Scottish Government

2019/20 Annual Audit Report

Prepared for the Scottish Government and the Auditor General for Scotland

April 2021

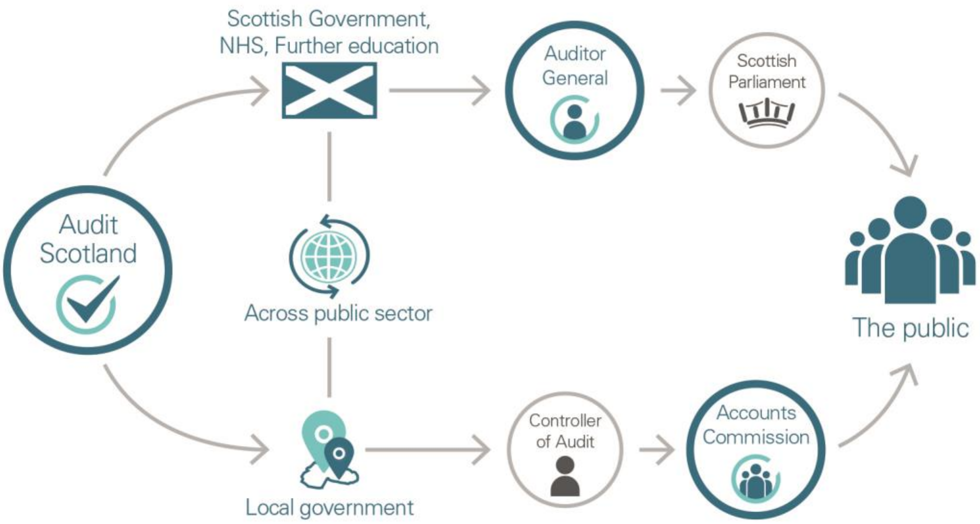
Who we are

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.

Contents

Key messages

2019/20 annual report and accounts

1 These are exceptional times for the Scottish Government. The effects of the Covid-19 health crisis will be felt across all aspects of the public sector and the wider economy for years to come. The Scottish Government's primary focus in recent months has been on responding to the pandemic's immediate threat to public health and the economy whilst outlining plans for how to repair and recover from the damage inflicted on individuals, businesses and communities. More than ever there is a need for the Scottish Government to ensure sound financial management and good governance are at the heart of its decision making to help ensure recovery plans are robust and effective.

2 The independent audit opinion is unqualified. This means in our opinion, we are content they show a true and fair view, following accounting standards, and that the income and expenditure for the year is lawful.

3 An 'Emphasis of Matter' paragraph is included in the independent auditor's report to draw attention to the impact of Covid-19 on property valuations. The audit opinion is not modified in respect of this matter.

Financial management

4 The Scottish Government's Consolidated Accounts for 2019/20 show that total net expenditure was £39,385 million, £669 million more than budget.

5 In March 2020, the Scottish Government announced plans for two large Business Support Schemes: The Small Business Support Grant and the Retail, Hospitality and Leisure Grant to respond quickly to the impact of Covid-19 on businesses. Although funding for these schemes was not included within the Scottish budget until 2020/21, the actions taken by the Scottish Government before the year end created a constructive obligation under accounting standards in 2019/20. The Consolidated Accounts include these costs, amounting to £912 million, resulting in an overspend of £669 million against the Consolidated budget.

6 There is a greater awareness across the organisation of the financial challenges facing the Scottish Government. Throughout the year, the Scottish Government Executive Team and non-executive directors received regular and good financial information on the Scottish Government's financial position.

7 The impact of Covid-19 and EU withdrawal on businesses is likely to increase the expectations and demands on the public sector to provide financial support. It will be essential for the Scottish Government to learn lessons from its experience of recent financial interventions in private companies. It will also be important for the Scottish Government to clearly outline its plans for future investment in private companies to ensure there is greater transparency over financial support provided and the value of public funds committed.

Financial sustainability

8 The Covid-19 pandemic has brought increased uncertainty and potential volatility to public finances over the medium term. As a result, the Scottish Government postponed its planned May 2020 publication of its annual medium-term financial strategy (MTFS) until January 2021 to better reflect the likely impact of the pandemic on public finances. There is a need for the strategy to make clearer the links between planned spending options and expected outcomes outlined in the National Performance

Framework to aid Parliament's understanding of the financial risks and opportunities emerging from the Covid-19 pandemic.

9 The pandemic and ongoing uncertainty of EU withdrawal pose significant risks to the sustainability of public finances. As a result, there is a need more than ever for a public consolidated account to provide a comprehensive and transparent assessment of the state of Scotland's public finances. The Scottish Government should now finalise the format and report publicly when it will produce a draft public consolidated account for audit.

Governance and transparency

10 The Governance Statement confirms that it complies with relevant guidance on corporate governance. It also highlights some of the main risks and opportunities for the organisation and any significant internal control issues in 2019/20. We are content that the Governance Statement is consistent with the financial statements and has been prepared in accordance with guidance issued by the Scottish Ministers.

11 The Scottish Government has strengthened aspects of its governance arrangements during 2019/20. The changes to corporate governance arrangements in response to Covid-19 were timely and appropriate and provided a structure to enable quick decision-making and information sharing across government directorates and corporate groups.

Value for money

12 The Scottish Government demonstrates a good commitment to its responsibilities towards equalities and provides a wide range of information on its website including a biennial report on Equality Outcomes and Mainstreaming.

13 The estimate of the whole-life costs of the Social Security implementation programme has been revised. There remain areas of uncertainty in the costs due to the stage and nature of the programme. This is a substantial area of investment for the Scottish Government and the impact of policy and delivery choices on longer-term costs are not yet clearly set out. The Scottish Government's progress on monitoring and reporting programme costs will be a key area of focus within our future audit activity.

Introduction

1. This report summarises the findings from our 2019/20 audit of the Scottish Government

2. The scope of our audit was set out in our Annual Audit Plan presented to the 22 June 2020 meeting of the Scottish Government's Audit and Assurance Committee (SGAAC). This report comprises the findings from:

- an audit of the Scottish Government's Consolidated 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 2019/20 were:

- an audit of the 2019/20 Scottish Government's 2019/20 Consolidated Accounts including the issue of an independent auditor's report setting out his audit opinions
- a review of the Scottish Government's main financial systems
- consideration of the four audit dimensions.

4. We undertook most of our planning work prior to the Covid-19 pandemic and the draft audit plan was shared with the Scottish Government in March 2020. Our Annual Audit Plan was revisited and updated to consider the potential impact of the Covid-19 pandemic on our audit approach for 2019/20 and presented to the SGAAC at its meeting in June 2020.

5. We fully recognise the unique and significant pressures that the public sector is under in responding to the threat posed by the current Covid-19 pandemic. These are exceptional times for the Scottish Government. The effects of the Covid-19 health crisis will be felt across all aspects of the public sector and the wider economy for years to come. The Scottish Government's primary focus in recent months has been on responding to the pandemic's immediate threat to public health and the economy whilst outlining plans for how to repair and recover from the damage inflicted on individuals, businesses and communities.

6. Our approach to audit during the pandemic aims to be flexible, pragmatic and consistent. It will be some time before we fully understand the impact on public services and finances, but it is clear sound financial management and effective governance are more important than ever. Audit has a key role in providing assurance and aiding scrutiny during these difficult circumstances and we will prioritise quality and independence.

Adding value through the audit

7. We add value to the Scottish Government through the audit by:

- identifying and providing insight on significant risks, and making clear and relevant recommendations
- sharing intelligence and good practice through our national reports (Appendix 4) and good practice guides
- providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability.

Responsibilities and reporting

8. The Scottish Government has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts that are in accordance with the Accounts Direction from the Scottish Ministers. The Scottish Government is also responsible for establishing appropriate and effective arrangements for governance, propriety and regularity that enable the Corporate Board to successfully deliver its objectives.

9. Our responsibilities as independent auditors are established by the Public Finance and Accountability (Scotland) Act 2000 and the *Code of Audit Practice 2016*, and supplementary guidance and International Standards on Auditing in the UK. As public sector auditors we give independent opinions on the annual report and accounts. Additionally, we conclude on the appropriateness and effectiveness of the performance management arrangements, the suitability and effectiveness of corporate governance arrangements, the financial position and arrangements for securing financial sustainability. Further details of the respective responsibilities of management and the auditor can be found in the *Code of Audit Practice 2016* and supplementary guidance.

10. This report raises matters from our audit. Weaknesses or risks identified are only those which have come to our attention during our normal audit work and may not be all that exist. Communicating these does not absolve management from its responsibility to address the issues we raise and to maintain adequate systems of control.

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

Auditor independence

12. Auditors appointed by the Auditor General must comply with the Code of Audit Practice and relevant supporting guidance. When auditing the financial statements auditors must comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies.

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 2019/20 audit fee of £1,129,720 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 the Scottish Government's Audit and Assurance Committee 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 Scottish Government employees who have been involved in our work for their cooperation and assistance during the audit.

Part 1
Audit of 2019/20 annual report and accounts

Main judgements

The independent audit opinion is unqualified. This means in our opinion, we are content they show a true and fair view, following accounting standards, and that the income and expenditure for the year is lawful.

An ‘Emphasis of Matter’ paragraph is included in the independent auditor’s report to draw attention to the impact of Covid-19 on property valuations. The audit opinion is not modified in respect of this matter.

Audit opinions

16. The annual report and accounts for the year ended 31 March 2020 were approved by SGAAC on 8 December 2020. We reported within the independent auditor's report that:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework expenditure and income were regular and in accordance with applicable enactments and guidance
- 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. We have included an ‘Emphasis of Matter’ paragraph in our independent auditor’s report which refers to the impact of Covid-19 on the valuations of property. Emphasis of Matter paragraphs are added to auditors’ reports where the auditor considers it necessary to draw users’ attention to matters which are fundamental to the understanding of the accounts. Key sources of estimation and judgement uncertainty section in the Statement of Accounting Policies of the Consolidated Accounts describes the uncertainty caused. The audit opinion is not modified in respect of this matter. Further information is contained in Exhibit 3 below.

Impact of Covid-19

18. The unaudited annual report and accounts were received in line with our agreed audit timetable on 30 September 2020. As our annual audit plan sets out, we revised the timetable in agreement with the Scottish Government to allow component bodies more time to complete the accounts and audit whilst responding to the pandemic. Notwithstanding the altered timetable, Covid-19 has affected the preparation and audit of the group accounts with outstanding information from component bodies received late in the audit process.

19. The completeness and accuracy of accounting records and the extent of information and explanations that we required for our audit were affected by the Covid-19 pandemic as a consequence of remote working. Examples included:

- supporting documentation for staff expenses
- supporting documentation confirming ownership for some property and land assets.

20. We did not consider these to be material to our audit opinions and have not modified our opinion accordingly.

21. In response to the unprecedented Covid-19 situation and its effect on government entities, HM Treasury reviewed the financial reporting requirements for 2019/20 and set revised minimum reporting requirements in order to ease the burden on preparers of annual reports and accounts. This guidance did not replace the Financial Reporting Manual (FReM) but provided minimum reporting requirements. There was no change to the required format and content of financial statements as detailed in the published 2019/20 FReM. The addendum to the FReM permitted entities to omit or simplify elements of the performance report.

Whole of Government Accounts

22. As at March 2020, the draft Whole of Government Account (WGA) pack has not been provided by the Scottish Government due to an issue with the HM Treasury's Online System for Central Accounting and Reporting which is used to generate the WGA pack.. Our audit work on the WGA pack will commence once the issue has been resolved.

Materiality

23. The assessment of what is material is a matter of professional audit judgement. It involves considering both the amount and the nature of a misstatement in the financial statements. On receipt of the unaudited annual report and accounts we reviewed our materiality calculations and they remained broadly the same and therefore had no impact on our planned audit approach as set out in our Annual Audit Plan 2019/20.

Exhibit 2
Materiality values

	Amount
Overall materiality This is the calculated figure used in assessing the overall impact of audit adjustments on the financial statements. It was set at one per cent of gross expenditure for the year ended 31 March 2020	£383 million
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 50 per cent of overall materiality	£192 million
Reporting threshold We are required to report to those charged with governance on all unadjusted misstatements in excess of the 'reporting threshold' amount. This was calculated at one per cent of overall materiality but capped at £0.25 million.	£0.25 million

Source: Audit Scotland

Risks of material misstatement

24. Our assessment of risks of material misstatement in the annual report and accounts and any wider audit dimension risks is outlined at Appendix 2. These risks influence our overall audit strategy, the allocation of audit staff resources and indicate how the efforts of the audit team were directed. Appendix 2 also identifies the work undertaken to address these risks and our conclusions from this work.

Significant findings from the audit

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 practice, covering accounting policies, accounting estimates and financial statement disclosures. The significant findings are summarised in Exhibit 3.

Exhibit 3
Key issues from the audit of financial statements

Issue	Resolution
1. Business Support measures We considered whether two large grant schemes (the Small Business Support Grant and the Retail, Hospitality and Leisure Grant) announced by Scottish Ministers before the end of March 2020 should be recognised as a provision in the 2019/20 consolidated accounts. The Scottish Government planned to account for this expenditure in 2020/21 and therefore did not include it within its draft 2019/20 accounts.	We raised and discussed the issue with Scottish Government finance colleagues. We also sought advice from our technical team and peers within Audit Scotland. Our conclusion was that the actions taken by the Scottish Government before the year end to publish detailed guidance on the schemes created a valid expectation of payment in businesses and therefore created a constructive obligation in line with International Accounting Standard 37, Provisions, Contingent Liabilities and Contingent Assets. We requested that the Scottish Government adjust the 2019/20 Consolidated Accounts to include a provision for £912 million to recognise the initial payments made for the schemes. The Scottish Government did not agree with our assessment but have amended the accounts accordingly.
2. Covid-19 impact on asset valuations External, professional valuers provide valuations that are applied in the measurement of land and buildings owned by the Scottish Government and other bodies within the consolidated accounting boundary. The total value of these assets at 31 March 2020 was £7.8 billion. The final valuation reports provided by the Valuation Office Agency and several other valuers include 'material valuation uncertainty' clauses regarding the impact of Covid-19. These highlight that a higher degree of caution should be attached to each valuation than would normally be the case. We assessed the audit opinions on consolidated bodies within the accounts in relation to material uncertainty disclosed by external valuers for property and land revalued at 31 March 2020 and their implications for the audit of the consolidated accounts.	We requested an appropriate disclosure to be added to the accounting policy on key sources of estimation and judgement. The Scottish Government agreed and amended the accounts accordingly. An 'emphasis of matter' paragraph was included within the Independent Auditor's Report regarding material uncertainty in revaluations of property and land assets as a result of the economic impact of Covid-19. Our audit judgement is that this disclosure is fundamental to the users' understanding of the accounts. The audit opinion is not modified in respect of this matter.

3. Social Security Scotland

The 2019/20 financial year is the first complete year that Social Security Scotland, an executive agency, is consolidated into the Scottish Government's accounts as a separate component audited body.

The 2019/20 Social Security Scotland accounts were qualified by the auditor. The 2019/20 accounts include Carer's Allowance expenditure of £284.4 million. Carer's Allowance is being delivered by the Department for Work and Pensions (DWP) on behalf of the Scottish Government through an agency agreement, meaning there is operational reliance on the DWP. Under this agreement, the benefit continues to be regulated by UK legislation. The auditor qualified his regularity opinion because of overpayments of Carer's Allowance. The DWP estimates the level of error and fraud in the benefit to be 5.2 per cent, which means an estimated £14.8 million of overpayments were made in Scotland. This expenditure was not in line with the relevant legislation. Further details can be found in a separate report on the 2019/20 audit of Social Security Scotland.

As a component audit, the qualified audit opinion on the Social Security Scotland accounts requires an assessment of the potential impact of its inclusion within the Scottish Government's Consolidated Accounts.

We assessed the potential impact of the qualified opinion and considered the qualitative and quantitative impact of the auditor's opinion on Carer's Allowance expenditure as it applies to the Consolidated Accounts.

We concluded that, for 2019/20, the likely amount of error and fraud incurred in Carer's Allowance is not significant enough to influence the economic decisions of the users of the accounts. The likely amount of error has been included in our summary of unadjusted errors.

4. Student loans

The Scottish Government's financial assets include student loans. Every year, the value of student loans is assessed to reflect the new loans issued, repayments and the likelihood that loans are not repaid.

The draft accounts provided for audit did not include consideration of the impact of Covid-19 on the assumptions and judgements in estimates produced from the student loans model.

We requested changes to the narrative on student loans. This included more detail on their assessment of the impact of Covid-19 on the potential valuation of the loans model, including the use of sensitivity analysis to outline possible different options under a best, worst and central scenario.

The Scottish Government provided more narrative within the accounts to explain their assessment. However, this did not include any sensitivity analysis and only provided the potential impact under a central scenario (an increase of £144 million to the impairment charge). By providing only an assessment under the central scenario, the Scottish Government are presenting only one possible outcome of the potential impact of Covid-19 on the loans model, excluding possible 'best' or 'worst' case scenarios.

We recommend that the Scottish Government implements a process that would allow it to readily assess the sensitivity of external factors on the value of the model under a range of different scenarios. This is particularly important given the level of uncertainty in the economy at present. (Appendix 1 Action 9)

5. European Structural and Investment Funds The Scottish Government's European Structural and Investment Fund programmes are currently both 'in suspension' by the European Commission (EC). The draft 2019/20 consolidated accounts included a contingent liability disclosure in relation to the potential non-recovery of EC income due to expenditure being deemed ineligible by the EC.	We considered the Scottish Government's treatment of the potential non-recovery of income as a contingent liability including whether this would be more appropriately accounted for as a provision. We concluded that the accounting treatment is reasonable due to a number of variables which undermine the reliability of an estimate, and we agreed that there is not sufficient clarity on some of these variables from the EC at this time to recognise a provision. We requested that the Scottish Government included additional information in the contingent liability disclosure note, regarding the risk that the EC could impose a financial penalty as a result of the programmes being in suspension. This additional disclosure has now been included in the revised consolidated accounts.

Source: Audit Scotland

Evaluation of misstatements

26. There were a number of presentational and monetary adjustments to the unaudited annual report and accounts arising from our audit. These were discussed with senior officials who agreed to make the necessary changes.

27. Gross monetary misstatements (errors) for the Scottish Government core portfolios, in excess of the 'reporting threshold' amount (£0.25 million) totalled £2.8 billion and were adjusted in the final accounts. Of this balance, £1.8 billion related to a consolidation adjustment to remove non-pay expenditure between NHS boards and £0.9 billion related to the provision for Covid-19 business support measures.

28. We are required to report to those charged with governance all unadjusted misstatements which we identified during our audit, other than those of an insignificant small amount. The total unadjusted errors within the consolidated accounts is £88 million. This balance is made up of £45.8 million relating to the core Scottish Government, £17.6 million relating to NHS bodies and £24.6 million relating to agencies and other consolidated bodies. Appendix 3 shows the unadjusted errors and their impact on the annual report and accounts. If these errors had been adjusted, the net impact would have been to decrease net expenditure and increase net assets by £5 million.

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.

Follow up of prior year recommendations

30. The Scottish Government has made some good progress in implementing our prior year audit recommendations. Details of new and prior year recommendations and the Scottish Government's planned actions are detailed in Appendix 1.

Part 2

Financial management

Main judgements

The Scottish Government's Consolidated Accounts for 2019/20 show that total net expenditure was £39,385 million, £669 million more than budget.

In March 2020, the Scottish Government announced plans for two large Business Support Schemes: The Small Business Support Grant and the Retail, Hospitality and Leisure Grant to respond quickly to the impact of Covid-19 on businesses. Although funding for these schemes was not included within the Scottish budget until 2020/21, the actions taken by the Scottish Government before the year end created a constructive obligation under accounting standards in 2019/20. The Consolidated Accounts include these costs, amounting to £912 million, resulting in an overspend of £669 million against the Consolidated budget.

There is a greater awareness across the organisation of the financial challenges facing the Scottish Government. Throughout the year, the Scottish Government Executive Team and non-executive directors receive regular and good financial information on the Scottish Government's financial position.

In recent years, the Scottish Government has taken a direct role in providing financial support to private companies. During 2019/20, the valuations and prospects for these loans and guarantees deteriorated due to the financial challenges facing the companies. The impact of Covid-19 and EU withdrawal on businesses is likely to increase the expectations and demands on the public sector to provide financial support.

Scottish Government budget performance 2019/20

31. The Consolidated Accounts show that total net expenditure during 2019/20 was £39,385 million, £669 million more than budget (Exhibit 4). The resource budget was overspent by £899 million (two per cent) against a budget of £36,796 million and capital underspent by £230 million (12 per cent) against a budget of £1,920 million.

32. On 18 March 2020 as the financial year drew to a close, the Scottish Government announced plans for two large Business Support Schemes: the Small Business Support Grant and the Retail, Hospitality and Leisure Grant to respond quickly to the impact of Covid-19 on businesses. Guidance on using the schemes was published on 30 March 2020 and the schemes commenced on 1 April 2020 with funding transferred to local authorities who administered individual payments on behalf of the Government. The actions taken by the Scottish Government prior to the end of 31 March 2020 created a constructive obligation under International Accounting Standard 37 Provisions, Contingent Liabilities and Contingent Assets and therefore the related costs amounting to £912 million are included within the 2019/20 Consolidated Accounts. This resulted in an overspend of £669 million against the Consolidated budget.

Exhibit 4
Performance against Consolidated Accounts budget in 2019/20

Performance	Final budget £m	Outturn £m	Over/(under) spend £m
Resource	36,796	37,695	899
Capital	1,920	1,690	(230)
Total	**38,716**	**39,385**	**669**

Source: Scottish Government Consolidated Accounts 2019/20.

33. The audit opinion on the regularity of expenditure within the Consolidated Accounts is unqualified. The Public Finance and Accountability (Scotland) Act 2000 states that the use of resources by the Scottish Administration (including the Scottish Government) must be authorised by Budget Act and must not exceed the amounts authorised for that year. The Budget (Scotland) Act 2019 set the expenditure limits that applied for the 2019/20 financial year. These limits are set at the Scottish Administration level, a level higher than the budget set for the Consolidated Accounts. The Scottish Administration budget combines the budgets for the Consolidated Accounts with budgets for other public bodies and accounts such as, Scottish Courts and Tribunals Services, Food Standards Scotland and the NHS and Teachers' Pension Schemes, all of which fall outside the consolidated boundary. The budget at the Scottish Administration level of £44,078 million is underspent by £122 million. Therefore, the overspend against the Consolidated Accounts budget does not represent unlawful expenditure.

34. High-level reasons for significant variances between actual and budgeted spend are included in the Consolidated Accounts. The largest underspend (£232 million) relates to the Transport, Infrastructure and Connectivity portfolio, which includes spending on projects deferred to future years and lower than anticipated demand for energy efficiency and low carbon economy schemes. This is largely offset by a £206 million overspend in the Education and Skills portfolio, which includes non-cash adjustments to the student loans model to reflect macroeconomic conditions.

35. Throughout the year, the Scottish Government Executive Team and non-executive directors received regular and good financial information on the Scottish Government's financial position through Director General assurance meetings, Director General people and finance meetings, Corporate Board and the Audit and Assurance Committee. The Chief Financial Officer also held regular meetings with non-executive directors to provide information on the financial position. There is also a greater awareness across the organisation of the financial challenges facing the Scottish Government and of the need for individual directorates to provide robust and clear spending assumptions in their financial plans. Overall, the Scottish Government has appropriate budget setting and effective monitoring arrangements in place.

Support to private companies

36. In recent years, the Scottish Government has taken a direct role in providing financial support to private companies in addition to support provided through its enterprise agencies, Scottish Enterprise and Highlands and Islands Enterprise.

Prestwick Airport

37. In November 2013, the Scottish Government purchased Prestwick Airport for a nominal price of £1 with the stated aim of protecting jobs and safeguarding what it considered to be a strategic infrastructure asset. During 2019/20, the Scottish Government's provided a further £3.5 million of loans to the Airport taking the total level of loan support to £43.4 million as at 31 March 2020. In its 2019/20 annual accounts, Transport Scotland valued this loan at £10 million to reflect expected losses in line with accounting standards.

38. In June 2019, the Scottish Government announced that the sale of Prestwick Airport was being progressed, in keeping with its long-term objective that the airport should be returned to the private sector. In October 2020, the Cabinet Secretary for Transport, Infrastructure and Connectivity confirmed to the Scottish Parliament that the preferred bidder, selected earlier in the year, had withdrawn from the process considering the global impact of Covid-19 on the aviation sector. The Airport is now in the process of engaging with other interested parties and any timescale for its sale remains unknown.

Ferguson Marine Engineering Limited

39. Over 2017 and 2018, the Scottish Government provided commercial loan facilities totalling £45 million to Ferguson Marine Engineering Limited (FMEL), a shipbuilding and engineering company based in Port Glasgow. The purpose of the loans was to support FMEL's completion of a contract to build two ‘dual-fuel’ ferry vessels for Caledonian Maritime Assets Limited (CMAL) valued at around £97 million and to improve the prospects of the company and shipbuilding on the Clyde. By April 2019, FMEL had drawn down the full loan facility of £45 million and no extended facilities were provided.

40. In August 2019, FMEL entered administration which led to the Scottish Government acquiring the business in December 2019 following a review of bids by the administrator. Following administration, a new company was established, known as Ferguson Marine (Port Glasgow) Holdings Limited (FMPG). FMPG is a company wholly owned by Scottish Ministers established under the Companies Act 2006. It does not fall within the boundary of the Scottish Government’s consolidated accounts and has appointed its own auditors for financial year 2019/20. In 2019/20, the Scottish Government spent £6 million on funding the cost of Ferguson Marine in administration prior to public ownership, in addition to £11 million in grant funding as a public body. This expenditure is included within the Transport, Infrastructure and Connectivity portfolio. The valuation of loans provided to Ferguson Marine remained at nil within the 2019/20 consolidated accounts.

41. In September 2019, the Scottish Government established a new Ferguson Marine Response Division to oversee the transfer of FMPG into public ownership and oversee options for the future of the company. Looking ahead it will be important for the Scottish Government to clearly outline and maintain effective sponsoring arrangements for FMPG, including clear roles and responsibilities as well as clarity over future funding arrangements and expectations of organisational performance and delivery of outcomes.(Appendix 1, Action point 1)

Burntisland Fabrications Limited

42. Over 2017 and 2018, the Scottish Government provided commercial loan facilities of up to £51 million to Burntisland Fabrications Limited (BiFab), a fabricator of oil, gas and offshore wind structures. Of this, £41 million was available to support the completion of key contracts for the Beatrice Offshore Wind Farm with a further £10 million available to BiFab to support business restructuring following the completion of the contracts. Included in the agreement with BiFab is a provision for the loans to be converted to an equity stake, not exceeding a 38 per cent shareholding in BiFab.

43. At the end of March 2019, BiFab had drawn down £37.4 million of the £41 million loan facility. This was subsequently converted to equity by the Scottish Government representing a total equity stake of 32 per cent. In the 2019/20 Consolidated Accounts, the Scottish Government’s stake was valued at nil to reflect expected losses in line with accounting requirements.

44. During 2019/20, BiFab had drawn down £9 million of the £10 million loan facility made available to support business restructuring. The Scottish Government has written this amount off in full in the 2019/20 Consolidated Accounts. On 7 May 2020, the terms of the loan facility were revised and extended to £15 million to cover the company's forecast trading losses. Between May and November 2020, BiFab drew down a further £4.5 million, taking total loans made under this facility to £13.5 million.

45. In December 2020, BiFab went into administration due to its current financial position. The Scottish Government stated there was no legal route for either the Scottish Government or the UK Government to provide further financial support to the company in the current situation.

Lochaber Aluminium Smelter – Liberty Group

46. In December 2016, the Scottish Government entered a 25-year financial guarantee relating to the hydro plant and aluminium smelter at Lochaber. This involved the government guaranteeing the power purchase obligations of the smelter if the business does not fulfil its obligations to pay for contracted power. The guaranteed annual amounts vary between £14 million and £32 million over the lifetime of the contract. The Scottish Government receives an annual fee in return for the guarantee which was classed as a financial asset in the Consolidated Accounts. The asset was valued at £21.4 million at the time of agreement in 2016/17. In 2019/20, the asset was valued at 'nil' as a result of an assessment of expected credit losses in line with accounting standards. The calculation of the government's potential exposure to default payments was also updated, resulting in the provision increasing by £3.3 million to £36.7 million.

The strategic approach to financial interventions

47. In our previous Section 22 report on the 2018/19 audit of the Scottish Government's consolidated accounts, we highlighted the need for the Scottish Government to develop a clear framework to outline its approach to financial interventions in private companies. The Scottish Government is developing a series of principles of support for financial interventions. This includes the development of a database which identifies companies of strategic importance to Scotland drawing on qualitative and quantitative information on employment, sector impact and vulnerability. The principles also outline the Scottish Government's consideration of HM Treasury's Green Book which applies five tests to intervention: strategic, economic, financial, commercial and management. The Scottish Government also provided more procedural guidance within the Scottish Public Finance Manual to support Accountable Officers and the decision-making process for potential interventions.

48. These are important components of a framework for financial interventions in private companies. The Scottish Government needs to develop this further to outline its approach to risk tolerance, financial capacity and expected outcomes for each case considered. In doing so, it will provide Parliament with the assurance over its strategic objectives in entering any future agreements. This is particularly important as the impact of Covid-19 and EU withdrawal on businesses is likely to increase the expectations and demands on the public sector to provide financial support. It will be essential for the Scottish Government to learn lessons from its experience of recent financial interventions in private companies. It will also be important for the Scottish Government to clearly outline its plans for future investment in private companies to ensure there is greater transparency over financial support provided and the value of public funds committed. (Appendix 1, action point 2)

European Structural and Investment Funds

49. The Scottish Government is responsible for managing two European Structural and Investment Funds for the period 2014 to 2020; the European Social Fund (ESF) and the European Regional Development Fund (ERDF). The ESF aims to help people improve their lives by learning new skills and finding better jobs, whereas the ERDF aims to improve regional economic performance and social cohesion.

50. In November 2019, the EC placed the ESF programme in suspension after the Scottish Government were unable to resolve all outstanding issues by this deadline. In January 2020, the EC also placed the ERDF programme into suspension. The Scottish Government cannot make claims for funding to the EC until the issues identified are resolved.

51. Suspensions were imposed because of concerns about the implementation of the management and control system. The EC had concerns about expenditure being valid after weaknesses in the nature and extent of verification checks performed by the Scottish Government were identified by the EC appointed auditors. In addition, for ESF, the application of a 40 per cent flat rate in grant claims for staff costs was a misinterpretation of EC regulations and the related expenditure in these claims had to be withdrawn. During this time, lead partners continued to make payments to beneficiaries from their own budgets, and in January 2020, the Scottish Government agreed to resume payments to lead partners on verified claims.

52. Under the Withdrawal Agreement, the UK will continue to participate in the Multiannual Financial Framework programmes, like ESF, until it ends in 2023. In the event of no agreement following the end of the transition period in January 2021, the HM Treasury Guarantee will apply. In lieu of recovering funds from the EC, the Scottish Government would instead reclaim from the UK Government. The Scottish Government understands it would need to comply with all relevant EC rules to obtain the HM Treasury Guarantee, so the Scottish Government's work to resolve existing audit issues and exit suspension remains valid.

53. As a result of entering suspension, the EC can impose a maximum penalty of up to 25 per cent of the whole programme, which would be in the region of £190 million although the possibility of such a significant amount is low. Any penalty would be subject to negotiation between the Scottish Government and the Commission. A contingent liability of £35 million is included in the Consolidated Accounts to reflect the amounts paid by the Scottish Government to lead partners but subsequently withdrawn from declarations to the EC as a result of the suspension.

54. The Scottish Government continues to work with lead partners to resolve the issues and are hopeful that the suspensions will be lifted before the end of March 2021.

Systems of internal control

55. 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 the body has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

56. Our findings from the review of systems of internal controls were included in our Management Report presented to the Scottish Government Audit and Assurance Committee on 22 September 2020. We concluded that, other than Payroll, the Scottish Government's main systems of internal control operate effectively.

57. Our testing identified cases where controls did not operate as expected, mainly within the payroll system. Our findings on payroll included actions identified from previous years' audits where management action remains outstanding. It is essential that management take action to address these weaknesses to ensure that risks to the systems are minimised and the integrity of the systems is maintained. Control weaknesses identified in previous years which are not addressed by planned management actions increase the risk of fraud and error remaining undetected.

58. No significant internal control weaknesses were identified during the audit which could affect the Scottish Government's ability to record, process, summarise and report financial and other relevant data to result in a material misstatement in the financial statements. The issues identified as part of our payroll testing were due to poor administrative controls in practice.

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

59. The Scottish Government is responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities. Furthermore, the corporate board is responsible for ensuring that its affairs are managed in accordance with proper standards of conduct by putting effective arrangements in place.

60. 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.

61. Appropriate arrangements are in place for the prevention and detection of fraud, error and irregularities. We are not aware of any specific issues that we need to bring to your attention.

National Fraud Initiative

62. The National Fraud Initiative (NFI) is a counter-fraud exercise across the UK public sector which aims to prevent and detect fraud. Computerised techniques are used 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.

63. Participating bodies were required to submit data in October 2018 and received matches for investigation in January 2019. The Scottish Government has concluded its investigation work and the results are recorded on the NFI system. We carried out an assessment of the SG's participation the 2018/19 NFI exercise in February 2020.

64. As part of the 2018/19 exercise, 3,462 data matches were identified and 1,339 matches were investigated or closed, with no instances of fraud or irregularity identified. Each of the data matches is allocated a fraud risk score and there is evidence that the Scottish Government considers the higher risk matches to be a priority and aims to address these promptly.

65. In our 2018/19 Annual Audit Report, we noted that NFI was included in the Annual Fraud Report presented to SGAAC, however this only referred to outcomes for the exercise across Scotland and not the Scottish Government's specific results and progress. The Scottish Government should routinely report its own progress in responding to NFI data matches to the Audit and Assurance Committee. (Appendix 1 Action 3)

66. At the time of our review, some work on procurement matches had not been completed by the Scottish Government due to staff resourcing issues. We also noted that some investigation work (to check central records on contracts awarded without competition against the identified areas for interest) was not recorded on the NFI website. It is recommended that all matches are considered in a timely manner and that all investigation work is documented on the NFI website as a formal record.

Part 3

Financial sustainability

Main judgements

The Covid-19 pandemic has brought increased uncertainty and potential volatility to public finances over the medium term. As a result, the Scottish Government postponed its planned May 2020 publication of its annual medium-term financial strategy (MTFS) until January 2021 to better reflect the likely impact of the pandemic on public finances. There is a need for the strategy to make clearer the links between planned spending options and expected outcomes outlined in the National Performance Framework to aid Parliament's understanding of the financial risks and opportunities emerging from the Covid-19 pandemic.

The pandemic and ongoing uncertainty of EU withdrawal pose significant risks to the sustainability of public finances. As a result, there is a need more than ever for a public consolidated account to provide a comprehensive and transparent assessment of the state of Scotland's public finances. The Scottish Government should now finalise the format and report publicly when it will produce a draft public consolidated account for audit.

In 2019/20, the Scottish Government borrowed £405 million. This was less than the £450 million outlined by Scottish ministers as part of the 2019/20 Scottish budget. The Scottish Government reported that borrowing was used to support its overall capital programme although no details of how this applied to specific projects is included within the Consolidated Accounts. As at 31 March 2020, the total principal level of capital borrowing outstanding was £1,071.6 million, with interest of £144.6 million applying over its remaining life.

The impact of Covid-19 on financial sustainability

67. Following the onset of the Covid-19 pandemic, the Scottish Government postponed its planned May 2020 publication of its third medium-term financial strategy (MTFS). In August 2020, the Cabinet Secretary for Finance informed the Scottish Parliament that this year's MTFS will be published alongside the 2021/22 draft Scottish Budget, which is now planned for January 2021. The introduction of an annual strategy followed a recommendation from the Parliament's Budget Process Review Group in 2017. The strategy aims to provide an assessment of the medium-term outlook for Scotland's public finances as the new financial powers from the Scotland Acts 2012 and 2016 come into effect.

68. The Covid-19 pandemic has brought increased uncertainty and potential volatility to public finances over the medium term. There is uncertainty as to how the economic impact of the pandemic will affect devolved tax and social security powers, as well as the wider pressures on the budget from increased demand for services. The move to a later publication date allows the Scottish Government to better reflect the likely impact of the pandemic on public finances including on spending plans and priorities, planned outcomes and options for ensuring financial sustainability.

69. Inevitably though, it will mean there is less time for the Parliament to scrutinise the strategy prior to the budget when compared to the timescales of recent years.

This will be particularly challenging for Parliament considering the number of significant concurrent risks impacting public finances, both in the short and medium term and the likely difficult choices required over public spending. There is a need for the strategy to make clearer the links between planned spending options and expected outcomes outlined in the National Performance Framework to aid Parliament's understanding of the financial risks and opportunities emerging from the Covid-19 pandemic. (Appendix 1, Action 4)

2019/20 financial position

70. The Consolidated Statement of Financial Position is one of the primary financial statements in the Consolidated Accounts. It summarises what is owned and owed by the core Scottish Government and those public bodies within the consolidated boundary. This shows taxpayers' equity – an accounting measurement of the amount of taxpayers' money applied that has continuing public benefit. It shows how much of this has arisen from the application of parliamentary funding (arising from the Scottish Block Grant, capital borrowing and devolved taxes) and how much resulted from changes in the value of physical assets over time.

71. Taxpayers' equity has increased in each of the last five years, largely due to an increase in physical assets (such as property and roads) and financial assets (such as loans and investments). Total liabilities (such as payments for private-financed projects) have increased from £8.8 billion to £9.6 billion. It is important to note that the position does not reflect all the assets and liabilities of the Scottish public sector. Key assets and liabilities are excluded such as capital borrowing, local government borrowing, and all public sector pension liabilities funded from the Scottish budget.

Borrowing

72. Under the terms of the Scotland Act 2016, Scottish ministers can borrow up to £3 billion for capital purposes, with an annual borrowing limit of 15 per cent (£450 million) of the overall borrowing cap. In 2019/20, the Scottish Government borrowed £405 million. This was less than the £450 million outlined by Scottish ministers as part of the 2019/20 Scottish budget. The loan will be repaid to the National Loans Fund across two separate timescales; £200 million over 20 years and £205 million over 25 years. Both are in line with timescales outlined in the Fiscal Framework.

73. The Scottish Government reported that 2019/20 borrowing was used to support its overall capital programme although no details of how this applied to specific projects is included within the Consolidated Accounts. This is the fifth year that the Scottish Government has used its capital borrowing powers and, as at 31 March 2020, the total principal level of capital borrowing outstanding was £1,071.6 million, with interest of £144.6 million applying over its remaining life. (Appendix 1, Action 5)

74. Details of the overall loan, repayments and interest payments are outlined in the Consolidated Accounts. The Scottish Government's borrowing and associated repayments are made via the Scottish Consolidated Fund (SCF). Borrowed amounts and repayments are made between the SCF and HM Treasury with the corresponding adjustments made to funding received by the Scottish Government from the SCF. This means there is no associated liability disclosed in the Statement of Financial Position within the Scottish Government's Consolidated Accounts. Details of the amount of capital borrowing and the associated liability are set out within a separate account prepared for the SCF.

75. The Scotland Acts of 2012 and 2016 also allow for revenue borrowing in specific circumstances such as forecast error or in-year cash management. By the end of March 2020, the Scottish Government had not borrowed for revenue purposes.

Public consolidated accounts for Scotland

76. In 2016, the Scottish Government committed to producing a consolidated account to cover the devolved public sector in Scotland including total assets, investments and liabilities such as local government borrowing and public sector pension liabilities. In July 2019, the Scottish Government issued a draft account based on 2017/18 financial information to its Audit and Assurance Committee for consultation. Audit Scotland provided observations on the draft account as well as comments on the potential audit requirements depending on the basis on which an account is prepared. The Scottish Government are in the process of developing a revised version of the account, based on more up to date financial information. Progress in finalising the draft account for audit has been delayed due to the priority given by the Scottish Government to responding to the Covid-19 pandemic and the preparation of the 2019/20 consolidated accounts.

77. The pandemic and ongoing uncertainty of EU withdrawal pose significant risks to the sustainability of public finances. As a result, there is a need more than ever for a public consolidated account to provide a comprehensive and transparent assessment of the state of Scotland's public finances. This is important for decision making over the longer term as it will provide information about the impact of past decisions on future budgets, the potential risks to financial sustainability and the scale of assets and liabilities, including those held by publicly owned companies. The Scottish Government should now finalise the format and report publicly when it will produce a draft public consolidated account for audit. (Appendix 1, Action 6)

Part 4

Governance and transparency

Main judgements

The Governance Statement confirms that it complies with relevant guidance on corporate governance. It also highlights some of the main risks and opportunities for the organisation and any significant internal control issues in 2019/20. We are content that the Governance Statement is consistent with the financial statements and has been prepared in accordance with guidance issued by the Scottish Ministers.

The Scottish Government has strengthened aspects of its governance arrangements during 2019/20. The changes to corporate governance arrangements in response to Covid-19 were timely and appropriate and provided a structure to enable faster decision-making and information sharing across government directorates and corporate groups. This was particularly critical for those at the forefront of the emergency response.

Performance reporting on the Scottish Government's own progress towards its aims and objectives remains very limited. The Scottish Government acknowledges that their Performance Report does not provide a complete picture and that more work is required to better link spending with outcomes.

Governance Statement

78. A Governance Statement prepared by the Permanent Secretary is a key feature of the Consolidated Accounts. It forms part of a wider accountability report and summarises how the core Scottish Government organisation is controlled and directed. HM Treasury's Financial Reporting Manual (FReM) states that the Scottish Government must prepare an annual governance statement within the annual report and accounts. Guidance is set out within the Scottish Public Finance Manual (SPFM) for the content of the governance statement and provides assurances around the achievement of the organisation's strategic objectives.

79. The SPFM does not prescribe a format for the annual governance statement but sets out minimum requirements for central government bodies. The process undertaken by management included conducting an assurance mapping exercise and working to an assurance plan that assessed the evidence underpinning the preparation of the governance statement.

80. The Governance Statement confirms that it complies with relevant guidance on corporate governance. It also highlights some of the main risks and opportunities for the organisation and any significant internal control issues in 2019/20. We are content that the Governance Statement is consistent with the financial statements and has been prepared in accordance with guidance issued by the Scottish Ministers.

Governance arrangements

81. During 2019/20, the Scottish Government strengthened aspects of its governance arrangements including greater clarity on the escalation process between DG assurance meetings and the Scottish Government's Audit and

Assurance Committee, an increased focus on risk management at both corporate and directorate levels and improved corporate reporting on people management.

82. In our Annual Audit Report on the 2018/19 audit of the Scottish Government's consolidated accounts, we highlighted the need for the Committee to operate in line with good practice and to provide greater scrutiny and challenge to support the advice and assurances given to the Permanent Secretary. We are pleased to see that the Scottish Government has made good progress against these recommendations. This includes the preparation of an annual report to summarise the Committee's own work in the past year. This includes a planned review of its own effectiveness as required by its own terms of reference. In addition, a new chair was appointed to the Committee during the year and a review of its own terms of reference was undertaken and approved in April 2020.

83. In March 2020, the Scottish Government responded to the significant emerging risks posed by the Covid-19 pandemic by reassessing and revising its corporate governance arrangements. The changes to corporate governance arrangements were timely and appropriate and provided a structure to enable faster decision-making and information sharing across government directorates and corporate groups. This was particularly critical for those at the forefront of the emergency response. The work undertaken over the last 18 months by the Government in developing its corporate resilience arrangements in anticipation of EU withdrawal provided a good basis for the rapid response demonstrated at the pandemic outbreak. Nevertheless, the scale and pace of response since March continues to place considerable strain on staff wellbeing across the organisation combined with existing staffing capacity pressures and the challenges of remote working.

84. We welcome the openness with which the Scottish Government has engaged with us on these arrangements. Looking ahead, it will be important for the Scottish Government to keep these arrangements under review to ensure they remain fit for purpose, particularly during this extended period of uncertainty.

85. Last year, the Scottish Government took initial steps to improve the effectiveness of its role in sponsoring public bodies. The Scottish Government has an important leadership role in supporting public bodies to better understand the risks and challenges facing them. In June and July 2019, the Scottish Government held workshops, attended by Audit Scotland, to discuss common themes and issues among sponsors. These covered governance and accountability, risk management and relationships. They highlighted the need for greater engagement on shared issues and risks between the Scottish Government and its public bodies.

86. During 2020, the Scottish Government planned several activities to improve sponsorship arrangements, including the establishment of a governance hub module on sponsorship training, accreditation for sponsors and workshops and networking events for Accountable Officers and sponsors. These are welcome developments; however, progress in implementing many of these plans has largely paused due to Covid-19. It will be important for the Scottish Government to agree a new timetable for when it expects to implement these plans and how it expects to monitor improvements. (Appendix 1, Action 7)

Performance reporting

87. The 2019/20 Consolidated Accounts include a performance report and an accountability report in line with the requirements of the Government Financial Reporting Manual (FReM). In May 2020, HM Treasury outlined minimum reporting requirements to support public bodies in their preparation of financial statements to reflect the pressures facing them as a result of the pandemic. This included the option to omit certain aspects of performance reporting.

88. The Scottish Government's performance report summarises financial performance for the year, with emphasis on performance against budget. It also contains some specific performance information which is required by current guidance on supplier payment performance, and signposts where more information is available on sustainability and environmental performance. Compared with previous years, the performance report provides more information on major areas of spend during the financial year and has made some minor improvements in linking performance by portfolio to outcomes.

89. Overall, performance reporting on the Scottish Government’s own progress towards its aims and objectives remains very limited, with users of the accounts directed to other publications and the National Performance Framework to find information. The Scottish Government acknowledges that the report does not provide a complete picture of performance reporting and that more work is required to better link spending with outcomes. This means that the Consolidated Accounts focus on the government's finances and do not report on the performance of individual portfolios or the Scottish Government as a whole. This limits the reader's ability to see the government's own contribution to national outcomes. The Scottish Government needs to quicken the pace of its work to provide a more comprehensive performance report of its own performance. In doing so, it would increase transparency, enhance reporting to the Scottish Parliament and the public, and help strengthen accountability and scrutiny. Looking ahead, the Scottish Government should consider reviewing Audit Scotland’s Good Practice Note which may help them to improve the qualitative aspects of their performance reporting in the 2020/21 Consolidated Accounts. (Appendix 1, Action 8)

Part 5

Value for money

Main judgements

The Scottish Government demonstrates a good commitment to its responsibilities towards equalities and provides a wide range of information on its website including a biennial report on Equality Outcomes and Mainstreaming.

The estimate of the whole-life costs of the Social Security implementation programme has been revised. There remain areas of uncertainly in the costs due to the stage and nature of the programme. This is a substantial area of investment for the Scottish Government and the impact of policy and delivery choices on longer-term costs are not yet clearly set out. The Scottish Government's progress on monitoring and reporting programme costs will be a key area of focus within our future audit activity.

Equalities

90. Covid-19 is expected to increase inequalities in Scotland. How the Scottish Government responds to this challenge will be a focus of our future audit work. The Scottish Government demonstrates a good commitment to its responsibilities towards equalities. Every two years, the Scottish Government produces an Equality Outcomes and Mainstreaming report as well as reports on the Gender Pay Gap Action Plan, Equality Budget Statement and Mainstreaming equality: SG's equality duties.

91. The 2019-21 Equality Outcomes and Mainstreaming report included a section on equality outcomes and provides an update on progress to date and work that will be taken forward over 2019 to 2021. It includes work on the gender pay gap and the actions being taken to address this. As part of this report the Scottish Government announced plans to conduct an equal pay audit.

92. As part of the 2020/21 Scottish Budget, the Scottish Government published an Equalities Budget Statement. This was a statement on the equality impacts of the budget with a focus on their protected characteristics and socio-economic circumstances. It also set out how the Scottish Budget 2019/20 addresses socio-economic inequality (such as working to give every child the "best possible start in life" through the "Getting it Right for Every Child" approach and the Council Tax Reduction scheme). The Scottish Government recognises there are further areas for improvement within its Equalities Budget Statement such as better distribution analysis and human rights budgeting.

Social Security implementation programme

93. We carried out our most recent audit work on the Scottish Government's Social Security implementation programme in early 2020. This was due to be published in a performance audit report in May 2020. Publication of the audit was paused and ultimately cancelled due to the Covid-19 pandemic.

94. Our work found that the Scottish Government continued to make good progress in implementing the devolved benefits in line with its plans. It launched a further five benefits in 2019/20 and had added delivery of a new benefit, Scottish

Child Payment, to the programme scope. Following our previous report in May 2019, the Scottish Government had taken action to strengthen programme arrangements, processes and overall financial management. The programme is now more robust and better placed for the complexity and risks involved in delivering the remaining benefits. The programme is being delivered using Agile planning methodologies, which means that detailed plans cannot be developed for the life of the programme. There still needs to be clarity about key decision points and interdependencies. Programme planning processes have been strengthened but there remained scope to further develop the clarity around the delivery of critical requirements for remaining benefits.

95. Addressing one of our key recommendations, the Scottish Government published a revised programme business case in February 2020. This provided an updated estimate of the whole-life costs of the implementation programme. At £651 million this is more than twice the high-level indicative estimate set out in the financial memorandum to the Social Security (Scotland) Act 2018. The business case also sets out estimated agency agreement costs and recharges to the UK Government’s Department for Work and Pensions (DWP) of £470 million over the course of the programme. The increase in estimated implementation costs reflects the degree of uncertainty in the original estimate, increased understanding of delivery requirements and changes in programme scope. The process of revising the business case was robust however there remain areas of uncertainly in the costs due to the stage and nature of the programme. This is a substantial area of investment for the Scottish Government and the longer-term impacts of policy and delivery choices on the Scottish budget are not yet clearly set out. The Scottish Government's progress on monitoring and reporting implementation costs will be a key area of focus within our future audit activity.

96. The Covid-19 pandemic has significantly impacted progress of the Social Security implementation programme. On 1 April 2020 the Scottish Government announced delays to its delivery timetable for the remaining devolved benefits. As a result, it has agreed that the DWP will continue to deliver existing benefits to people in Scotland over a revised transition period. The Scottish Government has since announced its revised delivery plans for Scottish Child Payment, Child Winter Heating Assistance, Child Disability Payment and Adult Disability Payment. These changes and the continuing uncertainty around the impact of the pandemic are likely to affect the estimated implementation costs; for example, affecting the profile of spend and the extent of DWP costs and recharges. The Scottish Government will need to address this alongside the wider economic and financial pressures it faces due to Covid-19.

97. Economic impacts of the pandemic are also likely to affect benefit expenditure, due to increases in benefit eligibility and uptake rates. It is too early to assess the extent of this and the impact on the Scottish budget. Further information on our audit work on Social Security is available in our section 22 report on the 2019/20 audit of Social Security Scotland and its associated annual audit report. We will continue to review progress of the Social Security implementation programme, with a particular focus on the impact of the Covid-19 pandemic and the management and reporting of implementation costs.

National performance audit reports

98. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. In 2019/20 several reports were published which are of direct interest to the Scottish Government. These are outlined in Appendix 4.

99. Details of national performance audit reports, both recently published and forthcoming, are presented to the Scottish Government through the relevant Director General Assurance group meetings.

Appendix 1

Action plan 2019/20

No.	Issue/risk	Recommendation	Agreed management action/timing
1	**Ferguson Marine Port Glasgow** Ferguson Marine (Port Glasgow) Holdings Limited (FMPG) is a company wholly owned by Scottish Ministers established under the Companies Act 2006. In September 2019, the Scottish Government established a new Ferguson Marine Response Division to oversee the transfer of FMPG into public ownership and oversee options for the future of the company. Looking ahead it will be important for the Scottish Government to clearly outline and maintain effective sponsoring arrangements for FMPG, including clear roles and responsibilities as well as clarity over future funding arrangements and expectations of organisational performance and delivery of outcomes. **Risk:** There is a risk that the complexity of the arrangements means roles and responsibilities, and expectations of future financial and organisational performance, are not clear.	The Scottish Government needs to clearly outline and maintain effective sponsoring arrangements for FMPG, including clear roles and responsibilities as well as clarity over future funding arrangements and expectations of organisational performance and delivery of outcomes.	**Agreed Action:** We will continue to maintain effective sponsor and shareholder function. **Explanation:** There is a good relationship and regular dialogue in place. A sponsor and shareholder resource has been created as part of a wider restructure in DG Economy. The support will evolve in response to the needs of the business and the strategic policy of Scottish Ministers. We have also recently implemented contractual changes to reflect the most appropriate mechanism for funding the completion of the vessels. This provides clarity on the mechanisms of funding moving forward. We agree that it is essential to have measurable deliverables in place in order to gauge performance. We have set objectives for the Board within their appointment letter which will be used in the appraisal of the Chair and Board members. Ferguson Marine also provide a monthly report detailing the progress of 801 and 802 against agreed project targets. In addition, the shipyard is currently drafting a development plan with SG input. This will include measurable objectives and

No.	Issue/risk	Recommendation	Agreed management action/timing
			reflect the progress required in the yard to ensure that it becomes more efficient and more competitive. Strategic Industrial Assets Division
2	**Financial interventions in private companies** This Scottish Government has made some improvements in developing important components of a framework for financial interventions in private companies. The Scottish Government needs to develop this further to outline its approach to risk tolerance, financial capacity and expected outcomes for each case considered. In doing so, it will provide Parliament with the assurance over its strategic objectives in entering any future agreements. This is particularly important as the impact of Covid-19 and EU withdrawal on businesses is likely to increase the expectations and demands on the public sector to provide financial support. **Risk:** There is a risk that the Scottish Government provides financial support to private companies without understanding its overall financial capacity, risk tolerance or expected outcomes, potentially increasing the risk of poor decision making.	The Scottish Government needs to develop its work further to outline its approach to risk tolerance, financial capacity and expected outcomes for each case considered. The Scottish Government needs to undertake a lessons learned review from its experience of recent financial interventions in private companies. It will also be important for the Scottish Government to clearly outline its plans for future investment in private companies to ensure there is greater transparency over financial support provided and the value of public funds committed.	**Agreed Action:** Further principles will be integrated into the Scottish Public Finance Manual shortly. An early meeting with Audit Scotland to discuss what further improvements may be possible. **Explanation:** The Scottish Government has acknowledged that there are lessons to be learned from recent experience to improve our existing approach. All of the interventions to date have followed the guidance in the Scottish Public Finance Manual. These transactions are reported to Audit Scotland and published in the Scottish Government's Annual Accounts, where possible. Transparency is balanced against the need for commercial confidentiality to protect both Scottish Government and counterparty interests and to ensure that the Scottish Government can operate as a credible party to any future transactions. An important lesson is the need to consolidate expertise and transfer knowledge between teams who are leading interventions. One action taken is to investigate the capability and capacity required across all phases of a transaction - response, advice and

No.	Issue/risk	Recommendation	Agreed management action/timing
			shareholding that may be required within the Scottish Government to respond to a potential increase in businesses seeking this kind of support. An interim analysis of review findings has been prepared and will be discussed with the incoming administration, following May's Scottish Parliamentary election. Director of COVID Business Support and Resilience
3	**National Fraud Initiative** In our 2018/19 Annual Audit Report, we noted that NFI was included in the Annual Fraud Report presented to SGAAC, however this only referred to outcomes for the exercise across Scotland and not the Scottish Government's specific results and progress. At the time of our review, some work on procurement matches had not been completed by the Scottish Government due to staff resourcing issues. **Risk:** There is a risk that the Scottish Government's progress and performance in relation to NFI may not be subject to appropriate levels of scrutiny if information reported to SGAAC is incomplete.	The Scottish Government should routinely report its own progress in responding to NFI data matches to the Audit and Assurance Committee.	**Agreed Action:** Already completed; the 2019-20 fraud report included this information and there will be appropriate reporting in the 2020-21 report. **Explanation:** We will continue to monitor progress of the risk based approach to reviewing matches undertaken in the Scottish Government and ensure these are investigated as appropriate ahead of the next annual report in December 2021. There were some procurement matches which were not followed up due to a high volume of COVID-related response work in that area; we will ensure any similar matches are reviewed as part of the next exercise already underway. Head of Governance and Risk
4	**Medium term financial strategy (MTFS)** The Scottish Government postponed its planned May 2020 publication of its annual medium-term financial	The Scottish Government should make clearer the links between planned spending options and expected outcomes in the	**Agreed Action:** Ongoing dialogue with Audit Scotland on scope of MTFS and enhancing the

No.	Issue/risk	Recommendation	Agreed management action/timing
	strategy (MTFS) until January 2021 to better reflect the likely impact of the pandemic on public finances. There is a need for the strategy to make clearer the links between planned spending options and expected outcomes outlined in the National Performance Framework to aid Parliament's understanding of the financial risks and opportunities emerging from the Covid-19 pandemic. **Risk:** Without good analysis of high-level financial plans linked to expected outcomes, there is a risk that it will make Parliament's scrutiny of the 2021/22 budget more difficult.	National Performance Framework to aid Parliament's understanding of the financial risks and opportunities emerging from the Covid-19 pandemic	exposition of budget risk in the publication. **Explanation:** We have a different view to Audit Scotland of the role of the MTFS in establishing a comprehensive outcome link. The MTFS that was published alongside the 21/22 budget sets out the high-level fiscal risks that need to be considered in the scrutiny of the budget. We are doing further work to enhance the understanding of budget risk in the next publication and to make funding and spending scenarios more useable for the public and parliament. Deputy Director, Fiscal Sustainability
5	**Capital borrowing** This is the fifth year that the Scottish Government has used its capital borrowing powers and, as at 31 March 2020, the total principal level of capital borrowing outstanding was £1,071.6 million, with interest of £144.6 million applying over its remaining life. The Scottish Government reported that 2019/20 borrowing was used to support its overall capital programme although no details of how this applied to specific projects is included within the Consolidated Accounts. **Risk**: There is a risk that this limits the reader's ability to understand the purpose of capital borrowing and its contribution to the Scottish Government's infrastructure programme.	The Scottish Government should publish details of how its capital borrowing is applied to specific projects to provide greater transparency over the purpose and impact of borrowing decisions.	**Agreed Action:** An early discussion to discuss what may be possible. **Explanation:** Capital borrowing is not applied to specific projects: the purpose and contribution of borrowing applies to the whole capital portfolio. The policy has been set out in successive MTFS and annual Budgets document plans, e.g. the 2019-20 Budget set out the baseline for the National Infrastructure Mission with increase in investment achieved by a combination of funding sources. Borrowing represents less than 10% of the CDEL budget; the volume of long life spend far exceeds the borrowing element of funding. Similarly, there is no attribution to specific assets of capital grant or devolved taxes. Sums borrowed flow into the

No.	Issue/risk	Recommendation	Agreed management action/timing
			Scottish Consolidated Fund (SCF): the SG and related bodies draw-down funding from the SCF and this is treated in the Annual Accounts in accordance with the FReM as funding; the repayment of borrowing and interest is also dealt with at the SCF level. The annual Fiscal Framework Outturn reports also provide information on borrowing. Deputy Director, Financial Management Directorate
6	**Public Consolidated Account** The Scottish Government has committed to producing a consolidated account to cover the whole public sector in Scotland. In July 2019, the Scottish Government issued a draft account based on 2017/18 financial information to its Audit and Assurance Committee for consultation and are in the process of developing a revised version of the account, based on more up to date financial information. Progress in finalising the draft account for audit has been delayed due to the priority given by the Scottish Government to responding to the Covid-19 pandemic. **Risk:** There is a need more than ever for a public consolidated account to provide a comprehensive and transparent assessment of the state of Scotland's public finances. This is important for decision making over the longer term as it will provide information about the impact of past decisions on future budgets, the potential risks to financial sustainability and the scale of assets and liabilities, including those held by publicly owned companies.	The Scottish Government should now finalise the format and report publicly when it will produce a draft public consolidated account for audit.	**Agreed Action:** Further engagement with Audit Scotland on the proposed format; in respect of audit assurance; the scope for this to be a product that develops over time; and what can be accommodated alongside the 2020-21 accounts and audit. **Explanation:** The commitment to producing a further account, in a form that will be accessible and add value, remains. The pressures of pandemic response and the necessary prioritisation of the 2019-20 statutory accounts and audit processes impacted on the capacity to make the progress that was planned. This is a complex task; work had been done and progress made. The current context unfortunately means that Finance capacity challenges continue in the short term. The scheduling of the 2020-21 has a bearing on our ability to progress this work. It is not therefore possible at this stage to

No.	Issue/risk	Recommendation	Agreed management action/timing
			set out a timescale for the production of the further public sector accounts with confidence, but this will be a key element of the forward planning work with Audit Scotland. Deputy Director, Financial Management Directorate
7	**Sponsorship** During 2020, the Scottish Government planned several activities to improve sponsorship arrangements, including the establishment of a governance hub module on sponsorship training, accreditation for sponsors and workshops and networking events for Accountable Officers and sponsors. These are welcome developments; however, progress in implementing many of these plans has largely paused due to Covid-19. **Risk:** There is a risk that there will be delays in improving the arrangements and understanding of sponsorship roles between the Scottish Government and public bodies.	The Scottish Government should agree a new timetable for when it expects to implement these plans and how it expects to monitor improvements.	**Agreed Action:** A new workplan with a timetable of activities is in place and has been shared with the Public Audit and Post Legislative Scrutiny Committee. **Explanation:** The workplan addresses the matters raised and will consider the current relationship with public bodies to ensure that this is fit for the future. There is also a short-life review of how to effectively manage risk and escalation of issues when challenges arise and the organisation and management of the relationship with public bodies across Scottish Government, and how both sponsor teams and public bodies can be supported effectively. A training package is being developed for Sponsor teams across the Scottish Government, for board members and practitioners including Accountable Officers. Director for Local Government and Communities
8	**Performance reporting** Performance reporting on the Scottish Government's own progress towards	The Scottish Government needs to quicken the pace of its work to provide a more comprehensive performance	**Agreed:** The Covid constraints on our capacity/resource in 2020 have affected progress on

No.	Issue/risk	Recommendation	Agreed management action/timing
	its aims and objectives remains very limited, with users of the accounts directed to other publications and the National Performance Framework to find information. **Risk:** There is a risk that this limits the reader's ability to see the Government's own contribution to national outcomes. This means that the reader is unable to see the links between the money spent by the Scottish Government, what it has achieved, and progress made towards achieving national outcomes.	report of its own performance. In doing so, it would increase transparency, enhance reporting to the Scottish Parliament and the public, and help strengthen accountability and scrutiny	performance reporting. We welcome Audit Scotland's recognition that some improvements have continued to be made during this year, and we would also note that this has been made despite the FReM addendum not requiring a performance analysis section in the Consolidated Accounts for 2020. We will continue to progress work on a more comprehensive performance report in line with AS recommendations and the Good Practice Note, including on Portfolios' performance and their contributions to the National Outcomes, for the publication of the next Consolidated Accounts. Deputy Director for Performance and Outcomes
9.	**Student loans** The Scottish Government's financial assets include student loans. Every year, the value of student loans is assessed to reflect the new loans issued, repayments and the likelihood that loans are not repaid. This is a complex model with a number of variables, both external factors and policy decisions, that can impact of its overall valuation at any given time. The Scottish Government does not have a process that enables it to readily assess the impact of changes to variables on the value of the model under a range of different scenarios. **Risk:** There is a risk that the Scottish Government may not fully appreciate the impact of external factors on the value of the Student Loans model.	The Scottish Government should implement a process that would allow it to readily assess the impact of external factors on the value of the model under a range of different scenarios. This is particularly important given the level of uncertainty in the economy at present.	**Agreed Action:** Discussions are in progress with Department for Education on a new Service Level Agreement, and sensitivity analysis is one of the areas being explored. Scottish Government will seek to provide a similar analysis to that produced by the Welsh Government within the 2020-21 accounts. It would be helpful to have a meeting late May to discuss with the Audit Scotland team what may be feasible. **Explanation:** The Scottish Government adheres to the process followed across all administrations in the UK: student loan impairment is considered when new macro-economic forecasts are provided by the Office of

No.	Issue/risk	Recommendation	Agreed management action/timing
			Budgetary Responsibility. These are provided to the Department for Education in a best/worst/most realistic scenario. As the holders of over 90% of the UK student loan book and to provide consistency of approach within the public expenditure framework, Department for Education make the decision on which scenario to follow, update the modelling template used by devolved administrations, and then disseminate for local update of administration-specific detail. Director of Finance, Student Awards Agency Scotland.
Follow up of prior year recommendations where not repeated above			
1	**Preparation of Annual Report and Accounts** The consolidated accounts presented for audit were incomplete and did not include key information relating to the Remuneration and Staff Report, Performance Report, Governance Statement, Financial Assets and Cash Flow Statement. We acknowledge that the Scottish Government were dealing with unprecedented levels of activity which accounted for some omissions. In addition, the preparation of the annual report and accounts extends beyond finance staff which often led to delays in information being provided. **Risk:** There is a risk that the Scottish Government are unable to complete lay their annual report and accounts in the Scottish Parliament within the timescales set.	The Scottish Government should ensure a comprehensive unaudited annual report and accounts are provided at the start of the audit process in line with the timetable agreed. There is a need for greater oversight and coordination of the annual audit and accounts preparation and completion process to ensure policy and other corporate functions can provide comprehensive and timely information for finance staff, and subsequently, for audit.	**Scottish Government update:** A post-audit review meeting was held with Non-Executive Directors (NXDs) and Audit Scotland on 27 November 2019 and a range of actions agreed for inclusion in the audit process for 2019-20 Accounts. A subsequent joint planning meeting with the audit team took place on 17 December 2019. In response to Covid-19, a revised timeline for the Accounts and related assurance processes was provided to the Scottish Government Audit and Assurance Committee at the April 2020 meeting for approval. An update to the administrative timetable for the production of the Annual Consolidated Accounts was agreed by

No.	Issue/risk	Recommendation	Agreed management action/timing
			the Committee and Audit Scotland.
2	**Assessment of accruals** The consolidated accounts include several judgements relating to accrued income and expenditure within the financial year. As with 2017/18, we queried the inclusion of some accruals relating to NHS expenditure and concluded that one was not valid as at the financial year end. Information to support the Scottish Government's assessment of accrued expenditure was not always readily available from finance teams. **Risk:** There is a risk that the Scottish Government inaccurately records income and expenditure for the year without a thorough assessment of accruals as part of the annual accounts preparation process.	The Scottish Government should ensure a thorough assessment of potential accrued income and expenditure is carried out as part of the annual accounts preparation process with appropriate evidence made available to audit on request.	**Scottish Government update:** Arrangements for the 2019-20 Accounts will be monitored closely during the audit process, with associated early flagging of areas of concern.
3	**Cash management** As at 31 March 2019, the Scottish Government held cash balances of £1 billion. This represents a significant increase from £585 million held at the end of March 2018. The Scottish Government stated that the significant balances held were due to poor cash forecasting. The Scottish Public Finance Manual states that the principles underlying the operation of government bank accounts should be the same as those applied to commercial bank accounts. This includes keeping balances to a minimum consistent with the principles of not providing funding in advance of need. **Risk**: There is a risk that the Scottish Government are not complying with the requirements of the Scottish Public Finance Manual.	The Scottish Government should undertake a review of its cash forecasting procedures to ensure that forecasts are as accurate as possible and therefore minimising the level of cash balances held at any point in time.	**Scottish Government update:** A review of cash management has been completed and reported to Corporate Board. Implementation will be monitored and then reviewed as part of close-down procedures for the 2019-20 budget year (March 2020). The SGAAC Financial Management paper provided in June included a report on cash management, highlighting the review and reporting on cash management activity around the financial year end.
4	**Grant management** Our 2018/19 audit work included expenditure testing of grant payments across several Scottish Government portfolios. We found that there was an inconsistent approach across the organisation in how grant conditions were being monitored and, in many	The Scottish Government should ensure that guidance issued about grants to other bodies is appropriately adhered to by all business areas, including the	**Scottish Government update:** Internal processes had previously identified risks in relation to compliance with grant administration and guidance. The current SG guidance has been amended and the

No.	Issue/risk	Recommendation	Agreed management action/timing
	cases, it was unclear if effective monitoring had taken place. **Risk:** There is a risk that the Scottish Government is not adhering to the SPFM and therefore may not be able to demonstrate that value for money is being achieved from its grant funding arrangements.	monitoring of grant terms and conditions.	Governance and Risk team have undertaken learning sessions within DG Economy and DG ECJ to ensure better compliance with the guidance. A new e-learning package has been published to complement the guidance. The Certificate of Assurance internal control checklist has been extended to cover compliance with the grant management guidance, including incorporation of the National Performance Framework, and assessment of skills and training on grant management. Supplementary guidance was also issued in March to highlight key COVID-19 Considerations for grant giving. Chief Financial Officer
5	**Audit and Assurance Committee** There is a need for the Audit and Assurance Committee to provide greater scrutiny and challenge to support the advice and assurances given to the Permanent Secretary as the Principal Accountable Officer. **Risk:** Without appropriate levels of scrutiny and challenge, there is a risk that the advice or assurances given to the Permanent Secretary may not be as accurate, informed or as comprehensive as they should be.	The Committee should produce an annual report to summarise their work from the past year. This should include a review of its own effectiveness as required by its own terms of reference. The Committee should also include an audit recommendations tracker to assess the Scottish Government's progress with audit recommendations at each meeting. This could be used for both external and internal audit recommendations.	**Scottish Government update:** A draft report by the Chair of SGAAC was considered by the Committee at its December 2019 meeting. The recommendations were agreed in January 2020 by the Committee with an associated implementation plan. Significant work is underway to support implementation led by the Board Secretary to the Scottish Government, the Chair and the Deputy Chair. The Committee agreed that Internal Audit would track high priority recommendations as standard Committee business at each meeting following the meeting in April 2020. The escalation process has been updated

No.	Issue/risk	Recommendation	Agreed management action/timing
			and circulated to SGAAC and DG Assurance attendees. Updated Terms of Reference were formally approved at the meeting in June 2020. Following recommendations in the SGAAC Review, a draft model annual report was prepared for the Committee's consideration at the June 2020 meeting, with completion planned ahead of the Accounts finalisation process in December 2020. The assessment of effectiveness is to be included in the draft Annual report for submission to the Permanent Secretary in line with SG's Corporate Governance Manual.

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		
1. Risk of material misstatement caused by management override Auditing Standards require that audits are planned to consider the risk of material misstatement caused by fraud, which is presumed to be a significant risk in any audit. This includes the risk of management override of controls that results in fraudulent financial statements.	Detailed testing of journal entries. Review of accounting estimates. Focused testing of accruals and prepayments. Evaluation of significant transactions that are outside the normal course of business. Consider internal audit reports. Consider the results of controls testing.	We carried out detailed testing of journal entries, accounting estimates and unusual transactions. The results of this audit work were satisfactory. We reviewed relevant internal audit reports. We reviewed the results of controls testing and increased our testing of payroll. This additional testing did not identify any further issues.
2. Risk of material misstatement caused by fraud over expenditure As most public-sector bodies are net expenditure bodies, the risk of fraud is more likely to occur in expenditure. There is a risk that expenditure may be misstated resulting in a material misstatement in the financial statements. Given the high volume and diverse nature of expenditure incurred by the Scottish Government, there is a risk of fraud over expenditure.	Perform detailed testing of significant transactions, particularly around the financial year end. Carry out analytical procedures. Monitor budgetary process and reporting. Consider any internal audit reports.	We tested controls in this area and tested transactions around the financial year end. This did not identify any issues of concern.
3. Estimation and judgements	Review of the student loans model (assumptions and application).	We reviewed the Student Loans model.

	There are significant degrees of management estimation in the measurement, valuation and disclosures of material account areas, including student loans, investments, contingent liabilities, financial guarantees and provisions. Specifically, in relation to student loans, the assumptions used in the valuation model are highly dependent on the macroeconomic environment and as such are likely to vary in the short term. Estimations and judgements create a higher risk that material areas in the accounts could be misstated.	Focussed substantive testing. Review of the identification of and record of contingent liabilities, guarantees, indemnities and letters of comfort. Test assumptions in contingent liability financial modelling. Review the disclosure of student loans, investments, contingent liabilities, guarantees etc.	We requested the Scottish Government update the disclosures regarding estimation and uncertainty risks in their accounting policies and notes and to include further details of sensitivity analysis of key estimation judgements within the accounts.
4.	**Support to private companies – valuation of investments and provisions** In recent years, the Scottish Government has taken a direct role in providing financial support to private companies in addition to support provided through its enterprise agencies. This includes: · • Loan facilities of £45m and subsequent purchase of Ferguson Marine Engineering Limited (FMEL) – impaired to £nil in 2018/19 • Loan facilities of up to £51m to Burntisland Fabrications Limited (BiFab) - £37.4m drawn down and converted to equity, impaired to £2m in 2018/19 · • Financial Guarantee to Lochaber hydro plant and aluminium smelter – annual fee financial asset impaired to £nil and expected credit losses provision of £33m in 2018/19 The valuations of these assets and liabilities can	Engagement with officers to discuss proposed approach to valuation of investments and financial guarantee provision for 2019/20. Consideration of valuation reviews carried out by the Scottish Government. Consider use of auditor's experts to support our audit judgements. Review of reports from the Scottish Government's external advisers.	We reviewed valuation reviews by the Scottish Government and reports from the Scottish Government's external advisors. We assessed the valuations and disclosures in the consolidated accounts.

	be uncertain and complex which means that there is an increased risk of misstatement in the consolidated accounts. This audit risk is further heightened with the impact of Covid-19 on the economy and the material uncertainty of valuations at 31 March 2020.		
5.	**Group audit considerations** The Scottish Government consolidated accounts are group accounts which include the financial results of all bodies within the Scottish Government accounting boundary. This means we have to ensure there are appropriate arrangements in place to confirm the information is audited appropriately and consolidated correctly. There are associated risks for 2019/20 including: • The impact of the Covid-19 pandemic may lead to delays or difficulties in the preparation and audit of component bodies' accounts which may impact on the timing, preparation and audit of the group accounts. • The auditor's opinion on the 2018/19 accounts of Social Security Scotland was qualified. The auditor was unable to obtain evidence regarding the regularity of Carer's Allowance Benefit expenditure of £151.7m. We assessed the impact on the consolidated accounts and concluded that the level of error was unlikely to be material. The Carer's Allowance forecast expenditure for 2019/20 has increased to £283m therefore we will need to re-assess the impact of the audit opinion on the Social	Ongoing engagement with component auditors. Guidance and information requests issued to component auditors to support group audit procedures. Review of consolidation packs received.	Covid-19 did lead to delays in obtaining audited component information which affected the preparation and audit of the group accounts. We considered the auditor's opinion on the 2019/20 accounts of Social Security Scotland. Our conclusion has been summarised in Exhibit 3, point 2. There is no further impact on our audit approach for the Consolidated accounts.

	Security Scotland's accounts on the Scottish Government's consolidated accounts.		
6.	**European Social Fund 2014-20** The European Social Fund programme was placed in suspension in November 2019. The Scottish Government and lead partners did not fully resolve all outstanding audit queries to the EC's satisfaction following a range of concerns over the management of the programme. The Scottish Government is reviewing existing claims deemed ineligible (£25m) and continuing work to reintroduce them as eligible. They expect the full amount to become eligible but timing is uncertain over how long the suspension will last. There is a risk that expenditure deemed ineligible may not be recovered or that the European Commission could impose financial penalties.	Ongoing engagement with the Scottish Government to review progress made in addressing the recommendations. Review of provisions and contingencies. Review appropriateness of disclosures in the Consolidated Accounts about potential irrecoverable amounts.	We audited ESF related figures and disclosures in the Consolidated Accounts. Exhibit 3 point 5 details our audit judgement that a contingent liability disclosure is most appropriate to recognise the financial risk of not recovering all grant expenditure from the EC.
Risks identified from the auditor's wider responsibility under the Code of Audit Practice			
	Financial management		
7.	**Forecast financial outturn** As at January 2020, the Scottish Government is predicting a £66 million fiscal resource forecast underspend for the 2019/20 financial year, having previously predicted a resource overspend. This is attributed to a number of one-off events including unspent Brexit consequentials, transfer of Registers of Scotland reserves and transfers from revenue to capital for the capitalisation of some	Testing of expenditure transactions re-classified as capital to ensure that there is sufficient and reliable evidence to support the treatment as capital. Review Finance Reports to the Corporate Board.	We reviewed finance reports to the Corporate Board. We tested expenditure to confirm its treatment as either revenue or capital. There is a greater awareness across the organisation of the financial challenges facing the Scottish Government. Throughout the year, the Scottish Government Executive Team and non-executive directors receive regular and good financial information on the Scottish Government's financial position.

	staff costs. There is a risk that the Scottish Government is relying on one-off events to meet its budget rather than managing spending in line with good quality forecasts.		
	Financial sustainability		
8.	**Medium-term financial strategy** In our 2018/19 Annual Audit Report, we noted that the Scottish Government's second medium-term financial strategy, Scotland's Fiscal Outlook, published in May 2019, does not reflect all the basic components of a medium-term financial plan. It does not include indicative spending plans or priorities, or links to outcomes and there is no detail on how the Scottish Government would address the possible £1 billion shortfall. The Scottish Government has postponed the publication of an updated medium term financial strategy planned for May 2020 in light of the pressures and uncertainty created by the current pandemic. With the absence of high-level financial plans, priorities and scenarios, there is a risk that it will make the Parliament's scrutiny of the forthcoming 2020/21 budget more difficult. This is particularly challenging when considering the impact of changes in spending patterns on outcomes set out in the National Performance Framework	Review of development of medium term financial strategy in further publications. Engagement with the Scottish Government to help further develop a robust medium term financial strategy that becomes a central part of the government's financial decision-making.	The Covid-19 pandemic brought increased uncertainty to public finances over the medium term. As a result, the Scottish Government postponed its planned May 2020 publication until January 2021, alongside the draft 2021/22 budget, to better reflect the likely impact of the pandemic on public finances. We will consider the medium-term financial strategy as part our 2020/21 audit.
	Governance and transparency		

9.	**Changes to governance arrangements in response to Covid-19** In March 2020, the Scottish Government revised it's governance arrangements to support their response to the Covid-19 pandemic. Added to this, there are permanent changes expected to senior roles within the Scottish Government over the next few months in the roles of Director-General for Health and Social Care and Chief Financial Officer. As with any changes to governance arrangements or key personnel, there is a risk that revised arrangements may not have the intended impact which can result in ineffective risk management, reduced internal controls or poor decision making.	Review the changes made to governance arrangements Engagement with Internal Audit Engagement with Permanent Secretary, Director Generals and Non-Executive Directors (NXDs) Attendance at DG Assurance and Scottish Government Audit and Assurance Committee (SGAAC) meetings Review of DG Assurance papers, SGAAC papers and other relevant papers	As we reported at paragraph 83, the changes to corporate governance arrangements were timely and appropriate and provided a structure to enable faster decision-making and information sharing across government directorates and corporate groups.
10.	**Scottish Government's Audit and Assurance Committee** In our 2018/19 Annual Audit Report, we reported that there is a need for the Audit and Assurance Committee to provide greater scrutiny and challenge to support the advice and assurances given to the Permanent Secretary as the Principal Accountable Officer. Without appropriate levels of scrutiny and challenge, there is a risk that the advice or assurances given to the Permanent Secretary may not be as accurate, informed or as comprehensive as they should be. In December 2019, the Committee presented the results of its own review which included recommendations for	Engagement with NXDs including chair of SGAAC. Attendance at SGAAC meetings. Review of progress with implementation plan and recommendations Engagement with Internal Audit. Review of Governance Statement. Review changes made to governance arrangements in response to Covid-19	The Scottish Government prepared an annual report to summarise the Committee's own work in the past year. SGAAC has planned review of its own effectiveness as required by its own terms of reference. A new chair was appointed to the Committee during the year and a review of its own terms of reference was undertaken and approved in April 2020.

	improvement. The Committee also agreed for a detailed implementation plan to be developed in 2020.		
11.	**Investment in core systems** There has been a lack of investment in core IT systems of the Scottish Government. The risk that the current systems will not be able to cope with the expanding demands placed on them is recognised by the Scottish Government. Our audit reports in 2018/19 highlighted issues and risks from our audit work carried out on the main IT systems that impact on the financial statements, including SEAS General Ledger, payroll and procurement. These include cyber security risks as well as risks of system failure or fraud and error.	Monitor actions taken to address risks via Corporate Risk Register. Test key internal controls for the main IT systems that impact on the financial statements.	Our conclusion on internal control systems is consistent with last year. There has been no financial investment in core IT systems during 2019/20 and these risks remain.
12.	**Scottish public sector accounts** The Scottish Government has committed to producing a consolidated account to cover the whole public sector in Scotland. As part of our 2018/19 audit, we recommended that the Scottish Government should quicken the pace of development in this area. This is important for decision making over the longer term as it will provide important information about the impact of past decisions on future budgets, the scale of liabilities, and potential risks to financial sustainability. In the absence of such an account, there is a risk of significant financial decisions being made-	Continued engagement with officials to understand the reporting basis that will be selected by officials for the account, so that we can continue to develop our audit approach for the first set of accounts. Engagement to produce plan for audit and publication.	We reviewed the Scottish Government’s workings and offered some observations. Before we can develop our thinking further on what the audit requirements might be, we would need the Scottish Government to confirm what reporting framework they would like to follow. As we report in Appendix 1, the Scottish Government should now finalise the format and report publicly when it will produce a draft public consolidated account for audit.

	without a clear picture of what is owned and owed by the wider public sector in Scotland.		
	Value for Money		
13.	**Financial interventions** As noted previously, the Scottish Government has taken a direct role in providing financial support to private companies in recent years. The need to develop a clear framework to outline the Scottish Government's approach to providing such support was highlighted in our audit report presented to Scottish Parliament in October 2019. The creation of such a framework would allow better scrutiny of financial intervention decisions, including the opportunities and risks, and provide greater transparency over decisions. In the absence of such a framework, there is a risk that value for money may not be obtained from such interventions.	Discuss progress against the recommendation with Scottish Government officials. Review any further updates to the SPFM and related guidance.	The Scottish Government is developing a series of principles of support for financial interventions. This includes the development of a database which identifies companies of strategic importance to Scotland drawing on qualitative and quantitative information on employment, sector impact and vulnerability. The principles also outline the Scottish Government's consideration of HM Treasury's Green Book which applies five tests to intervention: strategic, economic, financial, commercial and management. These are important components of a framework for financial interventions in private companies. The Scottish Government needs to develop this further to outline its approach to risk tolerance, financial capacity and expected outcomes for each case considered.

Appendix 3

Summary of uncorrected misstatements

We report all uncorrected misstatements in the annual report and accounts that are individually greater than our reporting threshold of £0.25 million.

The table below summarises misstatements that were identified during our audit testing and have not been corrected by management. Cumulatively these errors are below our performance materiality level as shown in Exhibit 2. We are satisfied that these errors do not have a material impact on the financial statements.

#	Account areas	Consolidated Statement of Comprehensive Net Expenditure		Consolidated Statement of Financial Position	
		Dr £000	Cr £000	Dr £000	Cr £000
1	NHS unadjusted errors	192	3,254	17,373	14,311
2	Agency unadjusted errors	4,470	0	20,183	24,653
3	Scottish Government core unadjusted errors				
i)	20/21 media costs accrued to 19/20 in error		1,300	1,300	
ii)	Depreciation missed on seven assets	991			991
iii)	Bank account balances not recognised		380	380	
iv)	PPE stock adjustment		5,073	5,073	
v)	Prepayment not recognised		675	675	
vi)	NHS consolidation adjustment: If inter-related trade receivable and payable balances to be eliminated were calculated in the same manner as in 2018/19, the balances to be eliminated would be £4.4m higher.			4,400	4,400
vii)	NHS consolidation adjustment: If the same logic was applied as last year, then the income and expenditure amounts to be eliminated would be £33m lower.	33,000	33,000		
Net impact		**38,653**	**43,682**	**49,384**	**44,355**

Appendix 4

Summary of national performance reports 2019/20

Central Government relevant reports

Social security: Implementing the devolved powers – May 2019

Enabling digital government – June 2019

Scotland's City Region and Growth Deals – October 2019

Privately financed infrastructure investment: The Non-Profit Distributing (NPD) and hub models – Jan 2020

Early learning and childcare: follow-up – March 2020

Scottish Government

2019/20 Annual Audit Report

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T: 0131 625 1500 E: **info@audit-scotland.gov.uk**
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