# Scottish Government

## 2020/21 Annual Audit Report

AUDIT SCOTLAND

**Prepared for the Scottish Government and the Auditor General for Scotland**

March 2022

# Contents

# Key messages

## 2020/21 annual report and accounts

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

## Financial management and sustainability

Total spending was £580 million less than budget. The resource budget was underspent by £373 million (0.8 per cent) against a budget of £48,573 million and capital was underspent by £207 million (9.7 per cent) against a budget of £2,128 million.

The 2020/21 financial year is the first in which the Scottish Government's funding to support the Covid-19 pandemic response is reflected in its financial performance. The Scottish Government's Consolidated Accounts for 2020/21 show that total net expenditure was £50,121 million. This was £10,736 million (27 per cent) more than in 2019/20 reflecting the significant additional amounts of public spending committed to responding to the Covid-19 pandemic.

The Scottish Government allocated £8.6 billion of Barnett consequentials to support its Covid-19 response activity through three budget revisions during 2020/21. This formed a significant part of the Scottish Government's financial response to supporting the health service, businesses, local government and the wider economy during the year.

High-level details are provided in the Consolidated Accounts over how this Covid-19 money was spent during the year. Publishing comprehensive Covid-19 financial reporting information which clearly links budgets, funding announcements and spending levels, will increase the transparency of the Government's financial reporting in an area of significant public and parliamentary interest.

The Scottish Government has committed to the development of a devolved public sector account on a two-stage basis beginning with production of an account at the Scottish Administration level and then add the other directly funded bodies. The second stage, which will incorporate NDPBs, other public bodies and local authorities, will require more in-depth analysis and review.

## Governance, transparency and value for money

The Scottish Government strengthened aspects of its governance arrangements. During 2020/21, there was a strong focus on the impact of the Covid-19 pandemic on the organisation, including the challenges facing staff capacity and wellbeing.

Significant changes have taken place across a number of important leadership roles within the Scottish Government, including a new Permanent Secretary, who will take up post in January 2022. Strong leadership and effective governance will remain critical as the Scottish Government seeks to recover from the effects of the pandemic and plan for the future.

The Scottish Government has overall arrangements in place to support performance management. It is recognised that performance management processes require review to ensure they are fit for purpose and remain relevant.

# Introduction

**1.** This report summarises the findings from our 2020/21 audit of the Scottish Government.

**2.** The scope of our audit was set out in our Annual Audit Plan presented to the March 2021 meeting of the Scottish Government 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.

**3.** The main elements of our audit work in 2020/21 have been:

- an audit of the Scottish Government's 2020/21 Consolidated Accounts including the issue of an independent auditor's report setting out his opinions
- a review of the Scottish Government's main financial systems
- consideration of the four audit dimensions.

**4.** The Covid-19 pandemic continues to have a considerable impact on the Scottish public sector. In response to the Covid-19 pandemic, there has been a significant increase in 2020/21 Scottish Government expenditure of £10,736 million which has been distributed through a range of delivery organisations such as local authorities, enterprise agencies and health bodies.

## Adding value through the audit

**5.** We add value 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

**6.** 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.

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

**8.** 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.

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

## Auditor Independence

**10.** 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.

**11.** 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 2020/21 audit fee of £1,157,850 as set out in our Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

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

**13.** We would like to thank the management and staff who have been involved in our work for their cooperation and assistance during the audit.

# 1. Audit of 2020/21 annual report and accounts

The principal means of accounting for the stewardship of resources and performance

## Main judgements

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

### The independent audit opinion is unqualified

**14.** The annual report and accounts for the year ended 31 March 2021 were considered by the Scottish Government Audit and Assurance Committee (SGAAC) on 13 December 2021. As reported in the independent auditor's report:

- 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.

### The unaudited accounts submitted for audit were incomplete

**15.** We received unaudited core schedules on 30 June 2021 in line with the agreed timetable. The core schedules received were largely complete although there were some omissions in the notes to the accounts.

**16.** We received the unaudited Consolidated Accounts on 30 September 2021 in line with the agreed timetable but again there were a number of incomplete sections including elements of the Performance and Accountability reports, the Cashflow Statement and notes, the Provisions, Contingent Liabilities and Assets, along with incomplete variance explanations on the portfolio outturn statements.

**17.** An updated version of the Consolidated Accounts was received on 12 November 2021. The accounts had been updated substantially from the earlier version but there remained some outstanding areas which were not finalised until 9 December 2021.

**18.** The audit of the core schedules did not progress at the pace anticipated. The time taken to receive audit evidence and responses to audit queries was very slow in many cases and covered information sought from both finance and policy areas. The continued delays in receiving audit evidence and responses to our queries impacted significantly on the audit process.

**19.** It is essential that the Scottish Government review their process for providing a complete set of unaudited accounts for audit review, and responding to audit queries, matters arising and general requests for evidence. This will ensure timeous resolution and completion of the audit.

## Recommendation 1

The Scottish Government should review their internal processes for the provision of a complete set of unaudited accounts for audit review and responding to audit queries to ensure the audit can be completed timeously. (Appendix 1, Point 1)

## Whole of Government Accounts (WGA) will be late

**20.** The NAO has advised that, due to the late completion of 2019/20 WGA, the process for 2020/21 is running late. HM Treasury has advised that the OSCAR system, used for completion of the WGA, will not be available for 2020/21 submissions before December 2021. The 2020/21 audit of the WGA will be completed thereafter.

## Overall materiality is £501 million

**21.** Our initial assessment of materiality was carried out during the planning phase of the audit. This was reviewed and updated on receipt of the unaudited annual report and accounts and is summarised in Exhibit 1.

### Exhibit 1
**Materiality values**

| Materiality level | 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 2021. | £501 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. | £251 million |

| Materiality level | Amount |
|---|---|
| **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 and our audit work to address these

**22.** Appendix 2 provides our assessment of risks of material misstatement in the annual report and accounts and any wider audit dimension risks. These risks influence our overall audit strategy, the allocation of staff resources to the audit and indicate how the efforts of the audit team were directed. Appendix 2 also identifies the work we undertook to address these risks and our conclusions from this work.

## Significant findings to report on the annual report and accounts

**23.** International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the body's accounting practices, covering accounting policies, accounting estimates and financial statement disclosures. The significant findings are summarised in Exhibit 2.

### Exhibit 2
**Significant findings from the audit of financial statements**

| Issue | Resolution |
|---|---|
| **1.Covid-19 grants** | |
| During 2020/21, the Scottish Government operated two large Business Support Schemes: Payments from these schemes totalled £1,599 million during the year. The schemes were established to respond quickly to the financial impact of Covid-19 and the need to make payments quickly meant the Scottish Government had to accept a higher-than-normal level of fraud risk.<br><br>It is the Scottish Government's responsibility to assess the potential levels of fraud and error and to monitor and review this on an ongoing basis. | We reviewed the additional information provided by the Scottish Government to support the assessment of fraud and error received late November/early December 2021.<br><br>We also considered the other evidence supporting the Scottish Government's view that there were low levels of fraud in these grants identified to date.<br><br>Reasonable disclosure has been made in the final version of the governance statement and performance report.<br><br>Although the Scottish Government is unable to quantify accurately the estimated level of fraud and error, we consider that |

| Issue | Resolution |
|---|---|
| The Scottish Government has relied on their delivery agents such as local authorities for the management, review and assessment of fraud.<br><br>We considered there had not been a robust assessment of fraud undertaken in advance of the payment of grants. Using a range of other information together with a review of fraudulent payments identified to date has provided the Scottish Government with a limited basis upon which to assess the levels of fraud. However this was not undertaken until end November/early December 2021.<br><br>In addition, there was no disclosure in the unaudited Consolidated Accounts around the level of Covid-19 grants paid and related information around the assessed levels of fraud.<br><br>(see paragraphs 24-32 below) | there is sufficient evidence to provide assurance that steps have been taken to minimise the level of fraud and error within these schemes and that the level of fraud/error likely to exist will fall considerably short of materiality.<br><br>We have requested and received assurances from the Principal Accountable Officer in the ISA 580 letter of representation that the estimated level of potential fraud and error is considered not to be material to these financial statements. |
| **2. Social Security Scotland** | |
| The 2020/21 financial year is the second full year that Social Security Scotland, an executive agency, is consolidated into the Scottish Government's accounts as a separate component audited body.<br><br>The 2020/21 accounts of Social Security Scotland include benefit expenditure of £3,260 million administered by the Department for Work and Pensions (DWP) under agency agreements with Scottish Ministers. Due to these delivery arrangements, Social Security Scotland cannot directly assess the levels of fraud and error in these benefits and is instead reliant on the DWP's annually published estimates.<br><br>The estimated overpayments as a result of fraud and error in relation to each type of benefit that is delivered by the DWP, ranged from 1.5 to 5.2 per cent of expenditure. This means an estimated £65.4 million of overpayments were made in Scotland. As a result, the auditor qualified their regularity opinion as these overpayments were not incurred in accordance with relevant legislation and regulations.<br><br>As a component audit, the qualified audit opinion on the Social Security Scotland accounts requires us to assess 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 expenditure as it applies to the Consolidated Accounts.<br><br>We concluded that, for 2020/21, the likely amount of error and fraud incurred in benefits and allowances is not significant enough to influence the economic decisions of the users of the Scottish Government accounts and therefore the audit opinion is not qualified in respect of this matter. The estimated amount of error has been included in our summary of unadjusted errors. |

| Issue | Resolution |
|---|---|
| **3. Lochaber Aluminium Smelter** | |
| Note 14 of the Consolidated Accounts refers to the Scottish Government's potential exposure to default payments in relation to the Lochaber Aluminium Smelter.<br><br>In 2018/19, the Government accounted for a provision of £33 million, increasing to £37 million in 2019/20.<br><br>In March 2021, Greensill Capital (UK) Limited, the major provider of working capital to GFG Alliance (the holding company), went into administration.<br><br>With the ongoing uncertainty regarding the financial stability of the GFG Alliance group, the Scottish Government has reviewed the level of provision required with regards to their guarantee. The provision in the draft 2020/21 Consolidated Accounts was increased to £161million as at 31 March 2021.<br><br>(see also paragraphs 52-55 below) | We reviewed the Scottish Government assessment of their potential exposure on the financial guarantee. We concluded that, for 2020/21, the Scottish Government's approach to setting the level of provision against the potential exposure through the guarantee was reasonable. |
| **4. Student loans** | |
| The 2020/21 Scottish Government Consolidated Accounts include a carrying value of £3,795 million for 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.<br><br>Our review of the student loans identified a significant number of discrepancies between working papers, disclosures in the accounts and the financial ledger. Staff turnover and limited handover arrangements at Students' Awards Agency for Scotland (SAAS) were contributing factors to the issues identified.<br><br>We also experienced difficulty in resolving some of our queries due to a lack of clarity on specific responsibilities over accounting for student loans between the Scottish Government and SAAS. | Our work identified a number of misstatements. These were discussed with management and necessary amendments processed through the ledger. The gross value of these adjustments was £155 million: gross expenditure increased by £76 million<br><br>The process for accounting for student loans should be reviewed to clarify respective responsibilities, minimise the level of errors and increase overall understanding of this complex area.<br><br>**Recommendation 2**<br><br>(refer Appendix 1, action plan) |
| **5. Transfer of Vessels 801 and 802 and associated loans to the Scottish Government** | |
| In recent years, Transport Scotland had provided Caledonian Maritime Assets Ltd (CMAL) with voted loans in respect of Vessels | We assessed the transfer of the voted loans and the assets (Vessels 801 and 802) to the Scottish Government through a review of the relevant settlement, |

| Issue | Resolution |
| --- | --- |
| 801 and 802 totalling £97.7 million (capital and accrued interest).<br><br>During 2020/21, the voted loans were transferred from Transport Scotland to the Scottish Government at book value. As part of a reorganisation of the contractual arrangements, an agreement was reached between CMAL and the Scottish Government to terminate the existing voted loans, including all capital and interest sums due. As part of this agreement, on 1 April 2020, ownership of Vessels 801 and 802 was transferred to the Scottish Government.<br><br>At 31 March 2020, CMAL valued the Vessels. As the value of assets transferred from CMAL in settlement of the voted loans (£74.8 million) was less than the value outstanding on the loans plus accrued interest (£97.7 million), the residual capital element of the voted loans and the accrued interest balances were written-off through the Scottish Government 2020/21 Consolidated Accounts.<br><br>(see also paragraphs 45-49 below) | termination and assets sale agreements and the journal postings to include the values in the Scottish Government Consolidated Accounts.<br><br>We concluded that the accounting for the transfer of the Vessels and the associated loans was properly presented in the Consolidated Accounts. |
| **6. European Structural and Investment Funds**<br><br>The Scottish Government's European Social Fund (ESF) remains 'in suspension' by the European Commission (EC).<br><br>The 2020/21 Consolidated Accounts include a provision of £28.7 million for the potential under-recovery relating to the conversion of ESF operations to unit costs.<br><br>During 2020/21, the Scottish Government also wrote off £16 million (against accrued income) which reflects ESF grant payments which had already been made by the Scottish Government to lead partners. When the Scottish Government made these payments to lead partners, they recognised the expenditure and the related grant income due as accrued income.<br><br>The ERDF suspension was lifted in December 2020.<br><br>The contingent liability included within the 2019/20 Consolidated Accounts (£35 million) no longer applies as the Scottish Government is now better placed to estimate the cost of under-recovery. | We considered the Scottish Government's treatment of the potential non-recovery of income as a provision.<br><br>We concluded that the accounting treatment as a provision and write -off, was appropriate with regards to accounting standards. |

| Issue | Resolution |
|---|---|
| (see also paragraphs 60-63 below) | |
| **7.Crown Office and Procurator Fiscal Services (COPFS)**<br>The Scottish Government's Consolidated Accounts include special payments of £40.2 million made by the Crown Office and Procurator Fiscal Service (COPFS) during 2020/21 of which £40.0 million relates to a specific legal case brought against the Lord Advocate by individuals prosecuted in connection with the acquisition and administration of Rangers Football Club.<br>The auditor of the COPFS noted in their 2020/21 Annual Audit Report that COPFS overspent its annual budget by £14.6 million due to unplanned costs arising from ongoing court proceedings against the COPFS. The Scottish Government authorised the overspend.<br>Some cases have resolved, with sums paid to the pursuers totalling £35.3 million to September 2021 (£27.2 million settlement costs and £8.1 million legal costs). In February 2021, the Lord Advocate made a statement in the Scottish Parliament about this matter and has committed to further public accountability and to a process of inquiry once all litigation has concluded. | We assessed the disclosures relating to the COPFS special payments and provision and concluded that, for the 2020/21 accounts, the disclosures provided in the Scottish Government Consolidated Accounts were appropriate. |

Source: Audit Scotland

## Covid-19 grants

**24.** A total of £9.5 billion was allocated for Covid-19 measures in 2020/21 through three separate budget revisions during the year. The Scottish Government estimated its actual spend on Covid-19 in 2020/21 was £8.8 billion. The Scottish Government relied on their delivery agents such as local authorities for the overall management of grants.

**25.** During 2020/21, the Scottish Government operated two large Business Support Schemes: The Business Support Fund Grants (including the Small Business Support Grant and the Retail, Hospitality and Leisure Grant) and the Strategic Framework Business Fund (including the Retail, Hospitality and Leisure Top-up Grant). The Scottish Government held the principal role in the provision of these funds. Payments from these schemes totalled £1,599 million during the year. The schemes were established to respond quickly to the financial impact of Covid-19 on businesses and were essential in supporting jobs and the wider economy at a critical time. The need to make payments quickly meant the Scottish Government had to accept a higher-than-normal level of fraud risk. Over the course of the year, the Scottish Government took action to minimise fraud risk, working closely with local authorities who administered individual payments on behalf of the Government.

**26.** Practice Note 10 Audit of Financial Statements and Regularity of Public Sector Bodies in the UK 2020 sets out that the audited entity retains the responsibility for ensuring the regularity of its transactions and for disclosing these transactions in the financial statements.

**27.** We raised the issue of regularity and responsibility of the Scottish Government in relation to fraud and error in March 2021. However, there were no disclosures in the draft accounts submitted to audit detailing the assessment of fraud and its value.

**28.** Following discussion, supporting evidence was provided promptly to us which outlined the process considered by the Scottish Government in relation to the evaluation of fraud and error within these business support funds.

**29.** We assessed the evidence provided together with proposed disclosures within the annual accounts. Based on this review we believe there is sufficient evidence to provide assurance that the Scottish Government has taken steps to minimise the level of fraud and error within these schemes. A description of this assessment is now provided in the Governance Statement.

**30.** We consider that the Scottish Government estimate of one to two percent, although not robust, is not an unreasonable assumption given levels of potential fraud in public sector schemes estimated by UK Counter Fraud Management Function (0.5 to 5 per cent for schemes where no fraud/error estimate is made) and the mitigating controls in place. These mitigating controls include: the use of the established Non-Domestic Rates systems, retrospective statements of compliance signed by local authority Chief Executive or Director of Finance for the Strategic Framework Business Grant scheme, and advanced statements of compliance for the earlier schemes along with acceptance of funds; an assurance mapping exercise undertaken by 31 local authorities, giving a positive (green) assurance conclusion.

**31.** The Scottish Government's internal control framework has also strengthened over the course of the year, with specific governance arrangements now in place to oversee Covid-19 business grant schemes and recovery.

**32.** The Scottish Government retains the responsibility for ensuring the regularity of transactions. It is necessary for the Scottish Government to continually review and monitor the levels of fraud and error and assure themselves as to the efficacy of the processes.

## Recommendation 3

Looking ahead, the Scottish Government should regularly assess and improve its estimates of fraud/error in Covid-19 grant related schemes. In doing so, the Scottish Government should consider direct testing of a sample of payments to assure themselves that estimates are robust and that controls to detect and prevent fraud and error are working in practice. They should also ensure regular public reporting to satisfy high levels of public interest in this area. (Appendix 1, Point 3)

### Student loans

**33.** As noted above we reviewed the disclosure and accounting in respect of student loans. In addition to the point above, we noted that:

- additional information was provided around the sensitivity analysis disclosures for example, the impact of changes in RPI, earning growth and the Bank of England case rate as a percentage point change. We consider that providing the impact of the percentage point range as a monetary value would be more helpful to the reader and provide greater transparency.

- the valuation of student loans depends on many factors. LIBOR was one of the factors used to estimate the Student Loans Sale Subsidy provision. The Financial Conduct Authority (FCA) has confirmed that all LIBOR settings will no longer be representative after 31 December 2021. SAAS will need to ensure that the Student Loans Sale Subsidy provision calculated is based on appropriate alternative assumptions. This increases the risk over valuation of the student loans provision.

### Evaluation of misstatements

**34.** There were 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.

**35.** Gross monetary misstatements (errors) for the Scottish Government core portfolios, in excess of the 'reporting threshold' amount (£0.25 million) totalled £641 million and were adjusted in the final accounts.

**36.** 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 £149.3 million. This balance is made up of £17.6 million relating to the core Scottish Government, £44.0 million relating to NHS bodies and £87.7 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 £86.8 million.

**37.** 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 on prior year recommendations

**38.** The Scottish Government has made some 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.

# 2. Financial management

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

## Main judgements

Total spending was £580 million less than budget. The resource budget was underspent by £373 million (0.8 per cent) against a budget of £48,573 million and capital was underspent by £207 million (9.7 per cent) against a budget of £2,128 million.

The 2020/21 financial year is the first in which the Scottish Government's funding to support the Covid-19 pandemic response is reflected in its financial performance. The Scottish Government's Consolidated Accounts for 2020/21 show that total net expenditure was £50,121 million. This was £10,736 million (27 per cent) more that in 2019/20 reflecting the significant additional amounts of public spending committed to responding to the Covid-19 pandemic.

The Scottish Government allocated £8.6 billion of Barnett consequentials to support its Covid-19 response activity through three budget revisions during 2020/21. This formed a significant part of the Scottish Government's financial response to supporting the health service, businesses, local government, and the wider economy during the year.

High-level details are provided in the Consolidated Accounts over how Covid-19 money was spent during the year. Publishing comprehensive Covid-19 financial reporting information which clearly links budgets, funding announcements and spending levels, will increase the transparency of the Government's financial reporting in an area of significant public and parliamentary interest.

### Scottish Government underspent its budget by £580 million in 2020/21

**39.** The Consolidated Accounts show that total net expenditure during 2020/21 was £50,121 million, £580 million less than budget (Exhibit 3). The resource budget was underspent by £373 million (0.8 per cent) against a budget of £48,573 million and capital underspent by £207 million (9.7 per cent) against a budget of £2,128 million.

**40.** This was £10,736 million (27 per cent) more that in 2019/20 reflecting the significant additional amounts of public spending committed to responding to the Covid-19 pandemic.

**Exhibit 3**
**Performance against Consolidated Accounts budget in 2020/21**

| Performance | Final budget £m | Outturn £m | Over/(under) spend £m |
|---|---|---|---|
| Resource | 48,573 | 48,200 | (373) |
| Capital | 2,128 | 1,921 | (207) |
| **Total** | **50,701** | **50,121** | **(580)** |

Source: Scottish Government Consolidated Accounts 2020/21

## Covid-19 expenditure

**41.** The Scottish Government allocated £8.6 billion of Barnett consequentials to support its Covid-19 response activity through three budget revisions during 2020/21. This formed a significant part of the Scottish Government's financial response to supporting the health service, businesses, local government and the wider economy during the year. Earlier Scottish Government analysis provided to Audit Scotland indicated that around £8.8 billion was spent on Covid-19 during the year. High-level details are provided in the Scottish Government's accounts over how this money was spent during the year. The Scottish Government needs to be proactive in publishing comprehensive Covid-19 financial reporting information which clearly links budgets, funding announcements and spending levels. This will increase transparency in the Government's financial reporting in an area of significant parliamentary and public interest.

## Recommendation 4

The Scottish Government should be proactive in publishing comprehensive Covid-19 financial reporting information which clearly links budgets, funding announcements and spending levels. This will increase transparency in the Government's financial reporting in an area of significant parliamentary and public interest. (Appendix 1, Point 4)

## Financial support to private companies

**42.** In recent years, the Scottish Government has taken a direct role in providing financing to private companies in the form of equity, loans and guarantees and taken certain businesses into public ownership in addition to support provided through its enterprise agencies, Scottish Enterprise and Highlands and Islands Enterprise and South of Scotland Enterprise.

## Prestwick Airport

**43.** 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. The total level of loan support provided up to 31 March 2021 is £43.4 million although this was valued at £11.6 million in Transport Scotland's accounts at the financial year end following an independent valuation. A further £1.2 million interest charges have accrued during the year resulting in total accrued interest of £6.3 million. In keeping with Transport Scotland's approach in previous years, the interest on these loans has been impaired to nil.

**44.** 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. Transport Scotland is still looking to sell Prestwick Airport once a buyer is found.

## Ferguson Marine (Port Glasgow) Holdings Limited

**45.** 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 (Vessels 801 and 802) for Caledonian Maritime Assets Limited (CMAL). By April 2019, FMEL had drawn down the full loan facility of £45 million and no extended facilities were provided.

**46.** 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.

**47.** As part of the reorganisation of the contractual arrangements, the Scottish Government entered into new contracts with FMPG for the completion of work on Vessels 801 and 802 as at 1 April 2020. The existing voted loans, including all capital and interest sums (£97.7 million) were terminated and ownership of the Vessels 801 and 802 and the associated equipment and design rights transferred from CMAL to the Scottish Government. In advance of the transfer of ownership, the Vessels were valued at £74.8 million. The difference between the valuation and the outstanding loans (£22.9 million) was written-off through the Scottish Government 2020/21 Consolidated Accounts.

**48.** In December 2020, the Scottish Parliament's Rural Economy and Connectivity Committee published its report into the cost overruns and delays associated with the delivery of Vessels 801 and 802. It concluded there had been serious failures in vessel procurement, project planning, project management and communication.

**49.** A performance audit to assess the management of the project to deliver Vessels 801 and 802 is underway with a view to publishing a report in March 2022. The audit will review the initial arrangements that were in place to manage the project and how well the Scottish Government, Transport Scotland and CMAL responded when problems arose. It will consider the learning that has been applied to the new arrangements and make recommendations to help improve the management of similar projects.

### Burntisland Fabrications Limited (BiFab)

**50.** In 2018/19 the Scottish Government converted £37.4 million of commercial loans it had advanced to BiFab into equity in the company representing a total equity stake of 32 per cent. In the 2019/20 Consolidated Accounts, the Scottish Government's equity stake was valued at nil to reflect expected losses in line with accounting requirements.

**51.** During 2020/21 the Scottish Government provided further loans of £4.5 million to BiFab. to help the completion of outstanding contracts. In December 2020, BiFab went into administration due to its challenging financial position. 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 and the loan of £4.5 million was fully written off in year. The Consolidated Accounts refers to the subsequent sale of the business in February 2021 and that the Scottish Government will continue to work with the administrators to maximise the recovery of public money.

### Lochaber Aluminium Smelter – Liberty Group

**52.** In December 2016, the Scottish Government issued a 25-year financial guarantee contract to SIMEC Lochaber Hydropower Limited. This contract guarantees the power purchase obligations of the Liberty Aluminium Lochaber Limited smelter if the business does not fulfil its obligations to pay for contracted power. The Scottish Government receives an annual fee in return for the guarantee.

**53.** The annual exposure to the Scottish Government is between £14 million and £32 million, over the lifetime of the contract. At the start of the contract in December 2016, the total potential financial exposure to the Scottish Government was £586 million. To reduce the exposure of the contract, the Scottish Government created a security package which includes first line security over the hydro plant, the smelter and land which formed part of the original purchase of the smelter by the GFG Group.

**54.** In March 2021, Greensill Capital (UK) Limited, a major provider of working capital to GFG Alliance, went into administration. This impacts on the Lochaber smelter as it is a subsidiary of Liberty Industries UK Limited, alongside Liberty Steel Limited under GFG Alliance. The situation is further complicated as the hydro power station that supplies the smelter is owned by GFG Alliance through its other main group of companies, SIMEC.

**55.** With the ongoing uncertainty regarding the financial stability of the GFG Alliance group, the Scottish Government reviewed the level of provision required with regards to their guarantee. The provision in the Consolidated Accounts increased from £37 million in 2019/20 to £161 million as at 31 March 2021. We have concluded for 2020/21, the Scottish Government's approach to setting the level of provision against the potential exposure through the guarantee is reasonable.

### The strategic approach to financial interventions

**56.** In the 2019/20 report on the audit of the Scottish Government's Consolidated Accounts, we highlighted the need 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. The Scottish Government had already recognised that there were a range of risks, for example, EU exit and Covid-19, likely to have a business impact and which could potentially increase the number of distressed and restructured businesses.

**57.** During the year, the Scottish Government established a new Covid Business Resilience and Support Directorate which includes the Strategic Commercial Interventions Division (part of DG Economy). The Division aims to consolidate expertise and knowledge and increase capacity to respond to cases that arise seeking support from the Scottish Government.

**58.** In previous reports we recommended that the Scottish Government develops a framework to outline its principles and approach for decisions about future investment in private companies. This is now being actioned by the Scottish Government. Such a framework should help the Scottish Government provide assurance to Parliament over its strategic objectives in entering any future agreements and the decision-making process involved.

**59.** It remains essential for the Scottish Government to learn lessons from its experience of recent financial interventions in private companies. In adopting a framework for investment, it is important that the Scottish Government clearly outlines its plans for future investment in private companies to ensure there is greater transparency over the value of financial support provided, the risks involved and the expected outcomes for the public.

## European Structural and Investment Funds

**60.** 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).

**61.** In November 2019, the EC placed the ESF programme in suspension after the Scottish Government was unable to resolve all outstanding issues by this deadline. In January 2020, the EC also placed the ERDF programme into suspension. While programmes are suspended, the Scottish Government's claims to the EC for reimbursement of funds will not be paid until all issues identified are resolved. The ERDF suspension was lifted in December 2020 but the ESF suspension continues.

**62.** In 2020/21, the Scottish Government recognised that implementing the agreed methodology will likely result in greater expenditure over the course of the programme than can be reclaimed from the EC. As a consequence, and in line with accounting standards, the Scottish Government wrote off £16 million in the 2020/21 Consolidated Accounts in respect of grant payments already made and has provided a further £28.7 million relating to the future under-recovery of costs.

**63.** Following the UK's withdrawal from the European Union, ESF funding will be replaced by UK Government-led funding programmes including the Shared Prosperity Fund, Community Renewal Fund and the Levelling-up Fund. Under the Withdrawal Agreement, the UK will continue to participate in the Multiannual Financial Framework programmes, like ESF, until it ends in 2023.

## Non-Domestic Rating Account

**64.** Non-domestic rates (NDR) are a tax charged on properties that are used for non-domestic purposes, for example, private businesses, and public and third sector properties. The tax is collected by individual councils and pooled by the Scottish Government. It is then redistributed to councils as part of the overall annual local government funding settlement. The Scottish Government, on behalf of Scottish Ministers, is required to prepare a NDR account at the end of each financial year, in accordance with the Local Government Finance Act 1992. The purpose of the account is to demonstrate that the non-domestic rates receipts collected by councils are redistributed to them by the Scottish Government.

**65.** The NDR account is made up of two key components:

- receipts from non-domestic rates income collected by councils; and
- payments redistributed to councils from the Scottish Government.

**66.** The amounts received from and redistributed to councils are subject to timing differences as, in any year, the amount raised by non-domestic rates will only become known once the financial year is over. To help manage variances, each council provides an estimate of what they expect to raise in non-domestic rates, less any retentions from relief schemes, and submits this to the Scottish Government at the start of each financial year.

**67.** Regulations made under the legislation permit mid-year adjustments to councils' funding only where revised NDR income estimates by councils are below 97 per cent of their initial estimates. During the 2020/21 financial year, to support councils' cashflows during the Covid-19 pandemic, the Scottish Government adjusted NDR receipts and payments based on councils' mid-year estimates. However, the adjustments included £60.3 million where the mid-year estimates were more than 97 per cent of the initial estimates. As a result, the NDR account includes £40.4 million of receipts and £19.9 million of payments which were not in accordance with the regulations. The auditor of the 2020/21 NDR account therefore qualified his opinion on regularity in relation to this matter.

**68.** The differences between NDR estimates and actual amounts do not impact the level of funding provided to councils during the financial year. The Scottish Government guarantees the combined amount of revenue grant funding and non-domestic rates distributions provided to councils each year and manages the financial risk of variances within its own budget. Where variances in non-domestic rates occur, the Scottish Government adjusts the council's general revenue grant to ensure funding levels to local government align to the levels agreed in the local government finance settlement for that year.

## Apart from payroll, financial systems of internal control operated effectively

**69.** 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.

**70.** 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 in June 2021. We concluded that, other than Payroll, the Scottish Government's main systems of internal control operate effectively.

**71.** 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. We recognise that several improvements to the control environment have been introduced over the course of the financial year.

**72.** 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.

## The Scottish Government applied appropriate controls for new or extended Covid-19 procurement contracts

**73.** 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.

**74.** 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. The National Fraud Initiative (NFI) is a counter-fraud exercise across the UK public sector which aims to prevent and detect fraud. The Scottish Government has started to investigate the matches.

**75.** The impact of the pandemic has required public bodies to extend existing contracts and enter new contracts to obtain goods and services to address Covid-19 challenges. We carried out an assessment of the arrangements in place at the Scottish Government to prevent fraud and corruption in the procurement function. This included a review of a sample of extended or new Covid-19 related contracts and assessing the procurement controls. We concluded that the Scottish Government had applied the appropriate controls regarding new or extended Covid-19 procurement contracts.

# 3. Financial sustainability

Financial sustainability looks forward to the medium and long term to consider whether a body is planning effectively to continue to deliver its services

## Main judgements

The Scottish Government borrowed to fund resource expenditure for the first time in 2020/21. During the year it borrowed £207 million from the National Loans Fund to be repaid over five years.

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 Scottish Government has committed to the development of a devolved public sector account on a two-stage basis beginning with production of an account at the Scottish Administration level and then add the other directly funded bodies. The second stage which will incorporate NDPBs, other public bodies and local authorities will require more in-depth analysis and review.

## 2020/21 financial position

**76.** 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.

**77.** 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). 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.

## Capital and resource borrowing were utilised during 2020/21

**78.** 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 2020/21, the Scottish Government borrowed £200 million. This was less than the £450 million outlined by Scottish ministers as part of the 2020/21 Scottish budget. The loan will be repaid to the National Loans Fund over 25 years. This is in line with timescales outlined in the Fiscal Framework. The Scottish Government have advised that 2020/21 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.

**79.** In 2020/21, the Scottish Government borrowed to fund resource expenditure for the first time. During the year it borrowed £207 million from the National Loans Fund to be repaid over five years. This was within the £300 million limit for Resource Borrowing for the financial year 2020/21. The Scottish Government reported the requirement for resource borrowing arose due to a forecasting issue where the 2017/18 level of Scottish income tax to be received was over-estimated by £204 million.

**80.** As at 31 March 2021, the total principal level of capital borrowing outstanding was £1,219.7 million, with interest of £164.3 million applying over its remaining life. Revenue borrowing outstanding at 31 March 2021 was £207 million with interest of £1.7 million accruing over the five-year repayment period.

**81.** Details of the overall loan, repayments and interest payments are outlined on pages 55 and 56 of 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.

## There is increased volatility to public finances due to the impact of Covid-19

**82.** In January 2021, the Scottish Government published its third Medium Term Financial Strategy alongside the 2021/22 draft Scottish Budget. 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 financial powers from the Scotland Acts 2012 and 2016 come into effect. The 2021 Strategy sets out its assessment of Scotland’s economic and fiscal outlook, as well as a broad spending outlook considering the effects of changing funding levels for government spending. The Scottish Government is due to publish its next iteration of the MTFS alongside its draft 2022/23 budget in December 2021.

**83.** In February 2021, the Scottish Government also published its Capital Spending Review setting out its indicative capital spending allocations in years 2021/22 to 2025/26 that aim to support the implementation of the Government’s

Infrastructure Investment Plan published at the same time. Looking ahead, in November 2021, the Cabinet Secretary for Finance and the Economy committed to publishing a Scottish Resource Spending Review before the end of May 2022.

**84.** 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. It is important that these key fiscal publications clearly reflect the likely impact of the pandemic on public finances including on planned outcomes and options for ensuring financial sustainability. This will help to aid Parliament's understanding of the financial risks and opportunities that emerge from the Covid-19 pandemic including the difficult choices required over public spending.

## The Scottish Government has outlined a two-stage process for the development of Public Sector Accounts

**85.** 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.

**86.** Progress in finalising the draft account for audit remains slow with the Scottish Government prioritising responding to the Covid-19 pandemic and the preparation of the 2019/20 and 2020/21 Consolidated Accounts. There have also been delays in finalising the 2019/20 Whole of Government Account which forms the basis for these pan-Scotland accounts largely due to ICT issues at HM Treasury.

**87.** The Scottish Government has committed to the development of a devolved public sector account on a two-stage basis. In the first stage, the Scottish Government aims to compile the account at the Scottish Administration level and then add the other directly funded bodies. This will include the 2020/21 financial outturn together with prior year comparators. The Scottish Government plans to provide this account for audit in Spring 2022.

**88.** In the second stage, the Scottish Government plans to further explore the use of the UK Whole of Government Account process to obtain the information about NDPBs, other public bodies and local authorities. The Scottish Government does not expect this to be complete until later in 2022 as incorporating that level of expenditure will require more in-depth analysis and review.

**89.** The consequences of the pandemic and the impact of EU withdrawal continue to pose significant risks to the sustainability of public finances. There remains a need for a public consolidated account to provide a comprehensive and transparent assessment of the state of Scotland's public finances particularly given the financial consequences of the pandemic and the investment required as part of the Government's recovery and renewal plans. 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.

**90.** We note the commitment made by the Scottish Government to the development of this account. We urge the Scottish Government to move as swiftly as possible towards fulfilling this revised timetable.

## Recommendation 5

The Scottish Government should commit to its revised timetable over the production of public consolidated accounts. Public sector accounts will be important to identifying the potential risks to financial sustainability including the scale of assets and liabilities held by the devolved public sector in Scotland. (Appendix 1, Point 5)

# 4. Governance and transparency

The effectiveness of scrutiny and oversight, and transparent reporting of information

## Main judgements

The Scottish Government strengthened aspects of its governance arrangements. During 2020/21, there was a strong focus on the impact of the Covid-19 pandemic on the organisation, including the challenges facing staff capacity and wellbeing.

Significant changes have taken place across a number of important leadership roles within the Scottish Government, including a new Permanent Secretary, who will take up post in January 2022. Strong leadership and effective governance will remain critical as the Scottish Government seeks to recover from the effects of the pandemic and plan for the future.

### Governance arrangements have operated effectively during the Covid-19 pandemic

**91.** 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. The statement confirms that it complies with relevant guidance on corporate governance. It also highlights the main risks and opportunities for the organisation and any significant internal control issues in 2020/21. 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.

**92.** The Scottish Government has strengthened aspects of its governance arrangements. During 2020/21, there was a strong focus on the impact of the Covid-19 pandemic on the organisation, including the challenges facing staffing capacity and wellbeing. The scale and pace of demands placed considerable strain on staff across the organisation combined with existing capacity pressures and the challenges of remote working. Improvements to risk management processes continue to evolve and embed across the organisation. This includes greater scrutiny and challenge of risks at both portfolio and corporate level. There remains scope for greater clarity on the impact of planned actions on reducing risk levels and the anticipated time taken to achieve risk targets across the organisation.

**93.** Over the last year, there were several changes to the Scottish Government's Corporate Board. These included new Directors General for both

Education and Justice, and Health and Social Care portfolios. In addition, there were new appointments to the posts of Director of Communications, Ministerial Support and Facilities and, Equality, Inclusion and Human Rights. A new Chief Financial Officer also started in November 2020.

**94.** This level of change will continue into next year with a new Permanent Secretary starting in January 2022. DG Economy retired in November 2021 with the role being split into DG Economy and DG Net Zero. External recruitment campaigns were run during 2021 for the posts of DG Economy and DG Net Zero were unsuccessful in identifying appointable candidates. These have been filled on an interim basis and will be re-advertised in early 2022. These are key roles for the Scottish Government and are essential to achieving the objectives set out in the national outcomes.

**95.** Currently, there are ten Non-Executive Directors (NXDs) whose role is to provide support and challenge to the Scottish Government. Three of the four NXDs currently serving on the Corporate Board will reach the end of their term during 2022. One other NXD left the Scottish Government during 2020/21 and was replaced later in the year.

**96.** The changes in senior leadership roles presents a good opportunity for the Scottish Government to reflect further on its governance and operational structures, its decision-making processes, and its overall senior capacity to ensure it can fully support the various demands, both internal and external, on the organisation in the years ahead. It will be important that the Scottish Government limits the use of interim appointments to ensure greater stability and certainty within its leadership group. Overall, it remains important for the Scottish Government to keep its governance arrangements under review to ensure they remain fit for purpose, particularly during this continuing period of change and uncertainty.

## Recommendation 6

The Scottish Government should continue to review its governance arrangements to ensure they remain fit for purpose, particularly as changes are made to its leadership. The use of interim appointments should be limited where possible to ensure greater stability and certainty within its leadership group. (Appendix 1, Point 6)

## Arrangements for sponsoring public bodies remains an area of concern

**97.** The Scottish Government's arrangements for sponsoring public bodies remains an area of concern. Last year, we reported that the Scottish Government had taken initial steps to improve the effectiveness of its role in sponsoring public bodies but that the establishment of a governance hub module on sponsorship training, accreditation for sponsors and workshops and networking events for Accountable Officers and sponsors had largely paused due to Covid-19.

**98.** We are pleased to report that the Public Bodies Unit has restarted its support and training role for sponsors. An online support portal has been launched providing guidance and training to sponsorship staff and a programme of training events has restarted. A training package has been developed and delivered to sponsor teams across the Scottish Government, and training has also been provided during the year to board members and practitioners, including Accountable Officers.

**99.** During 2021, the Scottish Government commissioned an external consultant to conduct a review of the Scottish Government's relationships with public bodies. The review will consider the current delivery of sponsorship arrangements within the Scottish Government including how it should organise and manage its relationships with public bodies. It will also consider how sponsors and public bodies can effectively manage risk and escalation of issues when challenges arise. The report is expected to make a number of recommendations for improvement and is due to be considered by the Scottish Government's Executive Team before the end of 2021. We shall review the effectiveness of changes made in forthcoming audit work.

# 5. Value for money

Using resources effectively and continually improving services

## Main judgement

The Scottish Government has overall arrangements in place to support performance management. It is recognised that performance management processes require review to ensure they are fit for purpose and remain relevant.

## The Performance Report within the Consolidated Accounts could be further improved

**100.** In addition to the opinion on the performance report covered in Part 1 of this report, we also consider the qualitative aspects of the performance report included in the annual report and accounts.

**101.** The 2020/21 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.

**102.** 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.

**103.** The purpose of a performance report is to provide information on a body, its main objectives and strategies, and the principal risks that it faces. It is required to provide a fair, balanced and understandable analysis of a body's performance and, is essential in helping stakeholders understand the financial statements. The performance report is therefore an opportunity for the organisation to 'tell its story' and enhance openness and transparency.

**104.** We concluded that the Scottish government's performance report met the requirements of the FReM but that enhancements could be made by introducing relevant diagrams and tables and by linking better the individual sections.

**105.** The performance report provides information around the impact of Covid-19 on performance during the year and the shift of priorities to address the different stages of the pandemic. The impact on national outcomes is well documented in Scotland's Wellbeing: The Impact of COVID-19 published in December 2020 by the Scottish Government. Initial evidence indicates that some outcomes were more adversely affected than others and that some will have a longer-term impact on society with existing inequalities expected to widen further.

**106.** For 2020/21, the Performance Analysis section of the performance report has been largely redesigned to provide the reader with a range of information on each portfolio's policy aims, impact of Covid-19 on these priorities, the deliverables during the year and the intended contribution to the national outcomes.

**107.** The additional information is welcome, but it requires to be refined further to ensure greater accessibility and transparency to the reader. It is difficult to form an overall picture of the performance of the Scottish Government from the various strands of information presented. In the absence of defined, measurable targets, it is difficult for the reader to assess whether the national outcomes are being achieved. In addition, it is challenging to link the performance information with the individual portfolio outturn statements which are provided in the financial statements.

**108.** The Scottish Government acknowledges that there is further room for improvement in the transparency of the reporting and the links between performance analysis and financial performance in the portfolio outturn statements. Further changes will enhance reporting to the Scottish Parliament and the public and help strengthen accountability and scrutiny.

## Recommendation 7

The Scottish Government should ensure greater accessibility and transparency of its performance reporting within the Consolidated Accounts, including better links between spending in portfolios and performance towards achieving national outcomes. This will help strengthen accountability and scrutiny of the Scottish Government's own performance.

Further enhancements could be made by introducing relevant diagrams and tables in the Performance Report.
(Appendix 1, Point 7)

### The Scottish Government had overall arrangements in place to support performance management

**109.** Value for money is concerned with using resources effectively and continually improving services. The Governance Statement also refers to the use of the balanced scorecard to assist the scrutiny of the key performance indicators and outlines progress towards the National Performance Framework outcomes.

**110.** In response to the pressures of the Covid-19 pandemic, the Performance Board met twice during 2020/21 and its responsibilities in the intervening periods were dealt with by the Executive Team. These responsibilities included oversight of the delivery of the National Performance Framework and the Programme for Government. Regular updates were also provided to Assurance Boards using the balanced scorecard.

**111.** The balanced scorecard brings together key performance information and is intended to complement Directorate performance monitoring and risk management, and includes progress updates of the Government's highest profile commitments.

**112.** At the June 2021 meeting of the Corporate Board, a significant review of the Corporate balanced scorecard was agreed. The Scottish Government has recognised that the current systems of performance reporting across all policy areas lacked integration and there was a disconnect between reporting on targets, key deliverables, spending, and contribution to outcomes.

**113.** An important element of the new process is the definition and agreement of a clear set of cross-government priorities which the Government want to see progress on and will form the core around which the system to track delivery and performance will be designed.

**114.** The aim is to develop an integrated approach to overseeing progress towards cross- government priorities, which should lead to the delivery of the National Performance Framework's outcomes. Attention has initially focussed on two cross-cutting priorities: child poverty and climate change. It is anticipated that the approach will be rolled out across all other cross – government priorities and reviewed and refined based on experience.

**115.** We consider that the development of this approach will assist the Scottish Government in providing more clarity and transparency in their performance reporting in the Consolidated Accounts.

## National performance audit reports

**116.** Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. In 2020/21 a number of reports were published which may be of direct interest to the body. These are outlined in Appendix 4.

# Appendix 1. Action plan 2020/21

## 2020/21 recommendations

| Issue/risk | Recommendation | Agreed management action/timing |
|---|---|---|
| **1. Preparation of financial statements**<br>The unaudited Consolidated Accounts were received on 30 September 2021 but there were a number of incomplete sections. An updated version was received 6 weeks later but there remained some outstanding areas which were not finalised until December 2021.<br>There is a risk that the audit is not completed in line with the statutory timetable and that the financial statements are qualified due to an absence of appropriate working papers. | The Scottish Government should review their internal processes for the provision of a complete set of unaudited accounts for audit review and responding to audit queries to ensure the audit can be completed timeously.<br>Paragraph 15 | Agreed.<br>Processes and scheduling need to improve to deliver more efficient processes and better quality outputs at an earlier stage. It is not, however, accepted that this can be achieved by internal SG processes alone (though these will be reviewed). The scheduling of the accounts and audit of the bodies to be consolidated needs to support what is needed for the draft consolidation deadline.<br>A lessons learned exercise with Audit Scotland and an internal review of processes and planning will improve the scheduling and structure of accounts production and audit work across the consolidation.<br>Head of Corporate Reporting<br>By end March 2022 |
| **2. Student loans**<br>We identified a significant number of discrepancies between working papers, disclosures in the accounts and the financial ledger during our audit of student loans. There was a lack of | The process for accounting for student loans should be reviewed to clarify respective responsibilities, minimise the level of errors and increase | Accepted.<br>We appreciate acknowledgement that this is a complex area of reporting. We will be conducting an end-to-end review of |

| Issue/risk | Recommendation | Agreed management action/timing |
| --- | --- | --- |
| clarity on specific responsibilities over accounting for student loans between the Scottish Government and SAAS.<br><br>There is a risk that the accounting and disclosures are not in accordance with agreed procedures resulting in a material misstatement in the financial statements. | overall understanding of this complex area<br><br>Exhibit 2, Point 4 | processes on the reporting of student loans.<br><br>SAAS Director of Finance<br><br>31/03/2022 |
| **3. Covid-19 grants: assessment of fraud and error** | | |
| There was no robust estimate of the level of fraud and error related to the business support grants provided in advance to audit. Evidence to support assessments of fraud and error was only provided in late November/early December 2021.<br><br>There is a risk that the financial statements will be qualified if there is no regular, robust monitoring, review and reporting of the assessment of the level of fraud and error incurred. | Looking ahead, the Scottish Government should regularly assess and improve its estimates of fraud and error in Covid-19 grant related schemes. In doing so, the Scottish Government should consider direct testing of a sample of payments to assure themselves that estimates are robust and that controls to detect and prevent fraud and error are working in practice. They should also ensure regular public reporting to satisfy high levels of public interest in this area.<br><br>Paragraph 24 | Partially accepted.<br><br>The timing point is accepted: the comprehensive assurance work has necessarily been retrospective and the Fraud Review was reported to the Governance Board in November. SG colleagues are comfortable with the basis of the estimate provided in the accounts as a defensible view of potential fraud within grants. The suggestion of direct sample testing is not accepted: direct sample testing for fraud of grants administered by third party partners would involve a significant amount of resource and may not be statistically reliable. In addition, the assurance work did not highlight any concerns about the controls operated.<br><br>There is additional work and additional reporting as signposted within the accounts. The improvements highlighted in the Fraud Review report will be implemented in any future work. |

| Issue/risk | Recommendation | Agreed management action/timing |
|---|---|---|
| | | Deputy Director<br>Covid Business Resilience and Support<br>Ongoing |
| **4. Public reporting** | | |
| Scottish Government analysis indicated that around £8.8 billion was spent on Covid-19 during the year. High-level details are provided in the Scottish Government's accounts over how this money was spent.<br>There is a risk that there is an insufficient level of publicly available information on how Covid-19 funding was spent, reducing transparency in an area of high public interest. | The Scottish Government should be proactive in publishing comprehensive Covid-19 financial reporting information which clearly links budgets, funding announcements and spending levels. This will increase transparency in the Government's financial reporting in an area of significant parliamentary and public interest.<br>Paragraph 41 | Accepted in Principle.<br>The Scottish Government will continue to be proactive in publishing information on funding and spending via Budget documents, accounts and other sources of information and statistics which are not confined to a single financial year, many of which are signposted in these accounts.<br>A discussion with Audit Scotland about what may be possible was held in early February 2022.<br>Head of Corporate Reporting |
| **5. Public sector accounts** | | |
| The Scottish Government has committed to the development of a devolved public sector account on a two-stage basis beginning with production of an account at the Scottish Administration level. The second stage which will incorporate NDPBs, other public bodies and local authorities will require more in-depth analysis and review.<br>There is a risk that decision making over the longer term will be negatively impacted without a comprehensive and transparent assessment of the state of Scotland's public finances. | The Scottish Government should commit to its revised timetable over the production of public consolidated accounts. Public sector accounts will be important to help identify the potential risks to financial sustainability including the scale of assets and liabilities held by the devolved public sector in Scotland.<br>Paragraph 85. | Accepted.<br>The commitment to the two stage approach and the proposed timetable were reported to Parliament by the Cabinet Secretary in November.  Work on the Scottish Administration and Scottish Budget follows the completion of all 2020-21 accounts and audits, with the aim of finalising in Spring 2022 before moving on the second stage.<br>Head of Corporate Reporting<br>Ongoing |

| Issue/risk | Recommendation | Agreed management action/timing |
|---|---|---|
| **6. Governance** | | |
| There were several changes to the Scottish Government's Corporate Board with two new Director Generals, two new Directors, a new Chief Financial Officer and a new Permanent Secretary joining. Three of the four Non-Executive Directors currently serving on the Corporate Board will reach the end of their term during 2022.<br><br>There is a risk that this loss of knowledge and experience impacts adversely on the effectiveness of leadership within the Scottish Government | The Scottish Government should continue to review its governance arrangements to ensure they remain fit for purpose, particularly as changes are made to its leadership. The use of interim appointments should be limited where possible to ensure greater stability and certainty within its leadership group.<br><br>Paragraph 96. | Accepted.<br><br>Governance arrangements will continue to be held under regular review in the light of evolving good practice. A review of sub board structures is currently underway and due to report to Corporate Board in 2022. Three new NXDs have been appointed and succession planning for Board memberships is regularly reviewed.<br><br>Board Secretary<br><br>Ongoing<br><br>Two DGs were appointed on an interim basis to provide stability and continuity to the Executive Team following unsuccessful external recruitment campaigns. Once the new Permanent Secretary is in post in early 2022, moves will be made to fill these posts on a permanent basis.<br><br>Deputy Director<br><br>Senior Resourcing and Staffing<br><br>31/12/2022 |
| **7. Performance reporting** | | |
| The performance report requires to be further refined to ensure greater accessibility and transparency to the reader. It is difficult to form an overall picture of the performance of the Scottish Government or assess whether the national outcomes are being achieved. It is challenging to | The Scottish Government should ensure greater accessibility and transparency of its performance reporting within the Consolidated Accounts, including better links between spending in portfolios and performance towards achieving national outcomes. This will help strengthen | Accepted.<br><br>Work was undertaken in 2020-21 to redesign the Performance Analysis section of the Performance Report.<br><br>We accept and recognise that there are further improvements which can be |

| Issue/risk | Recommendation | Agreed management action/timing |
|---|---|---|
| link the performance information with the financial statements.<br><br>There is a risk that users of the accounts are unable to gain a clear understanding of Scottish Government performance. | accountability and scrutiny of the Scottish Government's own performance.<br><br>Further enhancements could be made by introducing relevant diagrams and tables in the Performance Report.<br><br>Paragraph 107. | made to the Performance Report. As part of this iterative process, we will continue to build on our approach next year, in line with Audit Scotland's recommendation.<br><br>Director<br><br>Performance and Strategic Outcomes<br><br>Autumn 2022 |

## Follow-up of prior year recommendations (2019/20 Annual Audit Report)

| Issue/risk | Recommendation | Agreed management action/timing |
|---|---|---|
| **8. Ferguson Marine Port Glasgow**<br><br>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. | 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. | The establishment of key reporting structures and funding mechanism are complete, and active sponsorship and management of the shareholding is ongoing.<br><br>Objectives have been set for the Turnaround Director and Board and are detailed in the Framework Document, and form part of the appraisal process and gauge performance.<br><br>The shipyard is preparing a development plan which will evolve into a strategic business plan and capital investment strategy and will include measurable objectives, including progress required to ensure that it becomes more efficient and more competitive.<br><br>Deputy Director for Strategic Commercial Interventions.<br><br>Ongoing |

| Issue/risk | Recommendation | Agreed management action/timing |
|---|---|---|
| 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. | | |
| **9. Financial interventions in private companies**<br>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.<br>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.<br>The Scottish Government needs to undertake a lessons learned review from its experience of recent financial interventions in private companies.<br>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. | The Scottish Government is committed to learning lessons from our experience of interventions and to continuously improving our approach. The principles and guidance in respect of investment in private companies in the SPFM has been further reviewed and extended. The updated framework in the SPFM is expected to be published in March 2022.<br>Deputy Director for Strategic Commercial Interventions<br>Ongoing |
| **10. National Fraud Initiative**<br>In our 2018/19 Annual Audit Report, we noted that NFI | | Completed |

| Issue/risk | Recommendation | Agreed management action/timing |
|---|---|---|
| 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.<br><br>At the time of our review, some work on procurement matches had not been completed by the Scottish Government due to staff resourcing issues.<br><br>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. | The 2019/20 fraud report included this information and there will be appropriate reporting going forward.<br><br>The specific SG outcomes from the NFI exercise are included in the 2020-21 Governance Statement and also within the 2020-21 Annual Fraud report provided to Corporate Board and to the SG Audit and Assurance Committee. |
| **11. Medium term financial strategy (MTFS)**<br><br>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.<br><br>Risk: Without good analysis of high-level financial plans linked to expected outcomes, there is a risk that it will make | The Scottish Government should make clearer the links between planned spending options and expected outcomes in the National Performance Framework to aid Parliament's understanding of the financial risks and opportunities emerging from the Covid-19 pandemic. | 2019/20 Response: The Scottish Government have a slightly different view to Audit Scotland on the role of the MTFS, which is guided by the recommendations of the BPRG in that the MTFS should be a means of focusing on the longer-term sustainability of Scotland's public finances rather than establishing a comprehensive outcome link.<br><br>2020/21 Response: The 2021 MTFS was published alongside the Budget 2022/23 and Resource Spending Review Framework on 9 December 2021. The 2022 publication will revert to its usual timing in May.<br><br>DG Scottish Exchequer |

| Issue/risk | Recommendation | Agreed management action/timing |
|---|---|---|
| Parliament's scrutiny of the 2021/22 budget more difficult. | | |
| **12. 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.<br>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. | It is not accepted that Scottish Government capital borrowing should be applied or notionally applied to specific projects. The purpose and contribution of borrowing is to support the whole capital portfolio. This policy is set out in the Medium-Term Financial Strategies and annual Budget documents. Financial Management Directorate colleagues would be happy to discuss further with Audit Scotland. |
| **13. 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. | The Scottish Government should agree a new timetable for when it expects to implement these plans and how it expects to monitor improvements. | Partially completed<br>The review of the Scottish Government's relationship with public bodies has concluded and the report and recommendations within will be published alongside the Scottish Governments response in due course.<br>An online support portal has launched providing guidance and training to all sponsorship staff, and a programme of training events has restarted. A training package has been developed and delivered to |

| Issue/risk | Recommendation | Agreed management action/timing |
|---|---|---|
| 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. | | sponsor teams across the Scottish Government. An Accountable Officers workshop was delivered in December 2021 with an online learning module for Accountable Officers being delivered in Spring 2022.<br><br>Responsible officer:<br><br>Director for Local Government and Communities<br><br>Revised date:<br><br>Early 2022 |
| **14. 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 on its overall valuation at any given time.<br><br>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.<br><br>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. | Scottish Government is somewhat constrained in this respect, relying on models provided by the UK Department of Education (DfE) as primarily holders of the student loan book. Scottish Government will work with DfE where possible to consider future reporting.<br><br>SAAS Director of Finance<br><br>31/03/2022 |

# Appendix 2. Significant audit risks

The table below sets out the audit risks we identified during the 2020/21 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 financial statements and those relating to our wider responsibility under the Code of Audit Practice 2016.

## Risks of material misstatement in the financial statements

| Audit risk | Assurance procedure | Results and conclusions |
| --- | --- | --- |
| **1. Risk of material misstatement due to fraud caused by the management override of controls**<br>International Auditing Standards require that audits are planned to consider the risk of material misstatement in the financial statements caused by fraud, which is presumed to be a significant risk in any audit. This includes the risk of fraud due to the management override of controls. | Testing of journal entries.<br>Review of accounting estimates.<br>Focused testing of accruals and prepayments.<br>Evaluation of significant transactions that are outside the normal course of business.<br>Consideration of internal audit reports.<br>Substantive cut-off testing of income and expenditure transactions to ensure accounted for in the correct financial year.<br>Consideration of the results of controls testing. | We carried out detailed testing of journal entries, prepayments, accruals, accounting estimates and unusual transactions. The results of this audit work were satisfactory.<br>We reviewed relevant internal audit reports and concluded no impact.<br>Cut off testing was concluded to our satisfaction.<br>We reviewed the results of controls testing and adjusted our payroll substantive testing. This additional testing did not identify any additional issues. |
| **2. Risk of material misstatement caused by fraud in expenditure**<br>As most public sector bodies are net expenditure bodies, the risk of fraud is more likely to | Perform detailed testing of significant transactions, particularly around the financial year end.<br>Carry out analytical procedures. | We tested controls in this area and tested significant transactions around the financial year end. This did not |

| Audit risk | Assurance procedure | Results and conclusions |
|---|---|---|
| occur in expenditure. There is a risk that expenditure may be misstated resulting in a material misstatement in the financial statements.<br><br>In addition, with further devolution, benefits expenditure has increased by over £3 billion in 2020/21. In 2019/20, the auditor of Social Security Scotland qualified their regularity opinion because of overpayments of Carer's Allowance.<br><br>Given the high volume and diverse nature of expenditure incurred by the Scottish Government, there is a risk of fraud over expenditure. | Monitor budgetary process and reporting.<br><br>Consider any internal audit reports.<br><br>Regular communication with auditors of the Social Security Scotland Agency. | identify any areas of concern.<br><br>Our analytical procedures and monitoring of budgetary process and reporting did not raise any areas of concern.<br><br>We reviewed relevant internal audit reports and concluded no impact.<br><br>We considered the impact of the qualified opinion of the Social Security Scotland Agency and the impact of the auditor's opinion on expenditure as it applies to the Consolidated Accounts. Our conclusion has been summarised in Exhibit 2. |
| **3. Covid-19 expenditure** | | |
| In response to the Covid-19 pandemic, there has been a significant increase in expenditure of £8.8 billion, involving delivery organisations such as local authorities, enterprise agencies and health bodies.<br><br>Decision-making in a fast-moving environment presents challenges for the Scottish Government. These include maintaining good governance and controls while making decisions quickly, adapting performance measures and ensuring that anti-fraud arrangements remain robust at a time when the risk of fraud is increased.<br><br>There is a risk that assurance processes within the Scottish | Review of the extent and nature of Covid-19 grants distributed by the Scottish Government.<br><br>Consideration of the governance and accountability arrangements for distributing Covid-19 funding, including the level of scrutiny and steps taken to minimise fraud and error.<br><br>Review of performance targets for the efficiency and effectiveness of Covid-19 funding.<br><br>Consideration of internal audit's work on Covid-19 grants. | We reviewed a sample of large and small covid grant schemes distributed by the Scottish Government.<br><br>Our review included the consideration of the governance and accountability arrangements for distributing funding, including the level of scrutiny to minimise fraud and error. This review included consideration of performance and the efficiency and effectiveness of Covid-19 funding.<br><br>We held discussions with Internal Audit on |

| Audit risk | Assurance procedure | Results and conclusions |
|---|---|---|
| Government in relation to Covid-19 spend are limited and that internal control processes are compromised increasing the risk of material misstatement due to fraud, reported in the Consolidated Accounts. | | their report assessing the counter fraud provision within the Scottish Government.<br><br>Our conclusion has been summarised in Exhibit 2 and paragraphs 24-32. |
| **4. Estimation and judgements** | | |
| 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.<br><br>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.<br><br>Estimations and judgements create a higher risk that material areas in the accounts could be misstated. | Review of the student loans model (assumptions and application).<br><br>Review of the identification of, and record of, contingent liabilities, guarantees, indemnities and letters of comfort.<br><br>Test assumptions in contingent liability financial modelling.<br><br>Review the disclosure of student loans, investments, contingent liabilities and guarantees. | Our review of the Student Loans model identified misstatements. Further details can be found in Exhibit 2.<br><br>Our review of contingent liabilities, assets, guarantees, indemnities and letters of comfort identified a number of errors. The disclosures were updated.<br><br>We assessed the management experts used by Scottish Government to provide an estimation of the Lochaber smelter provision level and the valuation of non-current assets. No concerns were identified. |
| **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. There are risks associated with the 2020/21 consolidation process including:<br><br>• the continuing impact of the Covid-19 pandemic may lead to delays or difficulties in the preparation and audit of | Ongoing engagement with component auditors.<br><br>Guidance and information requests issued to component auditors to support group audit procedures.<br><br>Review of consolidation packs received. | Delays were encountered in obtaining audited component information which affected the preparation and audit of the group accounts.<br><br>We considered the auditor's opinion on the 2020/21 accounts of Social Security Scotland. Our conclusion has been |

| Audit risk | Assurance procedure | Results and conclusions |
|---|---|---|
| component bodies' accounts which may impact on the timing, preparation and audit of the group accounts.<br>• the auditor's opinion on Social Security Scotland (SSS) agency accounts has been qualified in the last two years, on the grounds of regularity in respect of Carer's Allowance benefit expenditure. This was assessed as not material to the Consolidated Accounts. With further devolution, benefits expenditure is expected to increase by £3 billion in 2020/21. There is a risk that the SSS audit qualification could become material to the Consolidated Accounts. | | summarised in Exhibit 2.<br>There is no further impact on our audit approach for the Consolidated Accounts. |

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

| Audit risk | Assurance procedure | Results and conclusions |
|---|---|---|
| **6. Financial governance** | | |
| Decision-making in a fast-moving environment presents a challenge for the Scottish Government and other public bodies. These challenges include ensuring:<br>• revised governance arrangements are appropriate and operating effectively, including risk-management arrangements<br>• anti-fraud arrangements remain robust<br>• there is effective scrutiny, challenge and informed decision making<br>• performance reporting is timely, reliable, balanced, transparent and appropriate to user needs. | Consideration of revised financial governance and accountability arrangements including the level of scrutiny and challenge and steps taken to minimise fraud and error.<br>Consideration of internal audit's work. | The Scottish Government's internal control framework has strengthened over the course of the year, with specific governance arrangements now in place to oversee Covid-19 business grant schemes and recovery.<br>We have made recommendations in Appendix 1 covering Governance, Performance Reporting, Public Reporting and the assessment of fraud |

| Audit risk | Assurance procedure | Results and conclusions |
|---|---|---|
| The pace of decision making, combined with remote working throughout 2020/21 means there is a risk that appropriate financial governance (such as effective controls) has not been applied leading to poor financial decision making and the potential for fraud and error. | | and error in relation to Covid-19 expenditure. |
| **7. 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.<br><br>Our audit reports in 2018/19 and 2019/20 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 the Corporate Risk Register.<br><br>Test key internal controls for the main IT systems that impact on the financial statements.<br><br>Review shared service programme (ERP) plans. | We concluded that the controls for the main IT systems that impact on the financial statements were operating effectively.<br><br>Progress has been made in the shared service programme with a main provider selected. We will continue to monitor the project. |
| **8. Scottish public sector accounts** | | |
| The Scottish Government has committed to providing accounts for the whole public sector in Scotland. Progress was delayed in 2019/20 due to the Covid-19 pandemic.<br><br>In the absence of such an account, there is a risk of significant financial decisions being made without a clear picture of what is owned and owed by the wider Public Sector in Scotland. | 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. | Progress in finalising the draft account for audit remains slow with the Scottish Government prioritising responding to the Covid-19 pandemic and the preparation of the 2019/20 and 2020/21 Consolidated Accounts.<br><br>The Scottish Government plans to provide this account for audit in February 2022. |
| **9. Sponsorship** | | |
| In 2019/20 we reported that, the Scottish Government's planned actions to improve its sponsorship | Monitor progress against the recommendations with | We have noted that the review of the Scottish Government's |

| Audit risk | Assurance procedure | Results and conclusions |
| --- | --- | --- |
| arrangements had largely been paused due to Covid-19. There is a need for the Scottish Government to clearly outline and maintain effective sponsoring arrangements, including clear roles and responsibilities, clarity over future funding arrangements and expectations of organisational performance. This includes how risks within sponsored bodies are escalated to the Scottish Government.<br><br>If sponsorship arrangements across government are not consistently effective, there is a risk to the delivery of outcomes and achievement of value for money. | Scottish Government officials.<br><br>Review any further updates to the SPFM and related guidance. | relationship with public bodies is reaching its latter stages. A report will be produced and presented to Executive Team in Autumn in which there will be recommendations. We will review the Scottish Government's progress against these recommendations. |
| **10. Procurement** | | |
| The impact of the pandemic required quick responses from the Scottish Government which included extending existing contracts and entering new contracts to obtain goods and services to address Covid-19 challenges.<br><br>There is a risk of procurement fraud and corruption where controls may be relaxed to help facilitate the quick purchase of goods and services. | Review a sample of extended or new Covid-19 related contracts, assessing controls applied.<br><br>Consider any internal audit reports. | We carried out an assessment of the arrangements in place at the Scottish Government to prevent fraud and corruption in the procurement function. This included a review of a sample of extended or new Covid-19 related contracts and assessing the procurement controls.<br><br>We concluded that the Scottish Government had applied the appropriate controls regarding new or extended Covid-19 procurement contracts. |
| **11. Financial interventions framework** | | |
| The need to develop a clear framework to outline the Scottish Government's approach to providing financial assistance to private companies was highlighted in the section 22 report presented to the Scottish Parliament in December | Discuss progress against the recommendations with Scottish Government officials.<br><br>Review any significant financial assistance offered to private | The Scottish Government has created a new division which aims to consolidate expertise and knowledge and increase capacity to |

| Audit risk | Assurance procedure | Results and conclusions |
|---|---|---|
| 2020 and has been highlighted to the Scottish Government for several years. We reported that the Scottish Government needs to set out its approach to risk tolerance, financial capacity and expected outcomes.<br>In doing so, the Government needs to ensure that there is greater transparency over the financial support that is provided and the value of public funds that are committed.<br>There is a risk that in the absence of a framework, value for money may not be obtained from such interventions. | companies during 2020/21. | respond to cases that arise seeking support from the Scottish Government.<br>The Scottish Government has started to develop a framework to outline its principles and approach for decisions about future investment in private companies.<br>See action point in Appendix 1. |

# 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 £250,000.

The table below summarises uncorrected misstatements that were noted during our audit testing and were not corrected in the financial statements. Cumulatively these errors are below our performance materiality level as explained in Exhibit 1. 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 | 10,223 | 16,330 | 33,776 | 27,669 |
| 2. | Agency unadjusted errors | 27 | 72,442 | 87,720 | 15,305 |
| 3. | SG Core unadjusted errors | | | | |
| i. | Income relating to 2019/20 | 275 | | | 275 |
| ii. | Accrual payable after one year | | | 5,682 | 5,682 |
| iii. | Accrual overstated | | 3,132 | 3,132 | |
| iv. | Balance not eliminated on consolidation | | | 1,224 | 1,224 |
| v. | CNORIS cases settled accrual overstated | | 1,000 | 1,000 | |
| vi. | Asset included in non-current assets in 2020/21 in error | | | 1,827 | 1,827 |
| vii. | Grant in Aid 21/22 funding processed in March 2021 | | 4,450 | 4,450 | |
| | **Impact** | 10,525 | 97,354 | 138,811 | 51,982 |

# Appendix 4. Summary of 2020/21 national performance reports

## April

Affordable housing

## June

Highlands and Islands Enterprise: Management of Cairngorm mountain and funicular railway

Local government in Scotland Overview 2020

## July

The National Fraud Initiative in Scotland 2018/19

## January

Digital progress in local government

Local government in Scotland: Financial overview 2019/20

## February

NHS in Scotland 2020

## March

Improving outcomes for young people through school education

# Scottish Government

## 2020/21 Annual Audit Report

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