

Scottish Funding Council

2018/19 Annual Audit Report



 AUDIT SCOTLAND

Prepared for the Scottish Funding Council and the Auditor General for Scotland

June 2019

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

Our vision is to be a world-class audit organisation that improves the use of public money.

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

2018/19 annual report and accounts

- 1 The financial statements of the Scottish Funding Council (SFC) give a true and fair view of its financial position as at 31 March 2019 and its expenditure and income for 2018/19.
- 2 The other information in the annual report and accounts is consistent with the financial statements and prepared in accordance with legal requirements.
- 3 The unaudited annual report and accounts presented for audit and the related working papers were incomplete. This delayed completion of the audit work.

Financial management

- 4 SFC has appropriate and effective arrangements in place for financial management.
- 5 Systems of internal control operated effectively in 2018/19, with scope for improvement in some areas.
- 6 SFC has developed a workforce plan and should ensure it has sufficient capacity across the organisation.

Financial sustainability

- 7 SFC should work to complete medium to longer-term financial plans which measure the likely impact of major developments affecting the higher and further education sectors. These plans should be linked closely to the objectives set out in its new Strategic Framework.
- 8 SFC recognises the significant financial implications that EU withdrawal may have on colleges and universities. It is working closely with the sectors to prepare for EU withdrawal.

Governance and transparency

- 9 SFC has effective governance arrangements that support the scrutiny of decisions.
- 10 SFC has developed a new Strategic Framework to align its priorities with the Enterprise and Skills Strategic Board's Strategic Plan.

Value for money

- 11 SFC monitors and reports performance against targets which support the National Performance Framework. It is developing its performance arrangements to align with its new Strategic Framework.

Introduction

1. This report summarises the findings from our 2018/19 audit of the Scottish Funding Council (SFC).
2. The scope of our audit was set out in our Annual Audit Plan presented to the December 2018 meeting of the Audit and Compliance Committee. This report comprises the findings from:
 - an audit of SFC's annual report and accounts
 - consideration of the four audit dimensions that frame the wider scope of public audit set out in the [Code of Audit Practice 2016](#) as illustrated in [Exhibit 1](#).

Exhibit 1 Audit dimensions



Source: *Code of Audit Practice 2016*

3. The main elements of our audit work in 2018/19 have been:
 - a review of SFC's main financial systems
 - an audit of SFC's 2018/19 annual report and accounts including the issue of an independent auditor's report setting out our opinions
 - consideration of the four audit dimensions of public audit.

Adding value through the audit

4. We add value to SFC through the audit by:

- identifying and providing insight on significant risks, and making clear and relevant recommendations for improvements that are accepted by management
- reporting our findings and conclusions in public
- sharing intelligence and good practice through our national reports ([Appendix 3](#)) and good practice guides
- providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and actions to secure financial sustainability.

5. In so doing, we aim to help SFC promote improved standards of governance, better management and decision-making and more effective use of resources.

Responsibilities and reporting

6. SFC has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing annual report and accounts that are in accordance with the accounts direction from the Scottish Ministers. The SFC annual report and accounts includes the following:

- Performance Report
- Accountability Report (which includes the Corporate Governance Report, Remuneration and Staff Report and Parliamentary Accountability Report)
- Financial statements and supporting notes.

7. SFC is also responsible for establishing appropriate and effective arrangements for governance, propriety and regularity that enable the board to successfully deliver its objectives.

8. Our responsibilities as independent auditor are established by the Public Finance and Accountability (Scotland) Act 2000 and the [Code of Audit Practice 2016](#), and supplementary guidance and International Standards on Auditing in the UK.

9. As public sector auditors we give independent opinions on the annual report and accounts. Additionally, we conclude on:

- the appropriateness and effectiveness of the performance management arrangements,
- the suitability and effectiveness of corporate governance arrangements,
- the financial position and arrangements for securing financial sustainability.

10. In doing this we aim to support improvement and accountability. Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.

11. This report raises matters from the audit of the annual report and accounts and consideration of the audit dimensions. Weaknesses or risks identified are only those which have come to our attention during our normal audit work and may not be all that exist. Communicating these does not absolve management from

its responsibility to address the issues we raise and to maintain adequate systems of control.

- 12.** Our annual audit report contains an agreed action plan at [Appendix 1](#). It sets out specific recommendations, responsible officers and dates for implementation. It also includes any outstanding actions from last year and progress against these.
- 13.** We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and therefore the 2018/19 audit fee of £72,980 as set out in our Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.
- 14.** This report is addressed to both SFC and the Auditor General for Scotland and will be published on Audit Scotland's website www.audit-scotland.gov.uk in due course.
- 15.** We would like to thank all management and staff for their cooperation and assistance during the audit.

Part 1

Audit of 2018/19 annual report and accounts



Main judgements

The financial statements of SFC give a true and fair view of its financial position as at 31 March 2019 and its expenditure and income for 2018/19.

The other information in the annual report and accounts is consistent with the financial statements and prepared in accordance with legal requirements.

The unaudited annual report and accounts presented for audit and the related working papers were incomplete. This delayed completion of the audit work.

SFC's annual report and accounts are the principal means of accounting for the stewardship of its resources and its performance in the use of those resources.

Audit opinions on the annual report and accounts

16. The annual report and accounts for the year ended 31 March 2019 will be presented to SFC's Board for approval on 25 June 2019. We reported within the independent auditor's report that:

- the financial statements give a true and fair view and were properly prepared
- expenditure and income were regular and in accordance with applicable enactments and guidance issued by Scottish Ministers
- the audited part of the Remuneration and Staff Report, Performance Report and Governance Statement were all consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

17. Additionally, we have nothing to report in respect of misstatements in information other than the financial statements, the adequacy of accounting records and the information and explanations we received.

Submission of annual report and accounts for audit

18. We received the unaudited annual report and accounts on 3 May 2019 in line with our agreed audit timetable but these and the working papers were incomplete. Significant outstanding items included:

- a complete and FReM compliant performance report
- working papers to support SFC's treatment of adjustments required under International Financial Reporting Standard 9 Financial Instruments
- evidence to support SFC's judgement on its accounting treatment of European Social Fund income.

19. This information was provided after the deadline for submission of Audit and Compliance Committee papers. It was relevant in considering our audit opinions. As a result, the completion of our audit work was delayed and we were unable to meet the timetable for the audit set out in our Annual Audit Plan.



Recommendation 1

SFC should review its timetable and arrangements for preparation, submission to audit and approval of its annual report and accounts to ensure they are achievable.

Risk of material misstatement

20. [Appendix 2](#) provides a description of those assessed risks of material misstatement in the annual report and accounts and the wider audit dimension risks that we identified in our Annual Audit Plan. It also summarises the work we have done to gain assurance on these risks.
21. We have reported two issues from our work on the risks of material misstatements highlighted in our 2018/19 Annual Audit Plan. These relate to financial transactions (in particular the application of IFRS 9 Financial Instruments) and European Social Fund income and are included in the action plan at [Appendix 1](#).

Materiality

22. Misstatements are material if they could reasonably be expected to influence the economic decisions of users taken based on the financial statements. The assessment of what is material is a matter of professional judgement and involves considering both the amount and nature of the misstatement.
23. Our initial assessment of materiality for the annual report and accounts was carried out during the planning phase of the audit. With regards to the annual accounts, we assess the materiality of uncorrected misstatements both individually and collectively.
24. On receipt of the unaudited annual report and accounts we reviewed our materiality bases and concluded that they remained appropriate. We updated the materiality amounts as show in [Exhibit 2](#).

Exhibit 2 Materiality values

Materiality level	Amount
Overall materiality	£18.8 million
Performance materiality	£14.1 million
Reporting threshold	£190,000

Source: Audit Scotland



Significant findings from the audit in accordance with ISA 260

25. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the body's accounting practices covering accounting policies, accounting estimates and financial statements disclosures.
26. The significant findings are summarised in [Exhibit 3](#). Where a finding has resulted in a recommendation to management, a cross reference to the Action Plan in [Appendix 1](#) is included.

Qualitative aspects of the audit

27. We identified two significant findings in relation to the qualitative aspects of accounting practices and these are highlighted in [Exhibit 3](#) (and [Appendix 1](#)).

Exhibit 3 Significant findings from the audit of financial statements

Issue	Resolution
<p>1. Financial Transactions - IFRS 9 accounting adjustments and disclosures</p> <p>The unaudited annual report and accounts do not reflect the adoption of International Financial Reporting Standard 9 Financial Instruments. SFC has not made the required adjustments and disclosures in the annual report and accounts.</p>	<p>SFC has concluded that, in its opinion, the impact of the IFRS 9 adjustments and disclosures is immaterial and on this basis it has not adjusted the annual report and accounts for IFRS 9. We have confirmed that accounting for IFRS 9 would not have a material impact on the 2018/19 annual report and accounts.</p> <p>Management has agreed to review its accounting policy for financial transactions annually.</p> <p> Recommendation 2 (refer appendix 1, action plan) Appendix 1</p>
<p>2. European Social Fund (ESF) income accounting treatment</p> <p>SFC is the lead partner for two European Social Fund (ESF) programmes; the Youth Employment Initiative (YEI) and Developing Scotland's Workforce (DSW). SFC provides funding to colleges to support these programmes and claims matched European funding through the Scottish Government. SFC continues to account for ESF income on a cash basis in the annual report and accounts due to its view of the uncertainty over the timing and receipt of this income. In 2018/19 SFC received £8.5 million of ESF income. SFC's accounting treatment of ESF income is no longer appropriate due to the significantly increased certainty over receipt of ESF income.</p> <p>In May 2019 SFC received a further £5.3 million in ESF income for a 2016/17 YEI claim. This has not been accrued in the 2018/19 accounts and the income for the year and the Statement of Financial Position is understated by this amount.</p>	<p>Management has agreed to carry out an annual assessment of the accounting treatment of ESF funding to ensure it is in accordance with the FReM.</p> <p> Recommendation 3 (refer appendix 1, action plan) Appendix 1</p>

How we evaluate misstatements

28. There are no material adjustments to the unaudited financial statements arising from our audit. There is one unadjusted error in the accounts that relates to European Social Fund income.
29. It is our responsibility to request that all misstatements, other than those below the reporting threshold, are corrected although the final decision on making the correction lies with those charged with governance considering advice from senior officers and materiality. Management do not propose to adjust for the item above as the amounts are not considered material in the context of the financial statements.

Follow up of prior year recommendations

30. We have followed up actions agreed in 2017/18 to assess progress with implementation. SFC has made some progress in implementing these actions. For actions not yet implemented, revised responses and timescales have been agreed with management, and are set out in [Appendix 1](#).
31. We would in particular highlight the opportunity to develop the performance report to provide a better picture of what was achieved with the public money allocated to SFC.

Part 2

Financial management



Main judgements

SFC has appropriate and effective arrangements in place for financial management.

Systems of internal control operated effectively in 2018/19, with scope for improvement in some areas.

SFC has developed a workforce plan and should ensure it has sufficient capacity across the organisation.

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

Financial performance in 2018/19

32. The main financial objective for SFC is to ensure that the financial outturn for the year is within the budget allocated by Scottish Ministers.
33. SFC's financial performance against Departmental Expenditure Limits (DEL) is shown in [Exhibit 4](#). SFC underspent its DEL budget by £4.4 million. This was mainly due to loan repayments by colleges of £5 million which are not treated as resource expenditure and no opportunities were lost to the sectors.

Exhibit 4 Performance against DEL in 2018/19

Performance	Final budget £m	Outturn £m	Over (under) spend £m
Resource DEL	1,711.1	1,711.7	0.6
Capital DEL	116.5	111.5	(5.0)
Financial transactions	40.0	40.0	-
Total DEL	1,867.6	1,863.2	(4.4)

Source: Scottish Funding Council resource return

34. SFC spent £7.5 million on running costs which was in line with its 2018/19 running costs grant-in-aid budget.

Budgetary processes

35. SFC's budget management process is complex, with the application of a financial year budget to an academic year along with the need to manage its corporate budget pressures and commitments.
36. We reviewed SFC's budgetary processes and budget monitoring arrangements. From the review of budget monitoring reports and committee papers, and attendance at committees we confirmed that senior management and members receive regular, timely and up to date financial information on SFC's financial position.
37. We concluded that SFC has effective budgetary monitoring and control arrangements that support Finance Committee and officer scrutiny of SFC finances.

Workforce capacity

38. There are increasing demands on SFC's resources. Alongside its ongoing activities for the further and higher education sectors, this includes work to support the Enterprise and Skills Strategic Board, preparing for the implications of EU withdrawal and administering European Social Fund funding to colleges. SFC did not have a workforce plan during 2018/19 setting out how it manages its resources in response to these pressures.
39. Earlier in this report we highlighted issues with the completeness of the annual report and accounts presented for audit which may be associated with a lack of capacity in the finance team.
40. SFC has developed a workforce plan that sets out its staffing requirements for 2019/20 and the associated financial implications. SFC plans to present this plan to the June 2019 Remuneration Committee meeting for comment.



Recommendation 4

SFC should work to implement its workforce plan to ensure it has sufficient capacity across the organisation.

Systems of internal control

41. As part of our audit we identify and inspect the key internal controls in those accounting systems which we regard as significant to produce the financial statements. Our objective is to gain assurance that SFC has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.
42. The findings from our review of systems of internal control were included in the management report presented to the Audit and Compliance Committee in March 2019. We identified areas where controls could be strengthened which were accepted and addressed by management. We carried out additional work to gain the assurance we required for the audit of SFC's 2018/19 accounts.

Standards of conduct for prevention and detection of fraud and error

- 43.** Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.
- 44.** We have reviewed the arrangements in place to maintain standards of conduct including the Staff Handbook and Civil Service and Members' Codes of Conduct. There are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.
- 45.** We have concluded that SFC has appropriate arrangements in place for the prevention and detection of fraud, error and irregularities, bribery and corruption. We are not aware of any specific issues that we need to bring to your attention.

National Fraud Initiative

- 46.** The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise coordinated by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify 'matches' that might suggest the existence of fraud or irregularity.
- 47.** We completed a review of NFI work in February 2019 and found that SFC is pro-active in investigating matches. SFC plans to report the results of NFI activity at the Audit and Compliance Committee in June 2019.

Part 3

Financial sustainability



Main judgements

SFC should work to complete medium to longer-term financial plans which measure the likely impact of major developments affecting the higher and further education sectors. These plans should be linked closely to the objectives set out in its new Strategic Framework.

SFC recognises the significant financial implications that EU withdrawal may have on colleges and universities. It is working closely with the sectors to prepare for EU withdrawal.

Financial sustainability looks forward to the medium and longer-term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

Financial planning

48. SFC received its draft budget allocation for 2019/20 from the Scottish Government in April 2019. The total budget allocation is £1,839.3 million. This covers the funding SFC distributes to higher and further education institutions and its corporate running costs.
49. SFC announced indicative funding allocations to universities and colleges in February 2019. It announced final outcome agreement funding allocations in May 2019 based on the budget allocation from the Scottish Government. The final allocations were broadly unchanged from the indicative allocations.

Changing landscape for public financial management and medium to longer-term financial planning

50. Scottish public finances are fundamentally changing, with significant tax-raising powers, new powers over borrowing and reserves, and responsibility for some social security benefits. This provides the Scottish Parliament with more policy choices but also means that the Scottish budget is subject to greater uncertainty and complexity.
51. A new Scottish budget process has been introduced, which is based on a year-round continuous cycle of budget setting, scrutiny and evaluation. As part of the new budget process, the Scottish Government published an initial five-year Medium-Term Financial Strategy (MTFS) in May 2018. The five-year outlook for the Scottish budget, set out in the MTFS, provides useful context for bodies' financial planning.
52. We reviewed the financial planning systems of SFC and assessed how effective they are in identifying and addressing risks to financial sustainability across the medium (two to five years) and longer-term (five to ten years).
53. We have previously recommended that SFC works to complete medium to longer-term financial plans which measure the likely impact of major

developments affecting the higher and further education sectors. SFC has provided colleges with financial planning assumptions covering a five-year period but its own financial plans for its higher and further education budgets continue to cover a one-year period. SFC has focused on providing support to universities and colleges with the upcoming Scottish Government spending review. The spending review is a detailed examination of portfolio budgets to set future spending plans and targets over a multi-year period.

54. SFC's 2019/20 corporate running costs budget included a two year forward-looking projection including scenario planning.
55. SFC recognises that further work is required on longer-term financial planning. It is part of strategic futures groups which aims to ensure a shared approach to longer-term financial planning and risk management in the higher and further education sectors. The next spending review period, which covers three years, provides an opportunity to take forward longer-term financial planning alongside SFC's wider skills alignment programme of activity.



Recommendation 5

SFC should work to complete medium to longer-term financial plans which measure the likely financial impact of major developments affecting the higher and further education sectors. These plans should be linked closely to the objectives set out in its new Strategic Framework.

EU withdrawal

56. There remains significant uncertainty surrounding the terms of the UK's withdrawal from the European Union (EU). EU withdrawal will inevitably have implications for devolved government in Scotland and for audited bodies. It is critical that public sector bodies are working to understand, assess and prepare for the impact on their business in three broad areas:
 - Workforce – the extent to which potential changes to migration are likely to affect the availability of the people and skills needed to deliver services.
 - Funding – the extent to which potential changes to existing EU funding programmes are likely to affect the finances of public bodies and the activity that such funding supports.
 - Regulation – the extent to which potential changes to EU regulations are likely to affect the activities of some public bodies.
57. SFC has included Brexit as a high level risk in its risk register. It has identified a risk that if it is unable to mitigate the most significant financial and other direct and indirect impacts on colleges and universities of leaving the EU, there will be a material and negative impact on their ability to deliver against their outcome agreements. SFC received funding from the Scottish Government to establish a temporary team to work with colleges and universities to identify the impacts of leaving the EU and to develop actions to mitigate the risks. This work included meeting individually with colleges and universities and producing a circular with summary statistics on key areas such as student numbers.
58. Officers presented a paper to the Audit and Compliance Committee providing details of the work SFC is doing to prepare to leave the EU. This paper also addresses the key issues identified in the Audit Scotland paper '[Withdrawal from the European Union](#)' and provides responses to the questions posed in this paper.

Part 4

Governance and transparency



Main judgements

SFC has effective governance arrangements that support the scrutiny of decisions.

SFC has developed its new Strategic Framework to align its priorities with the Enterprise and Skills Strategic Board's Strategic Plan.

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.

Governance arrangements

59. The corporate governance framework within SFC is centred around the Board, supported in its role by seven committees including the Audit and Compliance Committee and the Finance Committee. The Board is responsible for establishing the strategic processes within SFC and arrangements for ensuring the proper conduct of the affairs of SFC. The Board delegates responsibility for scrutiny to the Audit and Compliance Committee which meets quarterly.
60. Each year the Audit and Compliance Committee undertakes a self-assessment exercise. The Audit and Compliance Committee members demonstrate a clear understanding of their responsibilities, and of the respective roles of management, internal audit and external audit. Members participate in development opportunities on an ongoing basis to ensure their skills adapt to changing demands and put their skills and experience to good use in contributing to the committee's work.
61. We concluded that SFC has effective governance, decision-making and scrutiny arrangements in place which support good governance and accountability.

Openness and transparency

62. There is an increasing focus on how public money is used and what is achieved. In that regard, openness and transparency supports understanding and scrutiny. Transparency means that the public have access to understandable, relevant and timely information about how the board is taking decisions and how it is using resources such as money, people and assets.
63. Agendas, minutes and papers of Board and committee meetings are published on the SFC website. SFC is making more financial information publicly available through publication of parts of Finance Committee papers. It also now makes a wider range of Audit and Compliance Committee papers available on its website.

Performance report

64. In addition to the opinion on the performance report covered in Part 1 of this report, we also consider the qualitative aspects of SFC's performance report included in its annual report and accounts. The purpose of a performance report is to provide information on SFC's main objectives and strategies, and the principal risks that it faces. It is required to provide a fair, balanced and understandable analysis of a body's performance and, is essential in helping stakeholders understand the connections between performance and finances.
65. In 2017/18, we reported that SFC's performance report met the minimum requirements of the FReM and that improvements could be made to the performance analysis and financial commentary. This year's financial performance section provides a clearer analysis of how SFC spends its funding. However, there is scope to better explain the risks and uncertainties affecting each of SFC's performance measures. SFC should also consider including more information about how well it is delivering against its strategy.



Recommendation 6

SFC should consider the content of its 2019/20 performance report to ensure it provides users of the annual report and accounts with a more comprehensive analysis of its performance.

Enterprise and skills

66. In May 2016, the First Minister announced a review of the roles, responsibilities and relationships of Scotland's enterprise, development and skills agencies.
67. One of the key developments arising from the review was the establishment of the Enterprise and Skills Strategic Board. The Strategic Board's purpose is to maximise the impact of the collective investment in enterprise and skills development, and to create the conditions conducive to delivering inclusive and sustainable growth. It is tasked with improving the overall performance of the economy. Its membership is drawn from the chairs of each of the enterprise and skills agencies, as well as non-executive members from academic and private-sector bodies.
68. In June 2018, the Strategic Board published its outline Strategic Plan that set out its initial priorities (referred to as 'missions'). The full Strategic Plan was published in October 2018 and provided further detail on each of the missions:
- Business Creation and Growth – business creation can spur productivity growth.
 - Business Models and Workplace Innovation – harness the full potential of progressive business models, workplace innovation and Fair Work.
 - Future Skills Needs – providing the future workforce with the required complex skill-set.
 - Exporting – significantly improve Scotland's productivity through export growth.
69. Each mission aims to maximise the effect of the enterprise and skills system on productivity and inclusive growth, with a focus on 'hard alignment' between the agencies. Teams have been set up to develop the four missions and a Strategic Planning Joint Working Group ensures coherence among them. The Scottish Government has established an Analytical Unit, to support the

Strategic Board in its decision-making and assessment of the agencies' performance.

- 70.** The Strategic Plan also identified 14 actions for the agencies and 18 recommendations for the Scottish Government which are set out around the four inter-connected missions. SFC extended its 2015-18 strategic plan by one year to allow it to align its new strategy with the vision and actions of the Strategic Plan.
- 71.** Annual Ministerial Letters of Guidance are developed jointly and issued to the enterprise agencies at the same time. The Scottish Government issued an additional Letter of Guidance to the four agencies in January 2019. The letter makes clear that individual agencies are to undertake operational and strategic planning in line with the Strategic Board's Strategic Plan, and collectively pursue its actions. There is an expectation that the individual agencies work collaboratively with the other agencies, with the Scottish Government, and more widely as required to support the Strategic Board's aims.
- 72.** There are signs of increased collaboration between agencies. Skills Development Scotland (SDS) and SFC are working together to introduce a 'five-step model' for skills alignment. This is expected to establish a single demand and provision planning cycle for skills. An interim joint skills alignment director has been appointed to support improved skills alignment. The appointment of a permanent director will be announced shortly.
- 73.** We published a briefing paper in May 2019 titled '[Enterprise and Skills Review: Core areas of audit interest](#)'. This paper outlines progress since the review was announced and highlights core areas of audit interest. We will continue to monitor progress locally and at a national level.

Part 5

Value for money



Main judgements

SFC monitors and reports performance against targets which support the National Performance Framework. It is developing its performance arrangements to align with its new Strategic Framework.

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

Best value

74. [Ministerial guidance to Accountable Officers](#) for public bodies and the [Scottish Public Finance Manual](#) (SPFM) set out the accountable officer's duty to ensure that arrangements are in place to secure best value.
75. SFC assesses its compliance with the principles of Best Value by carrying out periodic self-assessment exercises. The last exercise was carried out in 2017 and the next exercise is planned for 2020.
76. The self-assessment measures SFC against the Best Value characteristics an organisation should be able to demonstrate, as identified by the Scottish Government. Senior officers identified nine actions for improvement from the self-assessment. These have been used to form a Best Value Improvement Plan.
77. SFC will report progress with improvement plan actions to the Audit and Compliance Committee in June 2019. SFC is proactive in ensuring it has appropriate arrangements for securing Best Value.

Performance management

78. The performance of SFC is monitored by the Board against several performance targets which support the delivery of the Scottish Government's national performance framework. SFC prepares an annual strategic plan performance report which includes a range of measures of inputs, activity, outputs and outcomes linked to the strategic plan. Updates on performance are presented at each Board meeting.
79. The strategic plan performance report measures performance against six outcomes. During 2018/19 one of the outcomes was 'ahead', four were 'on track' and one was 'behind'. The outcome that was behind was 'world leading research' and reflects a downward trend in some sector-level performance indicators, largely because the international environment for research is becoming even more competitive. Overall SFC reports that it is 'on track' to deliver its strategy.
80. SFC is updating its approach to align with the Strategic Plan that was issued by the Enterprise and Skills Strategic Board in May 2018. SFC's Strategic Framework 2019-22 is in the final stages of development. It also has plans to

develop a new performance report which distinguishes between the strategic performance of the further and higher education sectors and SFC's performance as a major public body.

National performance audit reports

81. We deliver a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. In 2018/19 several reports were published which are of direct interest to SFC. These are outlined in [Appendix 3](#).
82. Of those reports, our overviews of the further education sector are of course particularly relevant to SFC. The '[Scotland's colleges 2018](#)' report included specific recommendations for SFC. We have reviewed the progress SFC has made against these recommendations ([Exhibit 5](#)).

Exhibit 5

Performance against 'Scotland's colleges 2018' recommendations

Recommendation	Progress
SFC should revise its accounts direction to ensure colleges calculate their underlying financial position consistently.	SFC revised its accounts direction to include guidance for colleges in how to calculate the underlying operating position. This was issued on 13 July 2018. The 2018 Financial Forecast Returns from colleges included an adjusted operating position section. The methodology for calculating this section was agreed to ensure a consistent approach. SFC noted improvements but recognise that further work could be done.
SFC should progress its work with colleges to improve common assumptions for future financial forecasting returns, including clarifying when departing from assumptions would be justified.	Following consultation with college representatives, SFC provided more detailed guidance than in previous years on the assumptions that colleges should use in their 2018 forecasts. SFC noted improvements however further work is required to ensure a consistent approach.
SFC should determine what other actions are required to tackle the greatest gender imbalances in subjects to deliver its gender action plan.	SFC is addressing this recommendation through the Outcome Agreement (OA) process, with OAs showing an increased commitment to measures identified in the Gender Action Plan (GAP). To support this process, SFC ran a sectoral event in October 2018 to discuss progress to date, share best practice and consider how the sector can work together to deliver the GAP. SFC also visited six institutions during 2018/19 to discuss how the GAP is being implemented and governed. These visits will continue over the next few years with the intention that all college and university regions will be visited. These visits identified good practice and areas of improvement, and this was reported in SFC's progress report on implementation of the GAP published in February 2019.
SFC should agree with regional strategic bodies (RSB) in multi-college regions the most appropriate way of collecting information on college activities and clarify both why and when it needs to engage with, or collect information from, assigned colleges.	SFC is reviewing, alongside RSB partners, how information on college activity is collected. This builds on work with the Scottish Government and colleges to reduce the number of financial returns that colleges are required to submit. At present, colleges within multi-college regions often submit performance data directly to SFC due to timing issues and as it has staffing and software to allow for the most cost effective and efficient analysis of the data. Where practicable and economical SFC will collate a

Recommendation	Progress
	regional response rather than a college-level one. Work in this area is ongoing.

Source: Audit Scotland

- 83.** SFC has made progress in addressing the recommendations of the Scotland's Colleges 2018 report and work in these areas is ongoing. Officers present regular updates on progress made against the recommendations to the Audit and Compliance Committee.
- 84.** Audit Scotland published [Scotland's colleges 2019](#) in June 2019. The report highlights that, while colleges continue to meet SFC targets for learning activity, they also face financial challenges. The report highlights that the SFC needs to work with colleges and their boards to improve financial planning and to achieve greater transparency in the sector's financial position. It also highlights scope for the SFC to improve its performance reporting on colleges and ensure that the performance targets set for colleges are realistic. The recommendations of the report are set out in [Exhibit 6](#).

Exhibit 6

Scotland's colleges 2019 recommendations

Colleges should:

- agree their underlying financial position with the SFC prior to finalising their accounts
- improve data collection and response rates for student satisfaction and publish results
- use *How good is our college?* effectively to drive improved performance and enhance the quality of service provision.

College boards and regional bodies should:

- agree medium-term financial plans that set out the mitigating actions to ensure their college's financial sustainability
- submit agreed medium-term financial plans to the SFC along with financial forecast returns (FFRs).

The SFC should:

- work with colleges to agree their underlying financial position prior to finalising their accounts
- require colleges to submit medium-term financial plans to support FFRs in assessing financial sustainability across the sector
- publish college region performance against all outcome agreement measures
- publish good-quality student satisfaction data for every college.

The SFC and Scottish Government should:

- agree and publish a medium-term capital investment strategy that sets out sector-wide priorities
- review whether targets for college provision and student outcomes, including for students from deprived areas, remain relevant and realistic, based on current performance trends

- **work with colleges to deliver the necessary improvements in performance to meet agreed outcome agreement targets.**

Scotland's colleges 2019, Audit Scotland

85. In responding to the recommendations in Scotland's Colleges 2018, the SFC should consider how it can also address some of the more recent recommendations in Scotland's Colleges 2019 particularly when revising financial guidance for the sector. Management has advised us that these recommendations will be actioned in the 2019/20 financial forecast returns and in the accounts direction.

Appendix 1

Action plan 2018/19



No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p>Submission of financial statements for audit</p> <p>We received the unaudited annual report and accounts on 3 May 2019 in line with our agreed audit timetable but these and the working papers were incomplete. Significant outstanding items included:</p> <ul style="list-style-type: none"> • a complete and FReM compliant performance report • working papers to support SFC's treatment of adjustments required under International Financial Reporting Standard 9 Financial Instruments • evidence to support SFC's judgement on its accounting treatment of European Social Fund income. <p>This information was provided after the deadline for submission of Audit and Compliance Committee papers which delayed the completion of our audit work and meant we could not meet the timetable for the audit set out in our Annual Audit Plan.</p> <p>Risk</p> <p>SFC is unable to approve its annual report and accounts in accordance with its agreed timetable.</p>	<p>SFC should review its timetable and arrangements for preparation, submission to audit and approval of its annual report and accounts to ensure they are achievable.</p> <p>Paragraph 19</p>	<p>Agreed</p> <p>Director of Finance</p> <p>February 2020</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
2	<p data-bbox="256 412 628 730">IFRS 9 adjustments</p> <p data-bbox="256 461 628 730">The unaudited annual report and accounts do not reflect the adoption of International Financial Reporting Standard 9 Financial Instruments. SFC has not made the required adjustments and disclosures in the annual report and accounts.</p> <p data-bbox="256 752 628 1084">SFC has concluded that, in its opinion, the impact of the IFRS 9 adjustments and disclosures is immaterial and on this basis it has not adjusted the annual report and accounts for IFRS 9. We have confirmed that accounting for IFRS 9 would not have a material impact on the 2018/19 annual report and accounts.</p> <p data-bbox="256 1106 628 1330">Risk</p> <p data-bbox="256 1155 628 1330">SFC will receive higher levels of financial transactions funding in 2019/20. This may result in its accounting treatment no longer being appropriate.</p>	<p data-bbox="659 412 999 568">Officers should review the accounting treatment of financial transactions funded loans to ensure it remains appropriate.</p> <p data-bbox="659 591 823 613">Paragraph 27</p>	<p data-bbox="1054 412 1401 479">The accounting policy will be reviewed annually.</p> <p data-bbox="1054 501 1401 568">Assistant Director, Finance February 2020</p>
3	<p data-bbox="256 1366 628 1424">ESF income accounting treatment</p> <p data-bbox="256 1447 628 1868">SFC continues to account for ESF income on a cash basis in the annual report and accounts due to its view of the uncertainty over the timing and receipt of this income. In 2018/19 SFC received £8.5 million of ESF income. SFC's accounting treatment of ESF income is no longer appropriate due to the significantly increased certainty over receipt of ESF income.</p> <p data-bbox="256 1890 628 2123">In May 2019 SFC received a further £5.3 million in ESF income for a 2016/17 YE1 claim. This has not been accrued in the 2018/19 annual report and accounts and the Statement of Financial Position is understated by this amount.</p>	<p data-bbox="659 1366 999 1518">Management should carry out an annual assessment of the accounting treatment of ESF funding to ensure it is in accordance with the FReM.</p> <p data-bbox="659 1541 823 1563">Paragraph 27</p>	<p data-bbox="1054 1366 1401 1433">The accounting policy will be reviewed annually.</p> <p data-bbox="1054 1456 1401 1523">Assistant Director, Finance February 2020</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>Risk</p> <p>There is a risk that the income figure in the annual accounts is understated.</p>		
4	<p>Workforce capacity</p> <p>There are increasing demands on SFC's resources. This includes work to support the Enterprise and Skills Strategic Board, preparing for the implications of EU withdrawal and administering ESF funding to colleges. SFC did not have a workforce plan in place during 2018/19 setting out how it manages its resources in response to these pressures.</p> <p>Risk</p> <p>Workforce decisions are not coordinated leading to decision in one area having unintended consequences in another.</p>	<p>SFC should work to implement its workforce plan to ensure it has sufficient capacity across the organisation.</p> <p>Paragraph 40</p>	<p>Agreed</p> <p>Chief Operating Officer</p> <p>June 2019</p>

Follow up of prior year recommendations

5	<p>Medium to long-term financial planning</p> <p>SFC's financial plans only cover a one-year period. It is developing longer-term financial plans for its running costs and higher and further education budgets aligned to its strategic plan.</p> <p>Risk</p> <p>SFC does not have the information available to support a longer-term view of its financial position and its options for future funding.</p> <p>Update</p> <p>SFC has provided colleges with financial planning assumptions covering a five-year period but its own financial plans for its higher and further education budgets continue to cover a one-year period. SFC has focused on providing support to universities and colleges with</p>	<p>SFC should work to complete medium to longer-term financial plans which measure the likely financial impact of major developments affecting the higher and further education sectors. These plans should be linked closely to the objectives set out in its new Strategic Framework.</p> <p>Paragraph 55</p>	<p>Agreed</p> <p>The upcoming Spending Review provides the platform to take this forward.</p> <p>Director of Finance</p> <p>February 2020</p>
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No.	Issue/risk	Recommendation	Agreed management action/timing
	the upcoming Scottish Government spending review.		
6	<p data-bbox="256 483 507 517">Performance report</p> <p data-bbox="256 528 612 864">We have identified some improvements which could be made to the performance analysis and financial commentary. These include better explaining the risks and uncertainty affecting SFC's performance measures and a clearer analysis of how it spends its funding and what is achieved.</p> <p data-bbox="256 887 316 909">Risk</p> <p data-bbox="256 931 612 1043">SFC does not provide users of the annual report and accounts with a clear analysis of its performance.</p> <p data-bbox="256 1066 347 1088">Update</p> <p data-bbox="256 1111 612 1431">We have seen some improvement in the financial performance section that provides a clearer analysis of how SFC spends its funding. However we have again reported that there is scope to better explain the risks and uncertainty affecting each of SFC's performance measures.</p>	<p data-bbox="657 483 1023 696">SFC should consider the content of its 2019/20 performance report to ensure it provides users of the annual report and accounts with a more understandable analysis of its performance.</p> <p data-bbox="657 719 820 741">Paragraph 65</p>	<p data-bbox="1054 483 1145 506">Agreed</p> <p data-bbox="1054 528 1334 562">Chief Operating Officer</p> <p data-bbox="1054 584 1254 607">September 2019</p>

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 to 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>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 to change the position disclosed in the financial statements.</p>	<p>Reviewed the appropriateness of journal entries and other adjustments recorded in the general ledger and financial statements.</p> <p>Reviewed accounting estimates for bias.</p> <p>Evaluated significant transactions that are outside the normal course of business.</p> <p>Focussed testing of the regularity and cut-off assertions during the financial statements audit.</p>	<p>We concluded from our audit testing that all 2018/19 journal entries, accounting estimates and judgements, and significant transactions we reviewed were appropriate.</p>
<p>2 Risk of fraud over expenditure</p> <p>Most public-sector bodies are net expenditure bodies and therefore the risk of fraud is more likely to occur in expenditure.</p> <p>The risk of fraud over expenditure also exists in SFC due to the complexity and extent of expenditure incurred in carrying out its functions.</p>	<p>Analytical procedures on expenditure streams.</p> <p>Detailed testing of expenditure transactions focusing on the areas of greatest risk.</p> <p>Review actions taken in respect of NFI data matches.</p>	<p>We found no significant issues from our detailed testing of expenditure.</p> <p>SFC has been pro-active in investigating NFI matches.</p>
<p>3 Grants paid to colleges and universities</p> <p>The main activity of SFC is the award and payment of grants to colleges and universities. Due to the complexities around different year end dates and re-profiling of budgets, there is a risk that grants paid to institutions are incorrectly</p>	<p>Detailed testing of grant funding controls.</p> <p>Focused substantive testing of formula-based grant awards to individual bodies.</p> <p>Sample testing of grant commitments at the year end.</p> <p>Substantive cut-off testing of grant payments to ensure they</p>	<p>We found no issues from our testing of grant funding controls.</p> <p>We found no misstatements of grant payments to institutions from our sample testing of in year grant payments, commitments relating to the remainder of the academic year 2018/19 and funding clawbacks.</p>

Audit Risk	Assurance procedure	Results and conclusions
recorded in the financial statements.	are recognised in the correct financial year.	
<p>4 Financial transactions</p> <p>SFC receives financial transactions funding from the Scottish Government which sets conditions on how they are used. The level of this funding has increased significantly from £16.2m in 2017/18 to £40.0m in 2018/19. SFC has used the funding to issue loans to universities.</p> <p>There is a risk that loans issued to universities are incorrectly recorded in SFC's financial statements and that use of financial transactions funding does not meet conditions set by the Scottish Government.</p>	<p>Review appropriateness of accounting treatment to ensure it is correct, in particular compliance with the new requirements of IFRS 9 Financial instruments</p> <p>Consider the control arrangements in place for evaluating applications to ensure they meet the required conditions.</p> <p>Review how SFC ensures money is used for the purpose agreed.</p> <p>Review loan agreements to ensure the regularity and validity of the use of financial transactions funding.</p>	<p>We reviewed the accounting treatment of financial transactions in accordance with IFRS 9 and recorded our findings in part 1 of this report.</p> <p>We reviewed the control arrangement for evaluating applications and ensuring money is used for the purpose agreed and found this process to be satisfactory.</p> <p>We reviewed loan agreements and no issues were identified.</p>
<p>5 European social fund</p> <p>SFC is the lead partner for the Developing Scotland's Workforce European Social Fund (ESF) programme. It provides funding to colleges and claims European funding through the Scottish Government. It was also the lead partner for the Youth Employment Initiative ESF programme which ended in 2017/18 but for which claims are still outstanding.</p> <p>In prior years SFC accounted for ESF income on a cash basis due to uncertainty about the amount and timing of its receipt.</p> <p>The degree of uncertainty has reduced and there is the risk that the previous accounting approach is no longer appropriate and results in incorrect treatment in the accounts.</p>	<p>Review evidence of amount and timing of receipt of ESF income and whether the accounting treatment adopted is appropriate.</p>	<p>SFC continues to account for ESF income on a cash basis in the annual report and accounts due to its view of the uncertainty over the timing and receipt of this income. In 2018/19 SFC received £8.5 million of ESF income. SFC's accounting treatment of ESF income is no longer appropriate due to the significantly increased certainty over receipt of ESF income.</p> <p>In May 2019 SFC received a further £5.3 million in ESF income. This has not been accrued in the 2018/19 annual report and accounts and the income for the year and the Statement of Financial Position are understated by this amount.</p>
Risks identified from the auditor's wider responsibility under the Code of Audit Practice		
<p>6 Financial sustainability</p> <p>SFC's strategic plan for 2015 to 2018 contains high level objectives on the use of resources. Financial plans for higher education and further</p>	<p>Review SFC's progress on drafting medium to long-term financial plans.</p> <p>Consider SFC's arrangements for monitoring and reporting on</p>	<p>SFC's financial plans only cover a one-year period. SFC should work to complete medium to longer-term financial plans which measure the likely financial impact of major developments affecting the higher and further</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>education cover a one-year period.</p> <p>There is a risk that SFC does not have the information available to support a longer-term view of its financial position including, for example, the potential financial impact of significant events, such as EU withdrawal.</p>	<p>the financial health of institutions.</p> <p>Review updates to briefing material.</p>	<p>education sectors. These plans should be linked closely to the objectives set out in its new strategic framework.</p> <p>SFC are provided with financial forecasts annually from the colleges and universities. Officers provide regular updates to the Finance Committee on the financial health of institutions.</p>
<p>7 Workforce plan</p> <p>There are increasing demands on SFC's resources. This includes work to support the Enterprise and Skills strategic board (see below), preparing for the implications of EU withdrawal and administering ESF funding to colleges. SFC does not have a workforce plan setting out how it will manage its resources in response to these pressures.</p> <p>There is a risk that workforce decisions are not coordinated leading to decisions in one area having unintended consequences in another.</p>	<p>Monitor SFC's progress in developing its workforce plan and review once finalised.</p>	<p>SFC did not have a workforce plan in place during 2018/19 setting out how it manages its resources in response to these pressures.</p> <p>SFC has developed a workforce plan that sets out its staffing requirements for 2019/20 and the associated financial implications.</p> <p>SFC plan to present this plan to the June 2019 Remuneration Committee meeting for comment.</p>
<p>8 Enterprise and skills review – strategic plan</p> <p>In October 2018, the enterprise and skills strategic board published its first strategic plan. The plan aims to provide clarity around strategic directions to SFC and other enterprise and skills agencies with the overall aim to increase productivity and drive inclusive economic growth in Scotland. The agencies are expected to progress actions set out in the strategic plan through enhanced collaboration and alignment.</p> <p>There is a risk that the transition to the new arrangements affects SFC's effectiveness in the short-term.</p>	<p>Review the new framework document between SFC and the Scottish Government for clarity over new roles, responsibilities and accountabilities.</p> <p>Review performance management arrangements in place to determine and report on the impact of new arrangements.</p> <p>Monitor progress with SFC's new corporate plan and strategic plan and review once published.</p>	<p>We reviewed the new framework document between the SFC and the Scottish Government that was published in July 2018. No issues were identified.</p> <p>Performance management arrangements are currently under review by the senior management team.</p> <p>SFC's Strategic Framework 2019-22 has been drafted and is in the final stages of completion. This has been agreed by the Board and is awaiting approval from Scottish Ministers. This includes an operational plan for 2019-20.</p>
<p>9 Openness and transparency</p> <p>There is increasing focus on how public bodies spend their money and the level of transparency in reporting.</p> <p>Openness and transparency</p>	<p>Review disclosures in the 2018/19 performance report.</p>	<p>We reviewed the disclosures in the 2018/19 performance report and found they are in line with the minimum requirements of the FReM.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>supports understanding and scrutiny of the use of public money.</p> <p>There is a risk that SFC does not provide a full and transparent account of its budget, how it has applied its budget and its overall performance.</p>		<p>We have seen some improvement in the financial performance section that provides a clearer analysis of how SFC spends its funding and what is achieved. However, we have again reported that there is scope to better explain the risks and uncertainty affecting each of SFC's performance measures.</p>

Appendix 3

Summary of national performance reports 2018/19

		 2018/19 Reports	
Local government in Scotland: Challenges and performance 2018		Apr	
Councils' use of arm's-length organisations		May	 Scottish Fire and Rescue Service: an update
Scotland's colleges 2018		Jun	
		Jul	 The National Fraud Initiative in Scotland 2016/17
Forth Replacement Crossing		Aug	 Major project and procurement lessons
Children and young people's mental health		Sept	 Superfast broadband for Scotland: further progress update
NHS in Scotland 2018		Oct	
Health and social care integration: update on progress		Nov	 Local government in Scotland: Financial overview 2017/18
		Dec	
		Jan	
		Feb	
		Mar	 Local government in Scotland: Challenges and performance 2019

The following reports may be of particular relevance to SFC:

[Scotland's colleges 2018](#) – June 2018

[The National Fraud Initiative in Scotland 2016/17](#) – July 2018

[Scotland's colleges 2019](#) – June 2019

Scottish Funding Council

2018/19 Annual Audit Report

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