting Manual (FRoM) and the Scottish Public Finance Manual (SPFM).
- ensuring the regularity of transactions by putting in place systems of internal control
- maintaining proper accounting records
- preparing a Scottish Government consolidation pack.

5. Our responsibility is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice, and guided by the auditing profession's ethical guidance. At the conclusion of our audit, we provide an independent auditor's report, for inclusion in the Annual Report and Accounts. The Independent Auditor's Report sets out our opinions on:

- whether the financial statements give a true and fair view of the state of the affairs of SQA and of the net expenditure for the year
- whether the financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union and as interpreted and adapted by the FRoM
- whether the financial statements have been prepared in accordance with the requirements of the Public Finance and Accountability (Scotland) Act 2000 and directions made thereunder by the Scottish Ministers
- the regularity of the expenditure and income.

6. Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#).

7. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. 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. It is the auditor's responsibility to 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 the annual report and accounts.

8. An action plan is included at [Appendix 1 \(page 25\)](#) setting out our recommendations to address the issues and risks we identified from our audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Agreed management action/timing". We recognise that not all risks can be eliminated or even minimised. What is important is that SQA understands its risks and has arrangements in place to manage them. The Audit Committee should ensure that they are satisfied with proposed action and have an adequate mechanism in place to assess progress and monitor outcomes.

9. As part of the requirement to provide fair and full disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2016/17 audit fee for the audit was set out in our Annual Audit Plan. Although it was necessary to perform greater than anticipated work on the audit of the Annual Report and Accounts, we have elected not to levy an additional fee this year.

10. This report is addressed to both SQA and the Auditor General for Scotland and will be published on Audit Scotland's website www.audit-scotland.gov.uk in due course.

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

Part 1

Audit of 2016/17 financial statements



Main judgements

The financial statements of SQA for 2016/17 give a true and fair view of the state of its affairs and of its net expenditure for the year.

We have issued an unqualified Independent Auditor's Report on the SQA Annual Report and Accounts for 2016/17.

Management made adjustments for all miscategorisation and omission errors. The overall impact of the corrections made was to increase general reserves by £1.428 million.

Unqualified audit opinions

12. The SQA's Annual Report and Accounts for the year ended 31 March 2017 was approved by the Board of Management on 17 August 2017.

13. We reported, in our Independent Auditor's Report:

- an unqualified opinion on the financial statements
- an unqualified opinion on regularity of expenditure and income, and
- an unqualified audit opinion on the auditable part of the remuneration and staff report, performance report and governance statement.

14. Additionally, we are satisfied that there are no matters upon which we are required by the Auditor General to report by exception.

Submission of annual report and accounts for audit

15. The first part of the Annual Report and Accounts, the financial statements and notes, was received on 9 May, in line with the agreed timetable. The second part, comprising the Performance Report and the Accountability Report, was received on 30 May, which was later than expected.

16. Experience at other bodies suggests that the provision of an Annual Report and Accounts package three to four weeks after the year end is a reasonable expectation. For the remainder of the audit engagement we expect that a complete and fully compliant Annual Report and Accounts will be submitted for audit in accordance with an agreed timescale. After completion of the audit, we would welcome a discussion with management on how we can improve the process in future years.

The Annual Report and Accounts is the principal means by which SQA accounts for the stewardship of its resources and its performance in the use of those resources.

[Action Plan \(Appendix 1, point 1\)](#)

17. A number of changes and adjustments were required before the Independent Auditor's Report could be issued. A summary of the most important changes is presented at exhibits 3 and 4. We expect that preparation of the Annual Report and Accounts will evolve over the next few years to provide citizens and stakeholders with a user friendly and FReM compliant guide to SQA's in-year activities and financial results. Management should implement a pre-audit review process prior to finalisation of the unaudited Annual Report and Accounts, to ensure that the document is comprehensive and free, as far as possible, from typographical errors.

[Action Plan \(Appendix 1, point 1\)](#)

18. The Audit Committee generally meets during the latter part of May each year. At this meeting both the Internal Audit Opinion and the Annual Governance Statement are submitted for noting and approval respectively. It would, in our view, follow best practice in the public sector to submit the unaudited Annual Report and Accounts to the Audit Committee for its approval at the annual May meeting.

[Action Plan \(Appendix 1, point 2\)](#)

19. The working papers provided with the unaudited Annual Report and Accounts were of variable quality. Management should ensure that adequate supporting documentation is readily available to support all figures, disclosures and assertions made in the unaudited Annual Report and Accounts.

[Action Plan \(Appendix 1, point 1\)](#)

Risk of material misstatement

20. 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 involved the highest level of judgement and potential impact on the financial statements. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance. [Appendix 2](#) sets out the significant audit risks identified and how we addressed each risk in arriving at our opinion on the financial statements.

Materiality

21. Materiality can be defined as the maximum amount by which auditors believe the financial statements could be misstated and still not be expected to affect the perceptions and decisions of users of financial statements. The assessment of what is material is a matter of professional judgement. A misstatement or omission, which would not normally be regarded as material by value, may be important for other reasons (for example, an item contrary to law).

22. Our initial assessment of materiality for the financial statements was undertaken during the planning phase of the audit. We assess the materiality of uncorrected misstatements, both individually and collectively in forming our opinions on the financial statements.

23. On receipt of the Annual Report and Accounts and following completion of audit testing we reviewed our original materiality calculations and concluded that they remained appropriate. Materiality on receipt of the unaudited financial statements is summarised at [Exhibit 2](#).

Exhibit 2

Materiality values

Materiality level	Amount
Overall materiality – This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It was set at 1% of gross expenditure for the year ended 31 March 2017.	£0.755m
Performance materiality – This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality, this would indicate that further audit procedures should be considered. Using our professional judgement we have calculated performance materiality at 75% of overall materiality.	£0.566m
Reporting threshold – We are required to report to those charged with governance on all unadjusted misstatements in excess of a reporting threshold amount. This has been calculated at 5% of overall materiality rounded to a memorable numeric.	£0.040m

Source: Audit Scotland

Evaluation of misstatements

24. It is our responsibility to request that all misstatements are corrected although the final decision on this lies with those charged with governance taking into account advice from senior officer and materiality levels. Management made adjustments for all monetary misstatements which exceeded our reporting threshold. Management also took the opportunity to correct an error of £0.028 million in the financial statements.

25. The overall impact of the corrections made was to:

- **Increase total comprehensive net expenditure for the year by £18.301 million**
- **Increase general reserves by £1.428 million**

[Exhibit 3](#) sets out the impact of each of the errors identified.

Significant findings from the audit

26. International Standard on Auditing (UK and Ireland) 260 requires us to communicate significant findings from the audit “to those charged with governance”. These are summarised at [exhibit 4](#). Where a finding has resulted in a recommendation to management, a cross reference to the Action Plan at [Appendix 1](#) has been included.

Other findings

27. In addition to the issues set out above and in accordance with normal audit practice, a number of presentational and disclosure amendments were discussed and agreed with management.

Exhibit 3

Evaluation of misstatements

Misstatement	Impact
Omission of pension liability (£18.141 million) from Statement of Comprehensive Net Expenditure	Total comprehensive net expenditure increased by £18.141 million. No impact on Statement of Financial Position (balance sheet) as correct entries had been made to that statement.
Holiday pay accrual overstated by £0.028 million.	Total comprehensive net expenditure reduced by £0.028 million. Statement of Financial Position (balance sheet), general reserve increased by £0.028 million.
Tangible assets overstated by £1.96 million and intangible assets understated by same amount.	Statement of Financial Position (balance sheet), adjustment between lines only. No impact on bottom line.
Financial investments part (£0.126 million) misclassified as non-current asset.	Statement of Financial Position (balance sheet), adjustment between lines only. No impact on bottom line.
Deferred income overstated by £1.400 million and Scottish Government funding was understated by same amount.	Statement of Financial Position (balance sheet), trade and other payables reduced by £1.400 million, general reserve increased by £1.400 million.
The annual service charge for the Optima building was understated by £0.160 million.	Total comprehensive net expenditure increased by £0.160 million.

Source: Audit Scotland

Exhibit 4

Significant findings from the audit of financial statements

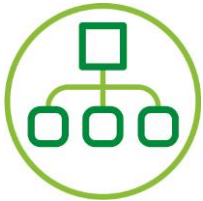
Issue	Resolution
<p>1. Pension liability</p> <p>The FReM requires that gains or losses on the remeasurement of a defined benefit pension liability are recognised under “other comprehensive net expenditure” in the Statement of Comprehensive Net Expenditure (SOCNE). The SOCNE submitted for audit did not include the required pension liability remeasurement disclosure of £18.141 million.</p>	<p>Management adjusted the SOCNE to include the pension liability disclosure for 2016/17 and prior year comparatives, as the liability had also been excluded from prior years’ statements.</p>

Issue	Resolution
<p>2. Remuneration report</p> <p>The FReM requires information on remuneration and pension entitlements for certain senior staff and directors to be disclosed in a remuneration and staff report. Pension entitlement calculations are complex and information should be requested from pension fund administrators to ensure accurate disclosure. However, we established that SQA finance staff had been calculating pension entitlements, for 2016/17 and in previous years, themselves. These calculations were inaccurate. Consequently, pension entitlements were understated in the Annual Report and Accounts submitted for audit.</p>	<p>Management obtained pension entitlement information from the pension fund administrator and adjusted the disclosures in the Remuneration and Staff Report. A restatement of the prior year comparatives was also required as the same errors were present in prior years' reports.</p>
<p>3. Assets under construction classification</p> <p>The FReM sets out criteria for the recognition of non-current assets. A tranche of non-current assets (£1.960 million) was incorrectly classified as "assets under construction" in the Statement of Financial Position (balance sheet) submitted for audit. The incorrectly classified assets were all software related with no physical substance and should have been classified as intangible assets.</p>	<p>Management agreed to adjust the financial statements to correctly classify the assets in question. As this error also occurred in prior years' financial statements; an appropriate restatement of prior year comparatives was also made.</p>
<p>4. Performance Report</p> <p>The FReM and the Scottish Public Finance Manual (SPFM) set out information that is to be disclosed in a performance report. The Performance Report submitted for audit as part of the unaudited Annual Report and Accounts was deficient in a number of areas.</p>	<p>Management agreed to provide additional information in the Performance Report to address the issues identified. This included providing the incomplete parts of the Performance Report, more significant details on the issues and risks affecting SQA and additional detail on performance.</p>
<p>5. Deferred income balance</p> <p>A deferred income balance of £1.400 million in respect of 2015/16 funding had been incorrectly included within liabilities. The funding from the Scottish Government related to additional resource allocation in 2015/16 due to a foreign bad debt provision. The error overstated liabilities and understated government funding. The error arose because the prior year journal entry had not been reversed in 2016/17.</p>	<p>Management adjusted for this error. The impact of this adjustment was to increase government funding and decrease liabilities by £1.400 million.</p>
<p>6. Governance statement</p> <p>The FReM requires a governance statement to be prepared in accordance with the SPFM. The SPFM sets out a number of essential features required in a governance statement. We concluded from our review of the Governance Statement submitted as part of the unaudited Annual Report and Accounts was deficient in a number of areas.</p>	<p>Management agreed to provide additional information to ensure the Governance Statement covered the essential requirements set out in the SPFM. This included providing additional information on management arrangements, risks and uncertainties and the effectiveness of governance arrangements.</p>

Issue	Resolution
<p>7. Non-current asset disposals</p> <p>As part of non-current asset disposal testing we established that there are no formal control processes in place for asset disposals. The transaction tested was written-off after a verbal request was made and there was no supporting documentation or evidence for the disposal. There is a risk that, in the absence of a formal policy and process, unauthorised and fraudulent asset disposals could occur.</p>	<p>Management agreed to review the asset disposal process and introduce a formalised process in place for in-year asset disposals.</p> <p>Action Plan (Appendix 1, point 3)</p>
<p>8. Segmental reporting</p> <p>International Financial Reporting Standard 8 requires entities to report segmental financial information based on geographical locations. SQA carries out activities outwith the UK and generated income and expenditure on these activities during 2016/17. The financial statements submitted for audit did not include any information on financial performance by geographical location.</p>	<p>It was not possible to obtain accurate information in time for the 2016/17 financial statements as SQA's current chart of accounts and customer hierarchy does not allow information on geographical location to be obtained from financial systems. Management have agreed to review the position to ensure that appropriate segmental information is available for future years.</p> <p>Action Plan (Appendix 1, point 4)</p>
<p>9. Financial assets classification</p> <p>SQA has financial asset investments of £0.341 million to provide for the costs of unfunded pension liabilities. During 2016/17 £0.126 million of the investments matured and the proceeds were lodged in a short term deposit account. This was not reflected on the Statement of Financial Position (balance sheet) where all investments were classified as non-current assets. Non-current assets were overstated by £0.126 million and current assets were understated by the same amount.</p>	<p>Management adjusted for this error and reclassified the deposit account of £0.126 million as a current asset.</p>
<p>10. Optima building service charge</p> <p>The annual service charge for the Optima building was understated by £0.160 million in the SOCNE.</p>	<p>Management adjusted for the understatement in the financial statements. As this error also occurred in prior years' financial statements; an appropriate restatement of prior year comparatives was also made.</p>

Part 2

Financial management



Main judgements

SQA effectively managed its 2016/17 budget.

Systems of internal control operated effectively in 2016/17 with scope for improvements in some areas.

Financial performance in 2016/17

28. SQA generates income from fees and charges (2016/17 £52.378 million) mainly from examination entry charges and direct funding (2016/17 £24.360 million) from the Scottish Government. Scottish Government funding includes items, such as rent charges, met directly by the Scottish Government. Total expenditure for the year, after interest, was £76.242 million. This produced a surplus of £0.496 million for the year. This compares well to a breakeven position forecast in the 2016/17 budget.

29. Prior to the start of the financial year, SQA agrees with the Scottish Government an annual budget and an initial funding allocation (called the Departmental Expenditure Limit (DEL)). Once the initial budget has been agreed, the Scottish Government issues a Budget Allocation and Monitoring (BAM) letter which acknowledges the requirement for additional funding for operational and programme grant costs not included in the initial funding allocation. The Scottish Government issues further BAM letters during the year updating the funding allocation to reflect the SQA's work programme. The final funding allocation for 2016/17 was revised to £24.155 million and the actual amount drawn down during the year was £21.595 million which is £2.560 million less than the SQA's funding allocation, (exhibit 5). The main reasons for the reduced requirement for Scottish Government funding were the reversal of a previous year bad debt provision and greater than anticipated contract income.

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

Internal controls

30. As part of our 2016/17 audit we tested key controls operating in the main accounting systems. Our objective was to gain assurance that SQA has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

31. Our findings were reported in an interim audit letter presented to the Audit Committee on 22 May 2017. We concluded that, generally, controls were operating effectively. However, we have suggested enhancements to controls and processes in the interim audit letter and in this report

Exhibit 5

Performance against Departmental Expenditure Limit (DEL) in 2016/17

Performance	Initial DEL £m	Final DEL £m	Actual drawdown £m	(Under allocation) £m
Resource DEL	1.800	22.194	19.634	(2.560)
Capital DEL	nil	1.961	1.961	nil
Total DEL	1.800	24.155	21.595	(2.560)
Ring-fenced DEL	nil	2.000	0.842	(1.158)
Total	1.800	26.155	22.437	(3.718)

Source: SQA audited annual report and accounts and Budget Allocation Monitoring letters

Budgetary processes

32. We reviewed SQA's budgetary processes and budget monitoring arrangements. From our review of budget monitoring reports, review of committee papers and attendance at committees we confirmed that senior management and members receive regular, timely and up to date financial information on the financial position.

33. We concluded that, generally, SQA has satisfactory budgetary monitoring and control arrangements that allow both non-executive directors and senior management to carry out effective scrutiny of financial performance. However, the current chart of accounts and customer hierarchy does not allow information to be reported on operations by geographical location. As a result the budget monitoring of commercial operations has been incomplete. This exposes SQA to the risk that commercial trading is non-profitable and increases the possibility that fraud and irregularity in these operations may be undetected. This is a legacy issue and implementation of the new financial ledger will address the risks by generating better quality financial monitoring information.

[Action Plan \(Appendix 1, point 5\)](#)

34. Weaknesses were also identified in project budget management by internal audit. The work done highlighted that the current financial system is not able to record capital expenditure and this is manually recorded and tracked. As a result, project budgets may not be effectively monitored and there may not be effective control on spend. Actions are being taken by management to implement and embed controls to mitigate these risks.

Prevention and detection of fraud and irregularity

35. We assessed SQA's arrangements for the prevention and detection of fraud and concluded that SQA had appropriate and adequate arrangements in place during 2016/17.

National Fraud Initiative

36. The National Fraud Initiative (NFI) in Scotland brings together data from local government, health boards and other public sector bodies to help detect and prevent a wide range of frauds against public funds. The NFI matching exercise can also be an important source of evidence for directors and managers that

internal control systems are operating effectively. The current matching exercise produced 410 matches of which 59 were categorised as priority and recommended for active investigation ([Exhibit 6](#)).

Exhibit 6

Total number of matches



410

Number recommended for investigation



59

Completed/closed investigations



13

Source: SQA NFI secured webpage

37. We are advised that work is currently underway to investigate matches, with an internal deadline of September 2017 for recommended matches to be investigated. At the time of the audit, only 13 matches had been investigated and completed. NFI work is tracked by way of a secured national website. Management advise that further progress has been made in the investigation of matches but that the website had not been updated to reflect this.

38. Overall, the arrangements in place to investigate matches and the processes employed by SQA are adequate. However, improvements could be made to ensure the secured website is updated on a regular basis as this will allow progress to be monitored more effectively.

Standards of conduct and arrangements for the prevention and detection of bribery and corruption

39. The arrangements for the prevention and detection of corruption are satisfactory and we are not aware of any specific issues that we need to record in this report.

Part 3

Financial sustainability



Main judgements

Reliance on direct funding from the Scottish Government will increase as a consequence of the increasing costs of delivering the Scottish qualifications system.

SQA could do more to develop medium to long term financial plans to bring together risks and opportunities affecting its financial position and financial sustainability.

The SQA pension liability has increased significantly over the year and this has had a significant effect on the Statement of Financial Position.

Financial planning

40. SQA generates income from fees and charges but relies on the Scottish Government providing deficit funding. A significant factor in the SQA operating net expenditure deficit is the funding model for levying charges for national examination entries. It is the policy of the Scottish Government to keep charges frozen at 2010/11 levels and provide deficit funding to meet the shortfall in the SQA costs. In 2016/17, income generated accounted for 68% of total income and funding from the Scottish Government accounted for 32% of total income.

41. The Board of Management approved SQA's 2017/18 budget in January 2017. The budget forecasts a breakeven position after Scottish Government funding is included. The budget sets out the level of funding required from the Scottish Government for 2017/18 at £32.484 million (£30.695 million resource DEL and £1.789 million capital DEL). This is a significant increase on the funding of £24.200 million received in 2016/17. The actual allocation provided by the Scottish Government will not be known until later in the financial year. The initial budget allocation monitoring letter set out an allocation of £2.800 million (£1.800 million resource DEL and £1.000 million capital DEL).

42. The 2017/18 budget forecasts £49.907 million will be generated from fees and charges. This is less than the £52.378 million generated in 2016/17. The main reason for the expected decrease is the ending of a number of contracts during 2016/17; although SQA anticipates some new income sources which would mitigate the negative impact of the contracts ending. Other budgetary pressures include expected increases in staff costs and increased IT costs to support the Business Change Programme.

2016/17 financial position

43. The Statement of Financial Position summarises what is owned and owed by SQA. The residual of what is owned and owed shows taxpayers' equity which is an accounting measure of the amount invested that has continuing public benefit. As

Financial sustainability looks forward to the medium and longer term to consider whether SQA is effectively planning to continue to deliver its services.

at 31 March 2017, SQA continues to rely on the Scottish Government to provide funding to cover the income/expenditure gap.

Medium to long term financial planning

44. The current budget process does not include medium to long term financial planning. One of the challenges for SQA is the short term financial planning cycle of the Scottish Government and the resulting difficulty in preparing medium/longer term funding strategies to address its priorities. While this is an obstacle to precise financial planning management should prepare a 3-5 year rolling budget using what information is available and incorporating sensitivity analysis and scenario planning. In the absence of medium to long term financial planning the future financial risks facing SQA may not be clearly understood.

Action Plan (Appendix 1, point 6)

Pension liability

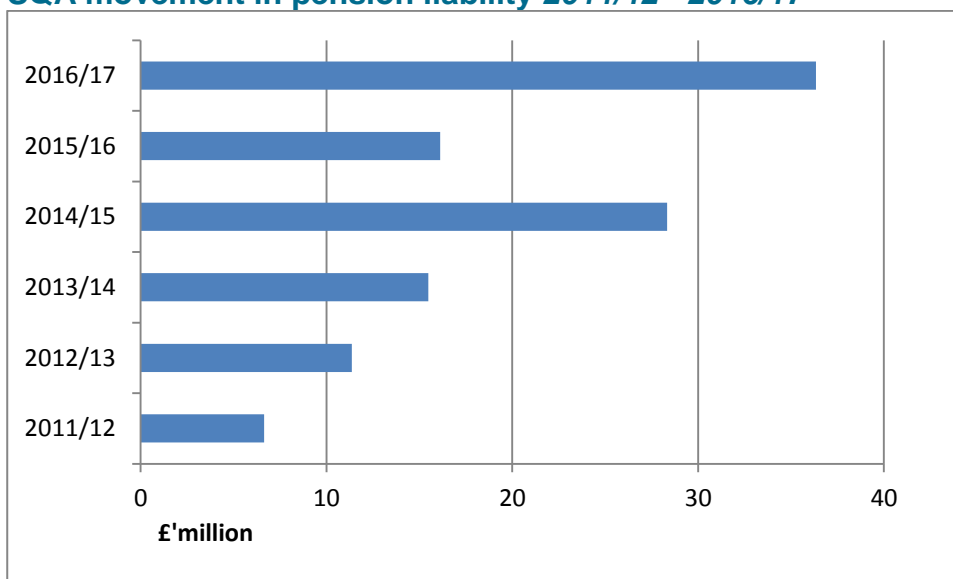
45. A significant pension liability (£36.336 million) has been included in the Statement of Financial Position. This section is included for information to non-executive directors as we consider that the large movement requires explanation and comment.

46. The pension liability represents the difference between expected future payments to pensioners and the underlying value of pension fund assets available to meet this liability.

47. The SQA is an admitted member of Strathclyde Pension Fund, one of the largest in the UK. Valuation of pension fund assets and liabilities is assessed by an independent firm of actuaries (Hymans Robertson LLP). Annual valuations are dependent on a number of external variables, including projected rates of return on assets, projected rates of price and pay inflation, interest rates and mortality estimates.

Exhibit 7

SQA movement in pension liability 2011/12 - 2016/17



Source: SQA annual accounts 2011/12 - 2016/17

48. As at 31 March 2016 the actuarial valuation of the SQA pension liability was £16.114 million increasing to an estimated £36.336 million liability as at 31 March 2017. Over the past six years or so there has been considerable volatility year on year on the valuation of liabilities across the public sector. For SQA the movement over the past six years is set out at exhibit 7. Small changes in actuarial assumptions can have a significant impact on the calculation of closing liabilities.

49. The pension fund actuary has indicated that the variable which had the greatest impact on the calculation of the 31 March 2017 liability was the decrease in the discount rate applied to investments. The discount rate is the rate which is used to estimate future returns on pension fund investments. Thus the expectation of lower future returns on pension fund investments has increased the overall liability.

50. In year payments made to the pension fund by SQA comprise employer and employee contributions. At the last reported triennial valuation (31st March 2014) the Strathclyde Pension Fund was 94.3% funded and had assets of £15.8 billion. The pension fund has a 12 year funding strategy in place to address the deficit.

Part 4

Governance and transparency



Main judgements

SQA has effective governance arrangements in place.

SQA is open and transparent in the way it conducts its business but improvements could be made to enhance engagement with the wider stakeholder community.

SQA has appropriate risk management arrangements in place.

Governance arrangements

51. The SQA is an executive Non-Departmental Public Body (NDPB). The Board of Management and Accountable Officer are responsible for establishing arrangements for ensuring the proper conduct of the affairs of SQA and for monitoring the adequacy of these arrangements.

52. The SQA board, including the Chair, consists of non-executive directors (NEDs) appointed by Scottish Ministers. The role of the Board of Management is to provide leadership, direction, support and guidance to ensure that SQA delivers its functions in accordance with the aims, policies and priorities of the Scottish Ministers. It is supported in this role by a number of standing committees with formally delegated remits, [Exhibit 8](#).

53. The Chief Executive, who is also the Accountable Officer, is appointed by the Board of Management, with the approval of Scottish Ministers. The Chief Executive is the principal adviser to the Board of Management and provides operational leadership to ensure that the SQA's functions are delivered and that objectives and targets are achieved.

54. In addition to the formal committee structure, SQA facilitates an Advisory Council, comprising NEDs and representatives from various stakeholder groups, including head teachers and a National Parent Forum member. The primary role of the Advisory Council is to consider and advise SQA on the needs and views of stakeholders in relation to qualifications and awards.

55. As part of our 2016/17 audit work we undertook a review of governance arrangements. We concluded that SQA has appropriate overarching and supporting governance arrangements which provide an effective framework for organisational decision making.

56. During the year a number of new members were appointed to the Board of Management. In addition, recruitment is currently underway for a new Chair. These changes will result in some loss of experience and knowledge and it is important that arrangements are put in place to ensure new members receive adequate information and training.

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision-making and transparent reporting of financial and performance information.

Exhibit 8

SQA governance structure



Source: SQA

Transparency

57. A comprehensive range of information on how SQA operates is available on its website. The website is, in our view, easily navigable and informative. Information available includes: statistics on examination performance, corporate plans and policies, freedom of information request instructions, registers of interests and good customer service contact information.

58. There is no bar to members of the public attending meetings of the Board of Management; however, there is no information available to the public on how to arrange attendance. In an effort to increase transparency, a number of public sector organisations broadcast meetings live on the web and/or make recordings of meetings available via their websites. As part of the commitment to openness and transparency SQA should consider whether greater public engagement could be achieved through promotion of public attendance at meetings and/or the use of technology to reach a wider audience.

[Action Plan \(Appendix 1, point 7\)](#)

Internal audit

59. Internal audit provides the Board of Management, the Accountable Officer and the Executive Management Team with independent assurance on SQA's overall risk management, internal control and corporate governance processes.

60. The internal audit function is carried out by Scott-Moncrieff. We undertook a central review of the adequacy of internal audit and concluded that operates accordance with the Public Sector Internal Audit Standards (PSIAS) and has sound documentation standards and reporting procedures in place.

61. To avoid duplication effort we place reliance on the work of internal audit wherever possible. In 2016/17 we did not place formal reliance on any of internal audit's reviews for the purposes of obtaining direct assurance for our financial

statements work. However, internal audit reviews were considered to gain an understanding of processes and systems and as part of our wider dimension work.

62. The annual internal audit opinion, required by PSIAS and reported to the May meeting of the Audit Committee, concluded SQA has a framework of controls in place that provides reasonable assurance regarding its governance framework, effective and efficient achievement of objectives and the management of key risks, and proper arrangements are in place to promote value for money and deliver best value.

ICT risks

63. As part of our audit work we reviewed the IT Strategy and did not identify any significant issues. Internal audit also carried out work on IT arrangements and identified improvements which could be made in a number of areas:

- Business continuity planning – business impact analysis would benefit from more clearly linking each department's primary functions with supporting activities and resources. There is also a need for recovery strategies to include a greater level of detail to support recovery of primary functions.
- IT security – improvements could be made in monitoring and controlling privileged accounts and ensuring there is a review of active accounts and activity is assessed for appropriateness.

Risk management

64. As part of the audit we reviewed the Risk Management Policy and Corporate Risk Register. We concluded that risk management arrangements in place were satisfactory. The most recent Corporate Risk Register is provided at all Board of Management and Audit Committee meetings. This allows NEDs to understand the risks affecting SQA and take the necessary actions to mitigate risks.

Part 5

Value for money



Main judgements

SQA should undertake a periodic formal review of its performance against the Scottish Government Best Value framework.

Key performance indicators, measuring success against strategic goals, should be periodically submitted to the Board of Management.”

Arrangements for securing Best Value

65. Accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value (BV). The Scottish Government guidance groups Best Value into five key themes, with two overarching themes. The five key themes are:

- Vision and leadership
- Effective partnerships
- Governance and accountability
- Use of resources
- Performance management

There are also two cross cutting themes which public sector bodies are expected to mainstream across all activities:

- Equality
- Sustainability

66. While there is clear evidence of elements of the Best Value framework being in place, other elements are less visible. The Board should have systems and processes to ensure that it can demonstrate that it is delivering Best Value by assessing and reporting on the economy, efficiency, effectiveness and equality in service provision. SQA should undertake a periodic and evidenced formal review of its performance against the Scottish Government Best Value framework.

[Action Plan \(Appendix 1, point 8\)](#)

Performance management

67. Aspects of performance information including: the financial position; business development position; progress on exam diet; qualification work programmes, are routinely considered by the Board of Management and supporting committees.

68. SQA monitors success against its strategic goals through the use of key performance indicators (KPIs). KPIs are set for each strategic goal. These are

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

regularly reported to the Audit Committee but are not reported to the Board of Management. There is a risk that not all NEDs are receiving sufficient information to enable them to effectively scrutinise and challenge performance.”

[Action Plan \(Appendix 1, point 9\)](#)

National performance audit reports

69. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2016/17, a number of reports were published which should be of direct interest to the Board, summarised at [Appendix 3](#).

70. From our attendance at the Audit Committee, and review of minutes, we concluded that the arrangements for considering national performance audit reports are consistent with good practice.

Appendix 1

Action plan 2016/17

2016/17 recommendations for improvement



Page/para no.	Issue/risk	Recommendation	Agreed management action/timing
8/16 9/17 9/19	<p>1. The Annual Report and Accounts submitted for audit was incomplete. In addition, working papers provided in support of the accounts were not always comprehensive.</p> <p>Risk</p> <p>Greater than planned SQA and external audit staff resources are used in delivering the audited Annual Report and Accounts. Potential to miss reporting deadlines / qualification to the Independent Auditor's Report.</p>	<p>SQA should plan to submit a comprehensive and compliant Annual Report and Accounts package three to four weeks after the year end.</p> <p>The Annual Report and Accounts should be reviewed against guidance and proof read prior to submission.</p>	<p>SQA worked to its existing timetable as it was understood that this was acceptable to the Auditors in this first year. SQA will review the timetable for 2017/18 to understand the changes in process needed to meet the recommendation. This review will also take into account the impact of the move to the new financial ledger which will take place during 2017/18.</p> <p>Director of Finance/Director of Corporate Services</p> <p>31 December 2017</p>
9/18	<p>2. The unaudited Annual Report and Accounts is not submitted to the May Audit Committee for approval.</p> <p>Risk</p> <p>No significant risk. Best practice recommendation.</p>	<p>It would in our view, follow best practice in the public sector to submit the unaudited Annual Report and Accounts for approval at the annual May meeting of the Audit Committee.</p>	<p>As stated above SQA will review the timetable for 2017/18 to understand the changes in process needed to meet this best practice recommendation. This review will consider the impact of the move to the new finance ledger in 2017/18.</p> <p>Director of Finance/Director of Corporate Services</p> <p>31 December 2017</p>



**Page/para
no.**

Issue/risk

Recommendation

**Agreed management
action/timing**

13/7

3. No formal control processes are in place for the disposal of assets. No supporting documentation or evidence of authorisation of disposal is retained.

Risk

In the absence of a formal policy and process, unauthorised and fraudulent asset disposals could occur.

Management should implement a policy and process for the disposal of assets, to include retention of evidence of authorisation, method of disposal and accounting for any proceeds.

This is agreed and actions are being taken to ensure adequate evidence is recorded.

Director of Finance
31 August 2017

13/8

4. International Financial Reporting Standard 8 requires entities to report segmental financial information based on geographical locations. The financial statements submitted for audit did not include any information on financial performance by geographical location.

Risk

Financial disclosures continue to be inconsistent with IFRS/FReM requirements.

It was not possible to obtain accurate information in time for the 2016/17 financial statements as SQA's current chart of accounts and customer hierarchy does not allow information on geographical location to be obtained from financial systems. Management have agreed to review the position to ensure that appropriate segmental information is available for succeeding years.

It is anticipated that the new ledger system will allow SQA to perform a more detailed level of analysis in 2017/18. This will be further enhanced when the cost allocation module of the new Corporate Business System is implemented in 2018/19.

Director of Finance
31 March 2018

15/33

5. The current ledger set up does not allow for the complete recording of costs against contracts. As a result the budget monitoring of commercial operations has been incomplete.

Risk

SQA is exposed to the risk that commercial trading is non-profitable and an increased possibility that fraud and irregularity in these operations may be undetected.

We are advised that the implementation of the new financial ledger will address the risks by generating better quality financial monitoring information.

SQA currently ensures that all commercial activities are priced to recover costs or to generate a surplus based on estimates of acceptable margins. The implementation of the new financial system will improve the level of expenditure analysis. This analysis will be further enhanced when the cost allocation module of the new Corporate Business System is implemented in 2018/19.

Director of Finance
31 March 2019



Page/para
no.

Issue/risk

Recommendation

Agreed management
action/timing

18/44	<p>6. The current budget process does not include medium to long term financial planning.</p> <p>Risk</p> <p>In the absence of medium to long term financial planning the future financial risks facing SQA may not be clearly understood.</p>	<p>Although the short term financial planning cycle of the Scottish Government is an obstacle to precise financial planning management should prepare a 3-5 year rolling budget using what information is available, incorporating sensitivity analysis and scenario planning as necessary.</p>	<p>Scenario planning and financial models have been prepared and discussed with Scottish Government. These focus in particular on pricing and other funding options. However, as a result of the implementation of CfE , the most significant change in the Scottish education system in a generation, and the DFM'S announcement on the new 3 year programme of work to review assessments for National Qualifications, SG has had little appetite to discuss funding models and forward budgets. SQA will ensure that future financial planning models are discussed with the Board.</p> <p>Director of Finance 31 October 2017</p>
21/58	<p>7. Improvements could be made to enhance engagement with the wider stakeholder community.</p> <p>Risk</p> <p>SQA is seen as having a reduced commitment to openness and transparency.</p>	<p>SQA should consider whether stakeholder engagement could be achieved through promotion of attendance at meetings and/or the use of technology to reach a wider audience.</p>	<p>SQA will consider this proposal with the new Chairman and the Board of Management.</p> <p>Chief Executive 31 December 2017</p>
23/66	<p>8. SQA should have systems and processes to ensure that it can demonstrate that it is delivering Best Value by assessing and reporting on the economy, efficiency, effectiveness and equality in service provision.</p> <p>Risk</p> <p>The organisation is missing opportunities to enhance service delivery.</p>	<p>SQA should undertake a periodic formal review of its performance against the Scottish Government Best Value framework.</p>	<p>Agreed. SQA has established a formal process for identifying and monitoring the realisation of Benefits and is investigating further actions that could be taken to demonstrate Best Value.</p> <p>Director of Finance 31 December 2017</p>



**Page/para
no.**

Issue/risk

Recommendation

**Agreed management
action/timing**

24/68

9. KPIs are used to monitor progress against strategic goals. Updates on progress are regularly submitted to the Audit Committee but not to the Board of Management.

KPIs should be reported to the Board of Management at regular intervals.

SQA will discuss this recommendation with the new Chairman and the Board of Management and agree the appropriate arrangements for reporting performance to the Board.

Risk

There is a risk that not all NEDs are receiving sufficient information to enable them to effectively scrutinise and challenge performance.

Chief Executive

31 December 2017

Appendix 2

Significant audit risks identified during planning

The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the annual report and accounts and those relating our wider responsibility under the [Code of Audit Practice 2016](#).

Audit Risk	Assurance procedure	Results and conclusions
Risks of material misstatement in the financial statements		
<p>1 Risk of management override of controls</p> <p>Management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. 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.</p>	<ul style="list-style-type: none"> • Detailed testing of journal entries. • Review of significant management estimates and evaluation of the impact of any variability in assumptions. • Focused testing of accruals and prepayments. • Evaluation of significant transactions that are outside the normal course of business. 	<p>Our audit procedures did not detect evidence of management override of controls.</p>
<p>2 Risk of fraud over income</p> <p>The extent and complexity of the authority's income streams entails an inherent risk of fraud. ISA 240 requires that audit work is planned to consider the risk of fraud over income, which is presumed to be a significant risk in any audit.</p>	<ul style="list-style-type: none"> • Analytical procedures on income streams. • Detailed testing of revenue transactions focusing on the areas of greatest risk. 	<p>Our audit procedures did not detect any evidence of fraud over income.</p>
<p>3 New ledger system</p> <p>SQA are in the process of implementing a new ledger system. At the time of writing, user acceptance testing is being conducted. However, a decision is still to be made as to whether the new system is to be fully implemented in 2016/17 or whether this will be deferred until 2017/18.</p> <p>Should the system be implemented prior to the year end, there is a risk that data</p>	<ul style="list-style-type: none"> • Discussions with management to confirm when the new ledger system will be implemented. • Performing an initial system review to gain understanding of the new ledger. • Review of user acceptance testing carried out by SQA. • Detailed testing of revenue and expenditure transactions focusing on 	<p>There were significant delays in implementing the new ledger system and implementation has been postponed until the 2017/18 financial year.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>migration errors and data corruption may impact on the preparation of the 2016/17 financial statements.</p>	<p>the areas of greatest risk.</p> <ul style="list-style-type: none"> Additional data validation and completeness checks. 	
<p>4 IT contract</p> <p>SQA is in dispute with a supplier following an exit audit of IT licence usage. The potential liability was disclosed as a contingent liability in the 2015/16 annual accounts.</p> <p>The Scottish Government is aware of the issue and is supportive of SQA's efforts to negotiate a solution with the supplier.</p> <p>There is a risk of misstatement of any potential liability in the financial statements.</p>	<ul style="list-style-type: none"> Discussion with management to establish the year end position. Monitor developments in this dispute throughout the year. Review adequacy and basis of disclosure as part of the 2016/17 financial statements audit. 	<p>We have reviewed the current position of the claim and we discussed it with management during the year.</p> <p>The claim has been disclosed as a contingent liability in the financial statements and we are satisfied with this accounting treatment.</p>

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





















<p>5 Current funding model</p> <p>SQA is unable, under the current funding model, to generate sufficient income to meet the cost of delivering the qualifications system in Scotland. Following preparation and approval of the 2016/17 budget by SQA, the Scottish Government issued a Budget Allocation and Monitoring letter which confirmed the budget and associated grant in aid. The letter also recognised that the SQA would require further grant in aid to meet operational and programme costs beyond those covered within its 2016/17 budget.</p> <p>There is a risk that expectation of annual additional grant in aid could adversely impact on SQA's pursuit of budget efficiencies and future financial sustainability.</p>	<ul style="list-style-type: none"> Discussion with management to establish the year end position. Review of correspondence with Scottish Government regarding 2016/17 funding. Review of arrangements to secure efficiencies. 	<p>We have reviewed the year end position and identified SQA required less Scottish Government funding than was allocated in 2016/17. However, the budget for 2017/18 highlights an increased reliance on funding from the Scottish Government with less income expected to be generated from fees and charges.</p>
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Audit Risk	Assurance procedure	Results and conclusions
<p>6 KPI reporting</p> <p>SQA monitor success against its strategic goals through the use of KPIs. KPIs are reported to the Audit Committee. KPIs are not reported to the Board on a regular basis.</p> <p>There is a risk that Board members are not able to apply an appropriate level of scrutiny and challenge to performance.</p>	<ul style="list-style-type: none"> Review of Board papers and minutes. 	<p>A review of Board papers throughout the year identified that KPIs continue to be reported only to the Audit Committee and not to the Board on a regular basis. Reported elsewhere in this report.</p>
<p>7 Capital expenditure budgetary control</p> <p>Internal Audit's report on Budgeting and Budgetary Control published in November 2016 identified that current finance system (SAP) is unable to track capital expenditure. Information in relation to capital costs is manually tracked and recorded on a separate Excel spreadsheet and then reconciled to SAP.</p> <p>This manual process increases the risk of errors and misstating the figures included in the 2016/17 financial statements.</p>	<ul style="list-style-type: none"> Focused substantive testing of expenditure transactions to ensure completeness and accuracy of the capital expenditure. 	<p>Substantive testing of capital and revenue expenditure did not identify any errors in classification between revenue and capital,</p>
<p>8 Long term financial planning</p> <p>One of the challenges for the Board is the absence of long term funding and policy information from the Scottish Government and the resulting difficulty in preparing medium to long term funding strategies to address work programmes and priorities. While this is an obstacle to precise financial planning the Board should take steps to prepare a 3-5 year rolling budget using what information is available and incorporating sensitivity analysis and scenario planning.</p> <p>In the absence of medium to long term financial planning the future financial risks facing the Board may not be clearly understood.</p>	<ul style="list-style-type: none"> Review of Board papers and minutes. 	<p>A review of Board minutes identified there is still no medium to long term budgeting in place. Reported elsewhere in this report.</p>

Appendix 3

Summary of national performance reports 2016/17



Month	Report Title	Report Title	Report Title
Apr			
May	 Common Agricultural Policy Futures programme: an update		
Jun	 South Ayrshire Council: Best Value audit report	 The National Fraud Initiative in Scotland	
Jul	 Audit of higher education in Scottish universities	 Supporting Scotland's economic growth	
Aug	 Maintaining Scotland's roads: a follow-up report	 Superfast broadband for Scotland: a progress update	 Scotland's colleges 2016
Sept	 Social work in Scotland	 Scotland's new financial powers	
Oct	 Angus Council: Best Value audit report	 NHS in Scotland 2016	
Nov	 How councils work – Roles and working relationships in councils	 Local government in Scotland: Financial overview 2015/16	
Dec	 Falkirk Council: Best Value audit report	 East Dunbartonshire Council: Best Value audit report	
Jan			
Feb	 Scotland's NHS workforce		
Mar	 Local government in Scotland: Performance and challenges 2017	 i6: a review	 Managing new financial powers: an update

Central Government relevant reports

[Common Agricultural Policy Futures programme: an update](#) – May 2016

[The National Fraud Initiative in Scotland](#) – June 2016

[Audit of higher education in Scottish universities](#) – July 2016

[Supporting Scotland's economic growth](#) – July 2016

[Maintaining Scotland's roads: a follow-up report](#) – August 2016

[Superfast broadband for Scotland: a progress update](#) – August 2016

[Scotland's colleges 2016](#) – August 2016

[Social work in Scotland](#) – September 2016

[Scotland's new financial powers](#) – September 2016

[i6: a review](#) – March 2017

[Managing new financial powers: an update](#) – March 2017

Scottish Qualifications Authority

2016/17 Annual Audit Report

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