Scottish Government

2022/23 Annual Audit Report

AUDIT SCOTLAND

Prepared for the Scottish Government and the Auditor General for Scotland

October 2023

Contents

Key messages

2022/23 annual report and accounts

1 The independent audit opinion is unqualified. This means in our opinion, we are content the 2022/23 Scottish Government Consolidated Accounts show a true and fair view, follow accounting standards, and that the income and expenditure for the year is lawful.

2 All other audited information was consistent with the financial statements and properly prepared in accordance with the relevant legislation.

Financial management and sustainability

3 Total spending was underspent by £509 million (1 per cent) against a budget of £50,276 million. This does not represent a future funding loss as the relevant underspend, as set out in the provisional and then final outturn, will be carried forward in the Scotland Reserve and applied in 2023/24.

4 The Scottish Government has effective financial management arrangements and, during 2022/23, responded well to emerging pressures.

5 The Scottish Government has strengthened its strategic approach to, and ongoing management of, financial interventions with the establishment of the Strategic Commercial Assets Division.

6 The public sector in its current form is not affordable. The Scottish Government must develop a programme of public service reform which balances the short-term financial pressures with the need for longer term change, recognising that this may require financial investment.

7 Workforce reform is essential to achieving financial sustainability, particularly given the recent pressures from public sector pay settlements. The Scottish Government needs to work with partners to make changes to the design and delivery of services.

8 The Scottish Government is currently considering a revised approach to meet its commitment to the development of a devolved public sector account, however no real progress has been made during 2022/23.

Vision, leadership and governance

9 The Scottish Government has well established assurance arrangements in place, however given its complexity there is potential for duplication and inefficiency. The whole governance and assurance arrangements should be refined and streamlined. We recognise that the Scottish Government are piloting new approaches to ensure they remain appropriate.

10 Corporate transformation is a way for the Scottish Government to achieve greater efficiencies and must be an immediate priority. Due to the scale and complexity of the programme there remains risk around the implementation date for the key HR and finance systems. Any increasing costs as a result of the delay in implementation will need to be managed.

11 The recent due diligence process for MV Glen Sannox and MV Glen Rosa (vessels 801 and 802) was robust and, as the value for money test for MV Glen Rosa (vessel 802) was not evidenced, resulted in the Director General - Economy receiving a Written Authority to proceed.

Use of resources to improve outcomes

12 The Policy Prospectus highlights three critical missions supported by 100 policy outcomes, however there are many other indicators and activities captured in other key strategies. The Scottish Government must focus activity to support the achievement of these critical missions.

13 Performance reporting within the Scottish Government could be improved. The absence of clearly defined, measurable performance targets for all priorities means it is difficult to assess whether the Scottish Government is delivering its intended aims in support of national outcomes.

Introduction

1. This report summarises the findings from the 2022/23 annual audit of the Scottish Government. This report is addressed to 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.

2. The scope of the audit was set out in an Annual Audit Plan presented to the March 2023 meeting of the Scottish Government Audit and Assurance Committee (SGAAC). This Annual Audit Report comprises significant matters arising from an audit of the Scottish Government's consolidated accounts and conclusions on the following wider scope areas that frame public audit as set out in the Code of Audit Practice 2021.

Responsibilities and reporting

3. 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.

4. The responsibilities of the independent auditor are established by the Public Finance and Accountability (Scotland) Act 2000 and the Code of Audit Practice 2021, and supplementary guidance and International Standards on Auditing in the UK.

5. This report contains an agreed action plan at Appendix 1. 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 of the Scottish Government from its responsibility to address the issues we raise and to maintain adequate systems of control.

6. We would like to thank non-executive members, and all staff, particularly those in finance, for their cooperation and assistance in this year and we look forward to working together constructively over the course of the five-year appointment.

Auditor Independence

7. The Auditor General for Scotland is the auditor of the Scottish Government. Carole Grant is the engagement lead responsible for the delivery of the audit. 2022/23 is the first of the new Code of Audit Practice introduced for financial years commencing on or after 1 April 2022.

8. 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 2022/23 audit fee of £1,185,680 as set out in our 2022/23 Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

9. We add value to the Scottish Government by:

- identifying and providing insight on significant risks, and making clear and relevant recommendations
- providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, arrangements to ensure the best use of resources and financial sustainability.
- sharing intelligence and good practice identified.

1. Audit of 2022/23 annual report and accounts

Public bodies are required to prepare annual reports and accounts comprising financial statements and other related reports. These are principal means of accounting for the stewardship public funds.

Main judgements

The independent audit opinion is unqualified. This means in our opinion, we are content the 2022/23 Scottish Government Consolidated Accounts show a true and fair view, follow accounting standards, and that the income and expenditure for the year is lawful.

All other audited information was consistent with the financial statements and properly prepared in accordance with the relevant legislation.

We obtained the required assurances to address the risks of material misstatement identified from our audit planning work.

Audit opinions on the annual report and accounts are unmodified

10. The annual report and accounts for the year ended 31 March 2023 were considered by the Scottish Government Audit and Assurance Committee (SGAAC) on 30 October 2023. 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 was prepared in accordance with the financial reporting framework
- the performance report and governance statement were consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

Overall materiality was reviewed on receipt of the unaudited annual report and accounts

11. Broadly, the concept of materiality is applied by auditors to determine whether misstatements identified during the audit could reasonably be expected to influence the economic decisions of users of the financial statements, and hence impact their opinion set out in the independent auditor's report. Auditors set a monetary threshold when considering materiality, although some issues may be considered material by their nature. It is ultimately a matter of the auditor's professional judgement.

12. Our initial assessment of materiality was carried out during the risk assessment and planning phase of the audit. This was reviewed and revised on receipt of the unaudited annual report and accounts as summarised in Exhibit 1.

Exhibit 1
Materiality values

Materiality level	Planning	Final
Overall materiality	£500 million	£480 million
Performance materiality	£250 million	£240 million
Reporting threshold	£0.25 million	£0.25 million

Source: Audit Scotland

13. The overall materiality threshold was set with reference to gross expenditure, which we judged as the figure most relevant to the users of the financial statements.

14. Performance materiality is used by auditors when undertaking work on individual areas of the financial statements. It is a lower materiality threshold, set to reduce the probability of aggregated misstatements exceeding overall materiality. Using our professional judgement, we have calculated performance materiality at 50 per cent of overall materiality, reflecting the Scottish Government's higher risk profile.

15. It is our responsibility to request that all misstatements, other than those below our reporting threshold, are corrected, although the final decision on making the correction lies with those charged with governance.

The unaudited core schedules and consolidated annual report and accounts were received in line with the agreed audit timetable but were incomplete

16. The unaudited core schedules were received on 29 June 2023 and the unaudited consolidated annual report and accounts on 7 September 2023, both in line with the agreed timetable. However, some key elements, including the valuation of the Lochaber provision and both the core and consolidated cash flow statements were incomplete and not received until late in the audit process.

17. The outstanding information, together with some delays in receiving responses to audit queries, caused pressure on both the audit team and Scottish Government finance staff. Moving forward we will have a lessons learned discussion with finance to ensure there is clarity on audit requirements and the associated timelines for all key elements of the accounts process to support efficiency and the return to earlier audit timescales.

Recommendation 1

All information should be available at the time of presenting the core schedules and consolidated accounts for audit.

Significant findings and key audit matters

18. Under International Standard on Auditing (UK) 260 we communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the body's accounting practices.

19. The Code of Audit Practice also requires all audits to communicate key audit matters within the annual audit report under International Standard on Auditing (UK) 701. These are matters that we judged to be of most significance in our audit of the financial statements.

20. The significant findings are summarised in Exhibit 2.

Exhibit 2
Significant findings and key audit matters from the audit of the annual report and accounts

Issue	Resolution
1. Lochaber Aluminium Smelter Note 15 of the Consolidated Accounts refers to the Scottish Government's potential exposure to default payments in relation to the financial guarantee associated with the Lochaber Aluminium Smelter. In March 2021, Greensill Capital (UK) Limited, the major provider of working capital to GFG Alliance (the holding company), went into administration. There continues to be significant uncertainty regarding the financial stability of the GFG Alliance group. As part of the 2022/23 Consolidated Accounts preparation process the Scottish Government reviewed the level of provision required for their guarantee and increased it by £21 million to £135 million.	We reviewed the Scottish Government assessment of their potential exposure on the financial guarantee. We concluded that, for 2022/23, the Scottish Government's approach to setting the level of provision was reasonable.
2. Impairment of MV Glen Sannox and MV Glen Rosa (vessels 801 and 802) Ownership of MV Glen Sannox and MV Glen Rosa (vessels 801 and 802) and associated equipment and design rights were transferred from Caledonian Maritime Assets Ltd (CMAL) to the Scottish Government in 2019. For the financial year 2022/23, the Scottish Government capitalised £64 million of construction costs for MV Glen Sannox and MV Glen Rosa (vessels 801 and 802). The vessels are valued based on the original contract price and subsequent expenditure, less an impairment figure. Given the significant time delay to completion, there is a risk that this method of valuation is inaccurate. The carrying value of MV Glen Sannox and MV Glen Rosa (vessels 801 and 802) in the Consolidated Accounts at 31 March 2023 is £82.6 million following an impairment of £59.7 million in 2022/23.	We reviewed the Scottish Government valuation process for MV Glen Sannox and MV Glen Rosa (vessels 801 and 802). We concluded that, for 2022/23, the Scottish Government's approach to the valuation of the vessels was reasonable.
3. European Structural and Investment Funds The European Commission's suspension of the Scottish Government's European Social Fund (ESF) was lifted on 31 October 2022. During 2022/23 the Scottish Government reviewed and revised its assessment of the provision.	We considered the Scottish Government's treatment of the potential non-recovery of income as a provision. We concluded that the accounting treatment as a provision was appropriate.

Issue	Resolution
The 2022/23 Consolidated Accounts include a provision of £12 million, a reduction of £31 million from 2021/22, for the potential under-recovery relating to the conversion of ESF operations to unit costs.	
4. Social Security Scotland Social Security Scotland, an executive agency, is included in the Consolidated Accounts. The 2022/23 accounts of Social Security Scotland include benefit expenditure of £3.4 billion administered by the Department for Work and Pensions (DWP) under an agency agreement 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. The estimated overpayments as a result of fraud and error in the benefits delivered by the DWP, ranged from 1.1 to 5.2 per cent of expenditure. This means an estimated £60.7 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. 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. We concluded that, for 2022/23, 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 Consolidated Accounts and therefore the audit opinion is not qualified in respect of this matter.
5. Crown Office and Procurator Fiscal Service The Scottish Government’s Consolidated Accounts include special payments of £16 million made by the Crown Office and Procurator Fiscal Service (COPFS) during 2022/23 which relates to specific legal cases brought against the Lord Advocate by individuals prosecuted in connection with the acquisition and administration of Rangers Football Club. A further £8.8 million has been included within provisions for liabilities and charges in respect of the same cases. To date, the COPFS has accounted for £60.5 million of unplanned costs in connection with these claims against the Lord Advocate. Some cases have been resolved, with sums paid to the pursuers totalling £51.7 million to March 2023. In February 2021, the Lord Advocate made a statement in the Scottish Parliament about this matter and has committed to further public accountability and	We assessed the disclosures relating to the COPFS special payments and provision and concluded that the disclosures provided in the Consolidated Accounts were appropriate.

Issue	Resolution
to a process of inquiry once all litigation has concluded.	
6. Monies retained by Scottish Government in error We identified two instances where funds were retained by the Scottish Government in error. The first was excess funding of £9 million which Scottish Courts and Tribunal Service (SCTS) returned to the Scottish Government rather than directly to the Scottish Consolidated Fund (SCF). This was not transferred back to SCF and effectively became Scottish Government working capital. In addition, £0.153 million of designated receipts due to be surrendered to the UK Consolidated Fund were sent to the Scottish Government bank account rather than to the Scotland Office.	We consulted with our technical experts and reviewed the transactions. We note that these monies were not formal revisions which required notification to Parliament and that this was an oversight. The Scottish Government have agreed to review their procedures going forward. **Recommendation 2**
7. Prestwick Airport Prestwick Airport transferred from Transport Scotland to the Scottish Government in January 2023. The transfer followed the formation of the Strategic Commercial Assets Division (part of Director General - Economy portfolio) who oversee the Scottish Government's commercial interests. The valuation, of £11.6 million, was based on an independent report in 2020/21 prepared as part of a proposed sales process. The valuation has not been updated to reflect current market value.	We accept management's view that a revaluation would not have a material impact on the value in the accounts and we acknowledge that an external valuation will be conducted before March 2024.
8. IFRS 16 Implementation The impact of implementing IFRS 16 was to reclassify leases that were previously treated as operating leases, requiring capitalisation of the underlying assets. The Consolidated Accounts refer to right of use assets and the related lease liability of £539 million. Within the Scottish Government core schedules, all future lease payments have been recognised as a Right of Use Asset (£54 million) together with a corresponding lease liability in the Statement of Financial Position. An adjustment was also required in respect of recognising peppercorn leases for the first time on the opening balance (£460,000).	We reviewed the IFRS 16 disclosures in the core schedules and agreed the balances to working papers and lease agreements. We confirmed that with the exception of a small number of errors, these were in line with relevant guidance.

Issue	Resolution
9. Prior year restatements A number of prior year restatements are noted in the Consolidated Accounts. These include: • The Scottish Government core accounts referred to £64 million for student loans incorrectly attributed to loan repayments in 2021/22 and which should not have decreased the outstanding loan balance. This adjustment affected the financial assets (note 11) and payables and other liabilities (note 14). • Trade payables (note 14) have reduced by £105 million as a result of a misclassification identified in the Social Security Scotland funding drawdown which was not reversed. A corresponding adjustment was made to increase the General Fund balance. • A net adjustment of £40 million impacted other payables and deferred income (note 14). The largest element of this (£35 million) was adjusted in respect of NHS Greater Glasgow and Clyde due to a reassessment of the recognition of services provided to other health boards. A corresponding adjustment was made to increase the General Fund balance.	We reviewed and assessed the restatements including assessing the assurances provided by other appointed auditors. We are content that the restatements have been appropriately reflected in the 2022/23 Consolidated Accounts.

Source: Audit Scotland

Student loans

21. In 2021/22 we reported that the working papers and engagement with the audit team on student loans had improved. We are pleased to confirm the continued improvement in engagement and the additional review undertaken by the Head of Finance and Procurement (Students Awards Agency Scotland) to ensure that the student loans recorded in the Scottish Government Consolidated Accounts were fully reconciled to supporting records. We did identify some areas for further investigation and discussion which will be taken forward by the Head of Finance and Procurement. These include:

- the disclosure of student loan debt write off as part of the losses and special payments note
- the separate disclosure of student loan debt written off and the unwinding of discounted cash flows in the financial assets note (note 11).

Non-current assets

22. The Scottish Government Consolidated Accounts record property, plant and equipment assets and intangible assets of £39 billion. The core Scottish Government holds assets worth £706 million.

23. As at 31 March 2023 there are over 1,500 assets with a nil net book value, which represents 39 per cent of the assets listed on their fixed asset register.

We are aware that the Scottish Government undertakes an annual asset verification exercise to identify assets which are no longer in use and which should be removed from the register. As part of this exercise, 370 assets were removed from the register during 2022/23. The verification exercise should result in assets that are no longer in use being removed from the register, or alternatively, asset lives being re-evaluated.

24. Reconciliations are carried out at the year end between the fixed asset register and the ledger. These reconciliations identified several variances between the two systems, often as a result of human error when inputting information onto the fixed asset register. This has resulted in several amendments in the fixed asset register in order to bring it in line with the ledger. We are aware that training has been provided to officers in an effort to reduce the level of human error.

25. As part of its corporate transformation programme, the Scottish Government intends to implement a new financial ledger during 2023/24 to replace the current main accounting system. We have been advised that the Scottish Government is undertaking a data cleansing exercise of all information held on the fixed asset register in advance of the introduction of the financial ledger system.

Our audit work responded to the risks of material misstatement we identified in the annual report and accounts

26. We have obtained audit assurances over the identified significant risks of material misstatement in the annual report and accounts. Exhibit 3 sets out the significant risks of material misstatement to the financial statements we identified in our 2022/23 Annual Audit Plan. It also summarises the further audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

Exhibit 3
Significant risks of material misstatement in the annual report and accounts

Audit risk	Assurance procedure	Results and conclusions
1. Risk of material misstatement due to fraud caused by management override of controls. As stated in the International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.	• Assess the design and implementation of controls over journal entry processing. • Make inquiries of individual involved in the financial reporting process about inappropriate or unusual journal activity. • Test journal entries and other adjustments during the financial year, at the year-end and post-closing entries. Focus on significant risk areas.	We undertook a range of audit work including: • detailed testing of journal entries, prepayments, accruals, accounting estimates and unusual transactions. • cut off testing. • reviewing the results of control testing and adjusting our samples where relevant.

Audit risk	Assurance procedure	Results and conclusions
This is presumed to be a significant risk in every audit.	• Evaluate significant transactions outside the normal course of business. • Assess any changes to the methods and underlying assumptions used to prepare accounting estimates compared to the prior year. • Substantive testing of income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year. • Focused testing of accruals and prepayments	The results of this audit work was satisfactory.
2. Estimation and Judgements – Student loans There is significant estimation and judgement in the measurement, valuation and disclosure of the material account area of Student Loans (2021/22: £4.8 billion). The assumptions used in the valuation model are highly dependent on the macroeconomic environment and as a result are likely to vary in the short term. Estimation and judgements create a higher risk that material areas in the financial statements could be misstated.	• Detailed review of the student loans model (assumptions and application). • Assess and where relevant test the management controls in place for the student loans model. • Focused substantive testing of student loans transactions and balances. • Evaluate significant transactions outside the normal course of business. • Consideration of student loans provision including movements. • Review of fair value adjustments affecting student loans asset.	Our audit work included: • review of the student loans model and the fair value adjustment affecting the student loans asset. • assessing the management controls in place for the student loans model. • substantive testing of student loans transactions and balances. The results of this audit work was satisfactory.
3. Risk of material misstatement caused by fraud in expenditure Practice Note 10 extends the requirements of ISA 240 to include consideration of fraud in expenditure for public bodies. This is a significant risk for the Scottish Government due to the high volume and diverse	• Analytical procedures across expenditure streams to support detailed testing. • Substantive testing of significant transactions across the financial year. • Monitoring of the budgetary process and reporting. • Substantive testing of expenditure transactions around the year-end to confirm they are	Our audit work included: • analysis of expenditure streams. • substantive testing of significant transactions across the financial year; and around the year-end. • substantive testing of accruals and prepayments.

Audit risk	Assurance procedure	Results and conclusions
nature of its expenditure. There is a risk that expenditure may be misstated resulting in a material misstatement in the financial statements. In addition, the auditor's opinion on Social Security Scotland agency accounts has been qualified on the grounds of regularity in respect of benefit expenditure each year. As the value of benefits administered by Social Security Scotland increases there is also a need to develop an estimate of the associated level of fraud and error.	accounted for in the correct financial year. • Substantive testing of accruals and prepayments. • Consider any relevant internal audit reports. • Regular communication with auditors of Social Security Scotland.	The results of this audit work was satisfactory.

Source: Audit Scotland

27. In addition, we identified "areas of audit focus" in our 2022/23 Annual Audit Plan where we considered there to be risks of material misstatement to the financial statements. Based on our assessment of the likelihood and magnitude of the risk, we did not consider these to represent significant risks. These areas of specific audit focus were:

- **Estimation and judgement – provisions, financial guarantees and investments**. We tested a sample of significant financial provisions, investments and guarantees and reviewed the appropriateness of the valuation of investments. We have included details of the more significant elements in Exhibit 2 and have concluded that the balances and disclosures within the annual report and accounts are not materially misstated.

- **IFRS 16 implementation**. We reviewed the IFRS 16 disclosures in the core schedules and agreed the balances to working papers and lease agreements. We confirmed that with the exception of a small number of errors, these were in line with supplementary guidance. Auditors of bodies within the consolidated boundary undertook similar reviews and our work on consolidation agreed the significant components to relevant audited accounts (Exhibit 2, point 8)

- **Presentation and audit of financial statements.** We noted that while both the core schedules and consolidated accounts were provided to audit by the dates agreed, there were omissions in both which impacted on the efficiency of the audit process (refer to Recommendation 1).

There were a number misstatements identified within the financial statements

28. There were presentational and monetary audit adjustments to the unaudited Consolidated Annual Report and Accounts. These were discussed with senior officials who agreed to make the necessary changes.

29. Gross monetary misstatements for the Scottish Government core portfolios, in excess of the ‘reporting threshold' amount (£0.25 million) totalled £34 million and were adjusted in the final accounts.

30. We are required to report all unadjusted misstatements which we identified during our audit, other than those of an insignificant small amount. The total unadjusted error within the Consolidated Accounts is £184.1 million. This balance is made up of £34.4 million relating to the core Scottish Government, £147.2 million relating to NHS bodies and £2.5 million relating to agencies and other consolidated bodies. Appendix 2 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 by £0.8 million and decrease net assets by £2.9 million.

31. 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.

Prior year recommendations are being progressed

32. The Scottish Government has progressed the prior year audit recommendations as detailed in Appendix 1.

2. Financial management

Financial management means having sound budgetary processes, and the ability to understand the financial environment and whether internal controls are operating effectively.

Conclusion

Total spending was underspent by £509 million (1 per cent) against a budget of £50,276 million. This does not represent a future funding loss as the relevant underspend, as set out in the provisional and then final outturn, will be carried forward in the Scotland Reserve and applied in 2023/24.

The Scottish Government has effective financial management arrangements and, during 2022/23, responded well to emerging pressures.

The Scottish Government has strengthened its strategic approach to, and ongoing management of, financial interventions with the establishment of the Strategic Commercial Assets Division.

Scottish Government underspent its budget by £509 million in 2022/23

33. The Consolidated Accounts show that total net expenditure during 2022/23 was £49,767 million, £509 million less than budget (Exhibit 4). The resource budget was underspent by £188 million (0.4 per cent) against a budget of £47,895 million. Capital was underspent by £321 million (13.5 per cent) against a budget of £2,381 million. High-level reasons for significant variances between actual and budgeted spend are included in the Consolidated Accounts.

34. The largest resource variances related to:

- Health and Social Care (£211 million) - lower than anticipated non-cash accounting transactions, including NHS provisions, impairments and depreciation.
- Net Zero, Energy and Transport portfolio (£62 million) - underspends in relation to Active travel, low carbon and other transport initiatives.

35. The largest capital variances occurred in:

- Education and Skills portfolio (£94 million) - due to the accounting for student loans with applications for loan funding being less than expected and student loan repayments being higher. This was partially offset by the impact of increases in the Bank of England base rate.

- Social Justice, Housing and Local Government portfolio (£72 million) - primarily due to higher than anticipated capital receipts from individual home owners who are part of the shared equity schemes.

Exhibit 4
Performance against fiscal resource in 2022/23

Performance	Final budget £m	Outturn £m	Over/(under) spend £m
Resource	47,895	47,707	(188)
Capital	2,381	2,060	(321)
Total	50,276	49,767	(509)

Source: Scottish Government Consolidated Accounts 2022/23

Budget processes were appropriate and responded to emerging pressures

36. The Scottish Government budget was increased as part of the Autumn and Spring Budget revisions. The major areas of additional expenditure at the Scottish Government as a result of the Spring Budget Revision included:

- £292.2 million of additional capital funding and £135 million of resource funding to Health and Social Care to support services
- an increase in gross funding to Social Security Scotland of £185.3 million (offset by £62.1 million funding reductions where forecasts have reduced) to fund increases in demand led benefit expenditure
- £178.9 million relating to additional funding provided to Social Justice and Local Government to support the Ukrainian Resettlement Directorate
- a further funding allocation of £130.6 million provided to the Justice and Veterans portfolio to fund Police and Fire Pensions.

37. During the year, the Scottish Government carried out two Emergency Budget Reviews (EBR). The EBRs consisted of a thorough review of all devolved spend planned for 2022/23 across all portfolios. It focused on identifying opportunities for savings that could then support measures to help with the cost of living crisis and support a path to balance in light of emerging pressures including inflation, pay deals and increased demand.

38. In September 2022, a package of £560 million savings was proposed. These savings included:

- budget reduction of £53 million for employability schemes

- increased in-year funding of up to £56 million generated by the ScotWind clearing process
- reduction of £37 million in concessionary fares spend
- spending reductions of £33 million to agriculture funds, with a commitment that this will be returned in future years.

39. The November 2022 review identified additional options for spending reductions and reprioritisation in order to support public sector pay and cost of living support. These amounted to around £615 million and fall across the government including:

- reprioritisation of spend within the Health and Social Care (which includes reprofiling of the National Care Service, utilisation of reserve funding held by integration authorities, mental health reduction)
- further resource savings of £33 million from across the Scottish Government
- approximately £180 million of capital and financial transaction reductions to support wider financial management (construction delays in further education projects, City Deals re-profiling, Low Carbon Funds).

40. The EBR also identified areas of growth with savings to fund around £35 million for a range of initiatives to provide support with the increased cost of living. These included an increase to the fuel insecurity fund, Scottish Child Bridging Payment and a new Island Cost Crisis Emergency Fund to help island households manage higher energy costs.

41. During 2022/23 there has been an increased focus on workforce planning, with recruitment controls introduced. These included the requirement for Director General approval before any internal or external recruitment, re-grading of roles and new temporary responsibility supplement opportunities. These measures are expected to be in place until the end of 2023/24 financial year.

Work is continuing to strengthen the strategic approach to, and ongoing management of, financial interventions

42. In March 2022, the Scottish Government published its Business Investment Framework to outline its principles and approach for decisions about future investment in private companies. The framework forms part of its investment guidance within the Scottish Public Finance Manual.

43. The framework is currently being updated to take account of the lessons learned reviews and ongoing engagement with the audit team.

44. During 2022/23, the Strategic Commercial Assets Division (SCAD) was formed. Its main purpose is to consolidate expertise and knowledge and increase capacity to respond to cases that arise seeking support or intervention from the Scottish Government and provide support across the whole lifecycle. The Division is now fully established with five units covering initial assessment for investment through to potential exit strategy.

45. SCAD is developing guidance around legal and commercial due diligence together with associated checklists. In addition, a number of reviews have been undertaken by independent consultants in order to learn lessons from earlier interventions.

46. Exhibit 5 outlines the financial support that has been made to private companies that are now being managed by SCAD. This is in addition to support provided through other bodies including the enterprise agencies, Scottish Enterprise, Highlands and Islands Enterprise and South of Scotland Enterprise.

Exhibit 5
Financial interventions to private companies

Financial intervention	Total financial investment	Current value in Consolidated Accounts
Prestwick Airport Purchased by the Scottish Government in November 2013 with the stated aim of protecting jobs and safeguarding the asset. Responsibility transferred from Transport Scotland to the Scottish Government in January 2023. [Total investment consists of capital (£43.4 million) and interest (£9.1 million)]	£52.5 million	£11.6 million
Ferguson Marine (Port Glasgow) Holdings Limited Established by the Scottish Government in December 2019 after Ferguson Marine Engineering Limited (FMEL) went into administration. The existing voted loans (£97.7 million) were terminated and the difference between the valuation of the ferry vessels (£74.8 million) and the valuation of the outstanding loans (£22.9 million) was written-off in 2020/21	£237.5 million	£82.6 million
Burntisland Fabrications Limited (BiFab) In 2018/19 the Scottish Government converted £37.4 million commercial loans into equity representing a total equity stake of 32 per cent. BiFab were placed into administration in December 2020 and the Scottish Government is now pursuing a return through the administration process.	£50.9 million	Nil

Financial intervention	Total financial investment	Current value in Consolidated Accounts
Lochaber Aluminium Smelter – Liberty Group In December 2016, the Scottish Government issued a 25-year financial guarantee contract to SIMEC Lochaber Hydropower Limited. The Scottish Government receives an annual fee in return for the guarantee. The annual exposure to the Scottish Government is between £14 million and £32 million, over the lifetime of the contract.	Nil	Provision of £135 million

Source: Audit Scotland

The Scottish Government is actively managing the financial risks associated with the upcoming closure of the European Structural and Investment Funds

47. The Scottish Government is responsible for managing two European Structural and Investment Funds for the period 2014 to 2020; the European Social Fund (ESF) and the European Regional Development Fund (ERDF). The Funds remain operational with access to funding available until June 2024.

48. A different methodology for reclaiming costs was agreed with the EU following the suspension of the ESF programme. The suspension was lifted in October 2022. As a result of implementing the new methodology, the Scottish Government anticipates being able to reclaim less than it pays out to lead partners. As a consequence, and in line with accounting standards, the Scottish Government assessed the recoverability and have written off £36 million to date (£16 million in 2020/21; £2 million unwinding of the write-off in 2021/22, and a further £21.5 million in the 2022/23 Consolidated Accounts) in respect of grant payments already made.

49. In addition, the Scottish Government has reviewed the calculation underlying the provision and assessed that the 2021/22 provision of £43 million relating to the future under-recovery of costs to be higher than required and has reduced the provision by £35 million, to £12 million. We have assessed the calculation and, taken together with the increased level of write off, the reduction in time remaining in the programme and the revised methodology, has resulted in a reasonable reflection of the provision. (refer to Exhibit 2, point 3)

50. The Scottish Government recognises the risk around the receipt, checking, claiming and disbursement of EU funds. A number of mitigating actions have been introduced to ensure they maximise the income to be received.

51. Following the UK's withdrawal from the European Union, ESF and ERDF funding is being replaced by UK Government-led funding programmes including the Shared Prosperity Fund, Community Renewal Fund, Community Ownership Fund and the Levelling-up Fund. Guidance setting out the requirements of the Shared Prosperity Fund was issued in August 2022. The UK Government has committed to match previous EU funding. Under the Withdrawal Agreement, the UK will continue to participate in the Multiannual Financial Framework programmes, like ESF, until it ends in 2024.

Apart from payroll, the Scottish Government's systems of internal control operated effectively

52. As part of our audit, we identify and test the key controls in the main accounting systems of the Scottish Government which we regard as significant to produce the financial statements. Our objective is to gain assurance that the Scottish Government has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

53. 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 2023. We concluded that, other than payroll, the Scottish Government's main systems of internal control operate effectively.

54. Our work on the payroll system identified instances where controls did not operate as expected resulting in weaknesses in the payroll reconciliation process and team leader checks. In response we adapted our audit approach for the financial statements, including increasing our substantive testing, and obtained the necessary assurances to support our audit opinion.

55. We recognise that management continue to make improvements to the payroll control environment and the introduction of the new HR and payroll system should address some of the control issues identified. However, there are still areas where management action is required to reduce the risk of fraud and error.

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

56. In the public sector there are specific fraud risks, including those relating to tax receipts, welfare benefits, grants and other claims made by individuals and organisations. Public sector bodies are responsible for implementing effective systems of internal control, including internal audit, which safeguard public assets and prevent and detect fraud, error and irregularities, bribery and corruption.

57. The Scottish Government has a number of arrangements in place in respect of prevention and detection of fraud and error; these include a guidance note on *Counter-Fraud, the Scottish Government Guide* which applies the principles from the SPFM to the Scottish Government directly. The guidance includes specific details of the fraud investigation process through the fraud response plan.

58. There is also a Whistleblowing policy in place and is available to all staff on the intranet; it includes a detailed flowchart which summarises the steps for raising, forwarding and investigating concerns.

59. The Scottish Government continues to develop its counter fraud activity with progress reports considered by the Scottish Government Audit and Assurance Committee twice a year.

60. Work is ongoing to improve the Scottish Government's understanding of its exposure to the risk of fraud and corruption. The Scottish Government is applying a Strategic Fraud Risk Profile tool which will create a high level 'heat map' of fraud risk across the Scottish Government. This tool should enable a high level review of inherent fraud risks and should provide a consistent approach across business areas.

61. An annual report on fraud within the Scottish Government's consolidation boundary is considered by the Scottish Government Audit and Assurance Committee. This includes information on any identified cases of fraud and error during the financial year.

62. The Scottish Government has adequate arrangements in place to prevent and detect fraud or other irregularities.

63. The register of interests for corporate board members is disclosed within the Scottish Government's performance report. Our review of the register of interests found that this was incomplete for some staff members of the board. In some instances there were no returns from board members and this was assumed that there were no directorships or significant interests held in the year. For completeness, we would expect returns to be submitted by all corporate board members including those who have nothing to disclose.

64. We have been advised that the Scottish Government is in the process of reviewing the policy on declaration and management of interests in line with new cabinet office guidance. In addition, the new HR system being introduced as part of the corporate transformation process, is to be configured to support the new process which is expected to include some improvements, including an upfront declaration of 'nil return' as well as easier real-time reporting and integration of system prompts to declare and review interests when individuals join the organisation and move posts. The new system will also prompt a review at least annually as part of end year performance review process.

The Scottish Government actively engages with the National Fraud Initiative

65. 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 actively engages with the NFI exercise.

66. There were 4,132 matches identified for the Scottish Government in the current exercise of which 1,007 are high risk matches. To date the Scottish Government has reviewed 3,045 (74 per cent) matches with one error identified.

67. Overall, good progress has been made with the follow up of matches, with work to review creditors matches ongoing and four payroll matches under investigation at this stage.

3. Financial sustainability

Financial Sustainability means being able to meet the needs of the present without compromising the ability of future generations to meet their own needs.

Conclusion

The public sector in its current form is not affordable. The Scottish Government must develop a programme of public service reform which balances the short-term financial pressures with the need for longer term change, recognising that this may require financial investment.

Workforce reform is essential to achieving financial sustainability, particularly given the recent pressures from public sector pay settlements. The Scottish Government needs to work with partners to make changes to the design and delivery of services.

During 2022/23 the Scottish Government borrowed £347 million from the National Loans Fund to support revenue and capital expenditure. Loan repayments are increasing and the Scottish Government will need to manage these repayments, alongside all other financial pressures, in the years ahead.

The Scottish Government is currently considering a revised approach to meet its commitment to the development of a devolved public sector account, however no real progress has been made during 2022/23.

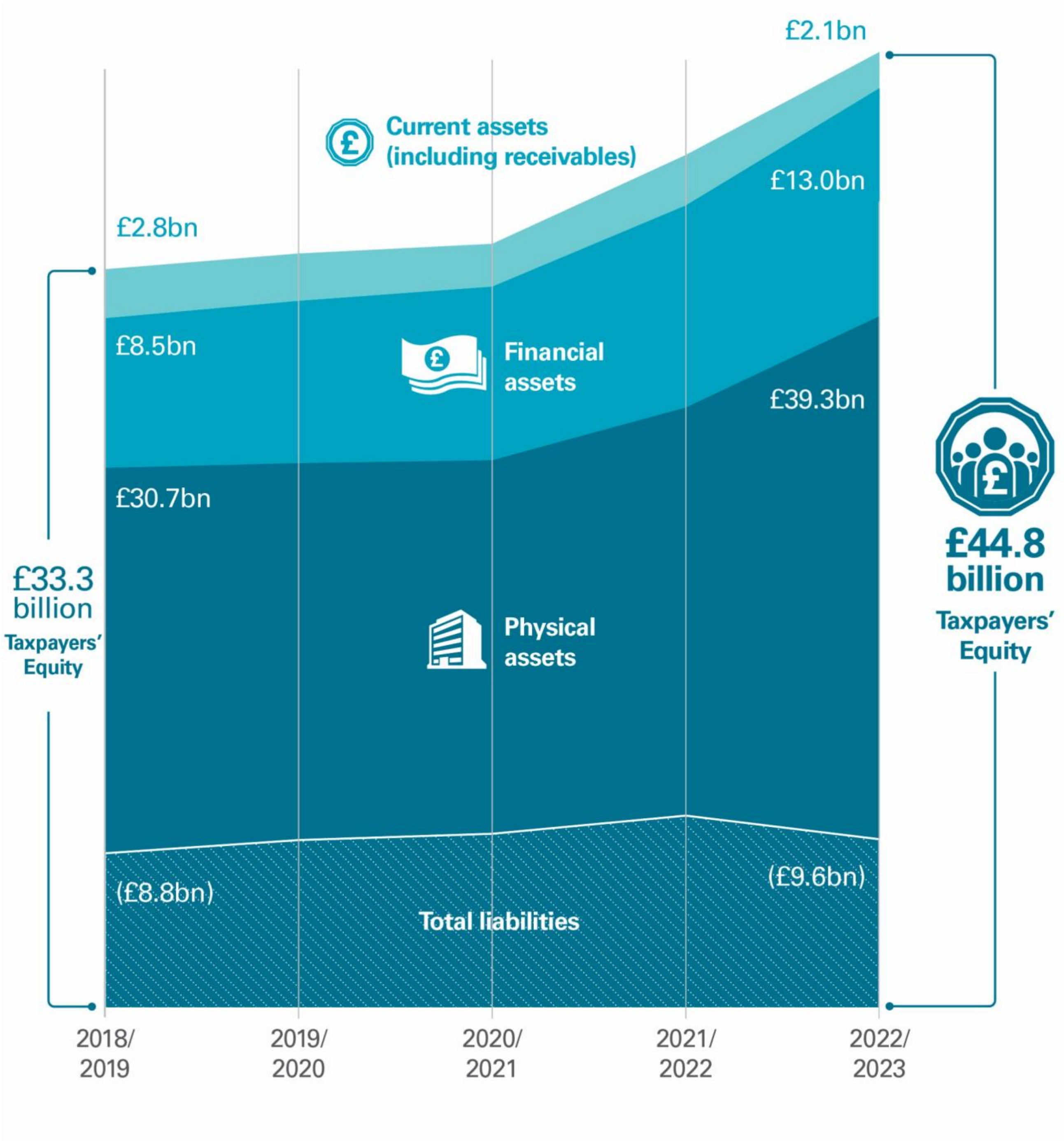
The Consolidated Accounts show a strong financial position, but this does not provide a full picture for the Scottish public sector

68. 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, borrowing and devolved taxes) and how much resulted from changes in the value of physical assets over time.

69. As detailed in Exhibit 6, taxpayers' equity has increased in each of the last five years from £33.3 billion to £44.8 billion, largely due to an increase in physical assets (such as property and roads) and financial assets (such as

loans and investments). Total liabilities (such as payments for private-financed projects) have increased from £8.8 billion in 2018/19 to £9.6 billion in 2022/23.

Exhibit 6
Financial position



Source: Scottish Government Consolidated Accounts

70. It is important to note that the position does not reflect all the assets and liabilities of the Scottish public sector. These accounts do not include resource and capital borrowing (paragraph 78), local government assets and borrowing

and all public sector pension liabilities. In 2016, the Scottish Government committed to producing a consolidated account to cover the devolved public sector in Scotland but this has not yet been achieved.

71. The original plan was for the wider Scottish public sector consolidated accounts to utilise data from the Whole of Government Accounts (WGA) process prepared by HM Treasury. The Covid-19 pandemic has had a significant impact on the WGA process with the 2020/21 account not signed off until July 2023.

72. In addition, due to the impact of Covid-19 pandemic on the audit regime across the UK, HM Treasury has raised the threshold for audit review. This means that the WGA returns for the majority of Scottish public sector bodies are below the audit threshold. The level of assurance that could be taken from the process would therefore be reduced.

73. The Scottish Government, in discussion with the audit team, are exploring the most effective and efficient method to prepare these accounts whilst ensuring they are meaningful and transparent. An alternative approach is currently being developed by the Scottish Government to permit the timely production of the information.

Recommendation 3

The Scottish Government needs to agree its approach to the provision of consolidated information for the Scottish public sector and agree a timetable for completion as a matter or priority.

In 2022/23 the Scottish Government utilised borrowing powers to support spending plans

74. 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 or £450 million. In 2022/23, the Scottish Government borrowed £300 million, less than the £450 million that was outlined by Scottish Ministers in the budget. The loans will be repaid to the National Loans Fund over 15 years, in line with the timescales outlined in the Fiscal Framework. The 2022/23 borrowing was used to support the overall capital programme.

75. In 2022/23, the Scottish Government borrowed to fund resource expenditure, as it has done in 2020/21 and 2021/22. During the year it borrowed £47 million from the National Loans Fund to be repaid over five years. The £300 million limit for resource borrowing was revised to £600 million for financial years 2021/22 to 2023/24 due to the conditions for a Scotland-specific shock being met. The Scottish Government can only apply this borrowing to meet forecast error in relation to tax receipts or demand-led social security spending.

76. As at 31 March 2023, the total principal level of capital borrowing outstanding was £1,542.7 million, with interest of £249.7 million applying over its remaining life, up to 25 years. Resource borrowing outstanding at

31 March 2023 was £480.4 million with interest of £17.1 million accruing over the five-year repayment period.

77. Due to the accumulation of annual borrowing in recent years, loan repayments are increasing and totalled £160 million in 2022/23 (£95 million in 2021/22). The Scottish Government will need to continue to manage this financial pressure of repayments alongside all other financial pressures in the years ahead.

78. Details of the overall loan, repayments and interest payments are outlined in the Consolidated Accounts. The Scottish Government's borrowing and associated repayments are made via the Scottish Consolidated Fund (SCF). Borrowed amounts and repayments are made between the SCF and UK National Loans Fund with the corresponding adjustments made to funding received by the Scottish Government. 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 borrowing and the associated liability are set out within a separate account prepared for the SCF.

Significant risks remain for the 2023/24 financial position

79. The 2023/24 Scottish Government Budget was passed by Parliament in February 2023 and was set at £59.7 billion. The current tough economic conditions, including pressures and demands arising from high inflation, has continued to intensify the financial pressure being faced by the Scottish Government.

80. Achieving financial balance in 2023/24 is a significant challenge. The Scottish Government has identified key pressures as well as some savings opportunities to close the gap. It recognises that further work is required to ensure a credible path to balance is maintained. Financial management has been a core element of the assurance and governance arrangements with the budget being closely managed, however significant risks remain.

The Scottish Government has prepared a medium-term financial strategy but the outlook is extremely challenging

81. In May 2022 the Scottish Government published its first Resource Spending Review (RSR) since 2011. The RSR set out indicative spending plans for five years up to 2026/27 aimed at delivering on its Programme for Government and Bute House Agreement commitments. It also highlighted the economic and fiscal challenges facing the government over the medium term. High-level spending plans were outlined for each government portfolio and included a number of assumptions and expectations.

82. Since then, the Scottish Government produced its sixth Medium-Term Financial Strategy (MTFS) in May 2023. The MTFS provides an assessment of the medium-term outlook for Scotland's public finances covering 2023/24 to 2027/28. The 2023 Strategy sets out its assessment of Scotland’s economic and fiscal outlook, alongside plans to manage the financial risks, as well as a broad spending outlook considering the effects of changing funding levels for government spending as outlined in the RSR. The 2023 MTFS recognises that the fiscal environment has changed since the previously published Resource and Capital Spending Reviews and commits to revising them.

83. The Scottish Government continues to face significant pressures on public finances resulting from a range of issues. These include the cost-of-living crisis, inflationary pressures, public sector pay, demand-led expenditure, the cost of delivering the statutory targets for child poverty and net zero, together with the impact of an aging population. Fiscal sustainability is one of the highest-ranking risks in the corporate risk register.

84. The Scottish Government expects available resource funding to grow from £45.3 billion in 2023/24 to £51 billion by 2027/28, an increase of 12.6 per cent (cash terms) and 6.8 per cent (real terms). This is due to increases in the Block Grant and the growth of the net tax position over this period. However, the projected increased spending over the medium term outstrips the forecasted increase in funding.

85. Scottish Government resource spending is forecast to increase from £45.3 billion in 2023/24 to £52.8 billion in 2027/28. This is an average increase of 3.6 per cent a year, higher than the forecast funding growth of 3.1 per cent. Current projections indicate a resource funding deficit of £1 billion (2 per cent) in 2024/25, rising to £1.9 billion (4 per cent) in 2027/28.

86. The capital funding outlook is even more challenging. Between 2023/24 and 2026/27 capital funding is expected to fall by 1.6 per cent (cash terms) representing a 6.7 per cent real terms reduction. This is due to the UK Government’s policy of holding capital spending flat in cash terms beyond 2024/25.

87. The projected capital spending outlook shows an increase from £6 billion in 2023/24 to £6.8 billion in 2025/26. As a result of the expected real terms fall in capital funding this will result in a 16 per cent capital funding deficit in 2025/26. This means the Scottish Government cannot deliver all their capital commitments to the original timescales within the funding available. We are aware that a programme of reprioritisation of capital projects is currently underway to address this. The Scottish Government needs to prioritise, delay or cancel projects and programmes in its Infrastructure Investment Plan and this should form part of the updated capital spending review (due to published alongside the 2024/25 budget).

88. The overall conclusion from the MTFS is that the Scottish Government will find it extremely challenging to remain within its future funding levels. We believe that public service reform is essential if the Scottish Government is to deliver on its commitments.

The current delivery of public services is not affordable and the Scottish Government needs to make changes to the design and delivery of services

89. As part of the MTFS and the First Minister's Policy Prospectus (April 2023), the Scottish Government set out a ten-year programme of public service reform. In response to this commitment the Scottish Government established the Public Service Reform Directorate which has responsibility for overseeing the range of activities across policy areas and identifying common themes, conditions and characteristics of reform. Directors General, as Accountable Officers, will update regularly to the Executive Team and Assurance groups, with Corporate Board having general oversight of progress.

90. A Public Services Reform Steering Group, which includes senior external representatives as well as some Non-Executive Directors (NXDs), provides advice and insight on how best to progress the public service reform programme. The Reform Action Group provides an internal forum for Director-led collaboration on reform issues and a new depute director and operational lead group is being established to share and discuss experiences.

91. The Scottish Government is working with public bodies to identify barriers and opportunities for reform, and to establish what actions and decisions would be required. Core templates and a framework for action were issued, and returns are currently being reviewed and collated. A focused workstream on potential revenue raising opportunities from public bodies will report later in the year, and three further thematic clusters with bodies collaborating on specific issues or topics have been established with initial outputs expected in early 2024. In addition, the Verity House Agreement commits the Scottish Government and local government to work together on a joint approach to reform.

92. Public service reform will take time and there is a need to balance short term efficiencies, to assist the challenging immediate financial situation, with longer term 'spend to save' options.

Recommendation 4

The Scottish Government must develop a clear roadmap of how the design and delivery of public services will be transformed to be financially sustainable.

Workforce reform is essential to achieving financial sustainability

93. In the RSR, the Scottish Government committed to keeping the total cost of the overall annual pay bill the same as 2022/23 from 2023/24 onwards and returning the total size of the devolved public sector workforce to around pre-Covid-19 levels by 2026/27.

94. The Scottish Government has now moved away from this approach, instead setting out a broader obligation for public sector bodies to ensure workforce plans and projections are affordable.

95. Workforce reform is part of the Scottish Government's wider approach to reforming Scotland's public services. It has set out a two-track approach to reform, targeting short-term efficiencies alongside more systemic long-term reform. Immediate reform areas include making efficiencies in service delivery, as well as new pay and workforce strategies.

96. Higher levels of inflation have meant that managing the in-year consequences of pay settlements has been particularly challenging over the last two years. The Scottish Government has agreed over £1.7 billion extra in pay deals during 2022/23 and 2023/24 and will have to make in-year budgetary changes to meet these costs. Recent pay deals have not been in accordance with the Scottish Government's pay policy. In addition wider changes to terms and conditions may be agreed, such as the NHS Agenda for Change and an independent review looking into police officers pay and benefits, which are likely to result in higher costs.

97. The MTFS identifies that NHS workforce will continue to grow which will in turn place pressure elsewhere in the system. Any decisions about the NHS workforce size and costs will have a large impact on Scottish Government sustainability in the medium term.

Recommendation 5

The Scottish Government should ensure it has a cohesive workforce strategy that factors in the impact of growth in the NHS.

The Scotland Reserve is an important component of the financial management system which supports longer term planning

98. The Scotland Act 2016 allows the Scottish Government to build up funds when devolved revenues are higher than forecast, smooth all types of spending (including carrying-forward underspends), assist the management of tax volatility and determine the timing of expenditure. The Scotland Reserve applied from 2017/18 onwards and is split between resource and capital.

99. The Scotland Reserve is capped at £700 million and annual drawdowns are limited to £250 million for resource and £100 million for capital. These drawdown limits were removed for years 2021/22 to 2023/24 as the Scottish Fiscal Commission forecast a Scotland-specific economic shock.

100. The Scottish Government's policy is to apply any underspends for use in the following financial year. The 2022/23 provisional outturn statement notes that £700 million was used to support expenditure in 2022/23 with a further £244 million due to be applied in 2023/24.

101. There is publicly available information about the Scottish Government's approach to the Scotland Reserve. There is also information available about the intended drawdowns from the Reserve to support annual spending plans and reporting on Reserve movements. The Scotland Reserve balance is not reported in the financial statements within the Scottish Government consolidated accounts. Information about the Scotland Reserve should be considered as part of the Scottish public sector consolidation detailed at paragraph 73 above.

A Revised Fiscal Framework has now been agreed

102. In August 2023 the Scottish and UK Governments jointly announced that they had reached agreement on revisions to the existing 2016 Fiscal Framework that governs funding arrangements for the Scottish budget. The Fiscal Framework sets out how the additional taxation and social security powers devolved by the Scotland Act 2016 will be administered.

103. The measures in the revised agreement apply immediately. The changes agreed are incremental, with the existing approach largely continuing with the introduction of some additional flexibilities to better accommodate the uncertainty and volatility that is now inherent in the Scottish public finances. These flexibilities include an increase to the borrowing limits and the use of reserves.

104. The increased flexibility around borrowing limits and the use of reserves will impact directly on the Scottish Government's budget. However as noted above in paragraph 77, any increase in borrowing, particularly resource borrowing which is repaid over a shorter period and with currently higher interest rates, will still fall to be met alongside all other financial pressures.

4. Vision, leadership and governance

Public sector bodies must have a clear vision and strategy and set priorities for improvement within this vision and strategy. They work together with partners and communities to improve outcomes and foster a culture of innovation.

Conclusion

The Scottish Government has well established assurance arrangements in place, however given its complexity there is potential for duplication and inefficiency. The whole governance and assurance arrangements should be refined and streamlined. We recognise that the Scottish Government are piloting new approaches to ensure they remain appropriate.

Corporate transformation is a way for the Scottish Government to achieve greater efficiencies and must be an immediate priority. Due to the scale and complexity of the programme there remains risk around the implementation date for the key HR and finance systems. Any increasing costs as a result of the delay in implementation will need to be managed.

The recent due diligence process for MV Glen Sannox and MV Glen Rosa (vessels 801 and 802) was robust and, as the value for money test for MV Glen Rosa (vessel 802) was not evidenced, resulted in the Director General - Economy receiving a Written Authority to proceed.

Governance arrangements continue to operate effectively

105. The Scottish Government has well established assurance arrangements in place, involving both Senior Management Team and NXDs, including:

- Corporate Board - meets quarterly to provide strategic oversight on key areas including strategy, performance and governance.
- Audit and Assurance Committee - meets quarterly to assess the effectiveness of the assurance arrangements in place.
- Director General Assurance Boards - quarterly meetings for each held portfolio to assess assurance arrangements for performance, finance, people and risk management.

- Executive Team - twice weekly meetings in various 'modes' to support focused consideration of key areas, for example delivery, strategic, people and investment assurance.

106. We have previously reported that many of the main governance groups are attended by the same individuals (both executive and non-executive) and cover similar topics, themes and risks. This introduces potential duplication, inefficiency, or blurred lines of responsibility between the different roles and remits of each group.

107. We are aware from our attendance at Assurance Group meetings that alternative approaches are being piloted, however the whole governance and assurance process should be reviewed, refined and streamlined where appropriate. The role of the Audit and Assurance Committee is paramount in ensuring efficient and effective arrangements are in place to provide advice, support and challenge to the Permanent Secretary, and in doing so, promoting good governance across the organisation.

Recommendation 6

A review of governance and assurance arrangements within the Scottish Government should be completed to ensure they are efficient and effective.

108. 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 the Scottish Government 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 2022/23. We reviewed these arrangements and concluded that they are appropriate, that the Governance Statement is consistent with the financial statements and has been prepared in accordance with guidance issued by the Scottish Ministers.

109. The Permanent Secretary (appointed January 2022) continues to review and develop the governance arrangements. In the Governance Statement the Permanent Secretary refers to the ongoing review of governance arrangements with the introduction of a Strategic Design Authority (to provide strategic oversight in relation to organisational development) and the Executive Team Investment Assurance mode (to support a consistent and sound evidence base for future financial commitments).

Risk management arrangements have continued to develop

110. Risk management is a standing agenda item at assurance group and other governance meetings. Development of risk management across the Scottish Government has continued to develop during the year resulting in the review of the Scottish Government's Risk Management Strategy and Policy which was completed in June 2023 alongside a review of internal guidance. We observed robust discussions on the relevant aspects of the risk register at the Director General assurance board meetings.

111. We have also referred, in previous reports, to workforce capacity and capability. The Principal Accountable Officer comments in the Governance Statement that this remains an issue of concern but that steps are being taken to address this.

112. There continued to be considerable strain placed on staffing capacity and wellbeing due to the volume of challenges faced by the Scottish Government throughout the year, most notably both the UK and Scottish Covid-19 inquiries and the response to the crisis in Ukraine. The risk around capability, capacity and wellbeing has been highlighted as a key cross-cutting risk on the corporate risk register.

There have been delays to the delivery of the corporate transformation programme and this, alongside the increasing costs, must be actively managed

113. The Scottish Government recognises the risk that the current HR and financial ledger systems are no longer fit for purpose due to the lack of investment in these key systems.

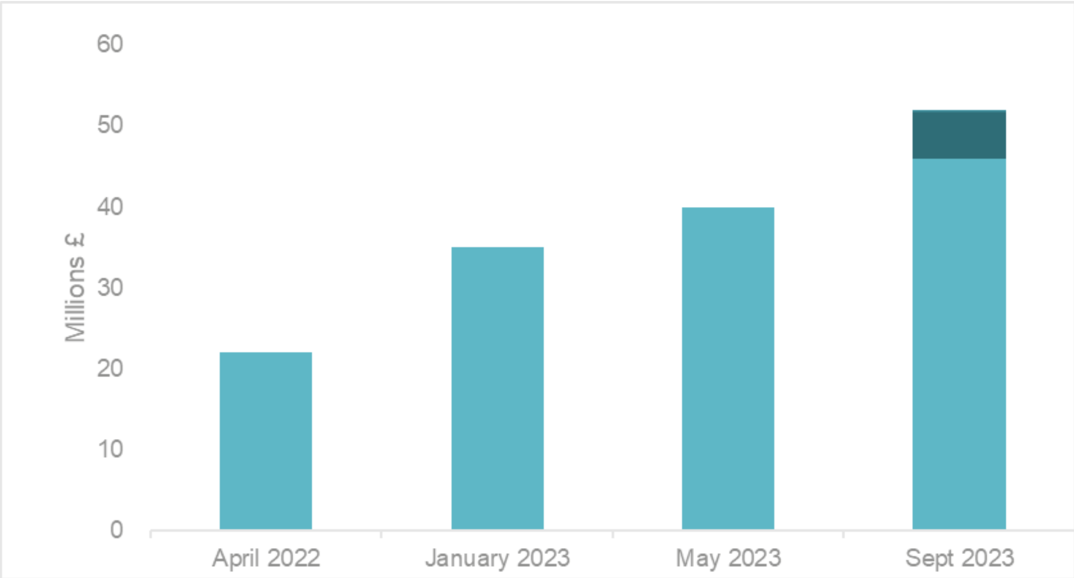
114. As part of its corporate transformation, the Scottish Government Shared Services Programme (SSP) is set to deliver a new HR and Finance system (Oracle Cloud), which replaces decades-old systems and is expected to provide shared services to Scottish Government core and over 30 public bodies. The original expectation was that the new HR module will be introduced between July and September 2023, followed by the introduction of a new finance system and associated modules by the end of 2023.

115. The Full Business Case for the Scottish Government Shared Services Programme Phase 1 (HR & Finance) was approved in April 2022. The Business Case has since been refreshed as a result of changes in timing and the impact of inflation on forecast costs.

116. There have been changes to the initial timeframe with the current expected go-live date now being April 2024 for both elements. There are some delays in reaching milestones around the finance system and there is a possibility that the go live for this part of the system will be delayed again. We are aware of the continuing challenges to the project around increased costs and complexity, and organisational capacity and capability challenges.

117. As shown in Exhibit 7, the cost of the project which was originally estimated to be approximately £22 million in April 2022 has increased to £35 million in January 2023 and to £40 million in May 2023. As at September 2023, the current estimated cost range is £46 - £52 million which takes account of increased costs due to an initial underestimation of the scale and complexity of the programme, and associated re-stated timelines. Cost benefit analysis undertaken by the Scottish Government indicates that the costs of running the new system over the next 7 years will be £56.9 million, compared to £82.8 million for the current system.

Exhibit 7
Shared Service Project cost



Source: Scottish Government

118. The successful implementation of this new finance system is essential in terms of contributing towards financial sustainability due to reduced continuing cost, public service reform due to the ability to further share services and will increase the reliability and security around this key financial system.

Recommendation 7

The Scottish Government should provide some clarity on how it will implement the Shared Services Programme in the face of increasing costs, while also ensuring that the constraints to delivery are addressed in order to avoid additional delays.

119. In addition to the new HR/Finance IT system the Scottish Government is continuing with its corporate transformation programme. This encompasses five key priorities: enabling a culture of continuous improvement, the People Strategy, the HR and Finance Transformation, the Technology Roadmap, and the Hybrid Estates Strategy. Resource and capacity challenges continue to underpin these projects.

120. The review of the Scottish Government estate is one of the key strands of the transformation programme. The Auditor General for Scotland reported in Investing in Scotland's infrastructure (September 2023) that the Scottish Government should consider how the public sector estate can support transformation of services as well as reducing the size of the estate and making it more efficient.

The recent due diligence process for MV Glen Sannox and MV Glen Rosa (vessels 801 and 802) was robust, but timelines are extending and costs continue to increase

121. 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 (MV Glen Sannox and MV Glen Rosa [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.

122. 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, Ferguson Marine (Port Glasgow) Holdings Limited (FMPG), which is a company wholly owned by Scottish Ministers established under the Companies Act 2006.

123. The oversight of FMPG by the Scottish Government is undertaken by a specific Ferguson Marine Governance and Oversight Unit which is part of SCAD. SCAD is being proactive in addressing matters raised in response to previous audit reports. An intervention assurance action plan has been prepared drawing from these reports with updates to actions taken.

124. Work to revise the framework agreement is ongoing and will set out the obligations and requirements for FMPG as a public sector organisation. The framework will include reference to compliance with the Scottish Public Finance Manual and is anticipated to be finalised by December 2023.

125. The Scottish Public Finance Manual (SPFM) requires the Accountable Officer to ensure the propriety and regularity of finances and ensure that any resources are used economically, efficiently and effectively, that is that value for money is achieved. If value for money cannot be achieved then the Accountable Officer should obtain written authority from ministers before taking any further action. Exhibit 8 outlines the timeline, associated costs to complete the vessels and due diligence process that have taken place.

Exhibit 8
MV Glen Sannox and MV Glen Rosa (vessels 801 and 802): timeline and due diligence

Date	MV Glen Sannox (vessel 801) timeline	MV Glen Rosa (vessel 802) timeline	Total cost to complete both vessels (since public ownership)	Due diligence process
Dec 2019	Dec 2021	Oct 2022	£110.3m - £114.3m	Initial decision to acquire
Aug 2020	June 2022	Feb 2023	£110.3m - £114.3m	-
June 2021	Sept 2022	July 2023	£110.3m - £114.3m	-
March 2022	May 2023	Dec 2023	£119m - £123m	High level AO assessment
Sept 2022	May 2023	Jan 2024	£202.6m	Full AO assessment
March 2023	May 2023	March 2024	£209.6m	-
June 2023	Dec 2023	Dec 2024	£223.1m	-
Sept 2023	March 2024	May 2025	£240m	AO assessment update planned

Source: Audit Scotland

126. In September 2022, as a result of the revised estimate of costs to complete MV Glen Sannox and MV Glen Rosa (vessels 801 and 802), the Scottish Government undertook a due diligence exercise to assess the estimates provided by FMPG which were undertaken by external advisors. As a consequence, the Accountable Officer (Director General - Economy) formed the view that value for money could not be achieved in respect of MV Glen Rosa (vessel 802) given its stage of completion, expenditure to date and the forecast costs to complete.

127. In accordance with the SPFM, on 13 May 2023, the Director General - Economy requested a written authority from the Cabinet Secretary for Wellbeing Economy, Fair Work and Energy. In response, on 14 May 2023, the Cabinet Secretary for Wellbeing Economy, Fair Work and Energy provided the Director General - Economy with the written authority, under section 15(8)(a) of the Public Finance and Accountability (Scotland) Act 2000, to continue with the build of MV Glen Rosa (vessel 802) at FMPG based on the current cost projections.

128. We were provided with full access to officials and the documentation that supported the Accountable Officer's decision to request a written authority. We have reviewed the procedure followed, the advice provided by third parties and the action taken by officials. We have confirmed, from the evidence available, that the process followed was in accordance with the requirements set out in the SPFM.

129. A further update on costs and delivery timescale was provided in the quarterly update by the FMPG Chief Executive Officer in September 2023 and is currently being considered by the Scottish Government.

Sponsorship arrangements for public bodies continue to develop and remain a priority area

130. The Scottish Government has implemented the recommendations set out in the independent review of its relationships with public bodies. The Public Bodies Support Unit (PBSU) has attended each Director General assurance board and the Audit and Assurance Committee to highlight areas of concern and outline required actions. The regular updates include the use of a RAG system to advise of any that are then escalated to ensure visibility across the Scottish Government.

131. It will take time for the Scottish Government to be able to fully demonstrate the impact of actions taken in response to the independent review. Cultural and behavioural changes are needed to foster good relationships with public bodies over time. Similarly, the benefits realised from improvements in training and support offered to sponsor teams will take time to evidence.

132. The relationships already built up between the PBSU and sponsored bodies are now being used to further the public service reform agenda. There continues to be a risk around staffing capacity and capability to successfully engage, support, challenge and maintain relationships with public bodies.

The Scottish Government moved swiftly to help displaced Ukrainians

133. Following the invasion of Ukraine in February 2022, and the displacement of its people, Scotland made a commitment to support 3,000 people displaced from Ukraine in the initial wave, and at least a proportionate share of the total number who come to the UK thereafter. The Scottish Government had to mobilise quicky in order to provide accommodation and support to those escaping the conflict. The Scottish Government had to introduce, at pace, new processes and procedures to deal with the Scottish super sponsor scheme and large number of arrivals. By the end of July 2023, the Scottish Government had sponsored over 32,600 visas and more than 25,100 displaced people from Ukraine had arrived in the UK on a visa with a Scottish sponsor.

134. The super-sponsor scheme was paused in order to stabilise the level of arrivals and refine capacity planning processes. The Scottish Government also decided to alleviate accommodation pressures by renting two passenger ships on a short-term basis with both ships departing by summer 2023.

135. In September 2022, the Scottish Government introduced the Ukraine Longer Term Resettlement Fund (£50 million capital fund) to bring vacant homes back into use in order to reduce the demand for temporary accommodation and improve the supply of housing stock for the medium term. By the end of March 2023, £10 million of the fund had been allocated.

136. The Scottish Government Consolidated Accounts reflects expenditure of £231 million and a financial commitment of £25.5 million in relation to temporary accommodation contracts.

5. Use of resources to improve outcomes

Public sector bodies need to make best use of their resources to meet stated outcomes and improvement objectives, through effective planning and working with strategic partners and communities.

Conclusions

The Policy Prospectus highlights three critical missions supported by 100 policy outcomes, however there are many other indicators and activities captured in other key strategies. The Scottish Government must focus activity to support the achievement of these critical missions.

Performance reporting within the Scottish Government could be improved. The absence of clearly defined, measurable performance targets for all priorities means it is difficult to assess whether the Scottish Government is delivering its intended aims in support of national outcomes.

Scottish Government followed the requirements of the Scottish Public Finance Manual in respect of the demonstration of value for money responsibilities.

The complicated landscape of priorities could hinder the achievement of outcomes

137. The MTFS sets out the key risks and three key pillars which will underpin the Government’s approach to strengthening the medium term position. The three pillars are:

- focusing spending decisions on achieving the Government’s three critical missions (equality, opportunity and community) and targeting resources to have the greatest impact on outcomes
- supporting sustainable, inclusive economic growth and the generation of tax revenues
- maintaining and developing the Scottish Government’s strategic approach to tax.

138. Aligning funding to priorities will be essential to decision making. Currently there are a multitude of commitments, but an absence of clearly defined performance measures with measurable targets for all priority areas. Key commitments include:

- National Performance Framework - 81 indicators linked to 11 National Outcomes
- Policy Prospectus – the three critical missions are supported by over 100 policy outcomes
- 2023/24 Programme for Government - links directly into the policy prospectus missions, with over 220 activities listed

139. There are also a number of major programmes currently being progressed by the Scottish Government, each with their own objectives, targets and policies. These include:

- Climate Change (38 outcomes, 21 sub outcomes, 61 Adaptation risks and 210 policies under the scope of the Programme)
- National Strategy for Economic Transformation (79 actions across six policy programmes: some of the actions refer to other plans for example, inward investment plan has another 30 actions)
- Child Poverty (101 actions)
- The Promise (49 outcomes)
- National Improvement Framework and Improvement Plan for Education (36 actions plus over 20 carry forwards from previous year)
- Education Reform (currently paused)
- New Deal for Local Government (Verity House Agreement)
- National Care Service.

Recommendation 8

The Scottish Government needs to clarify its priorities and have measurable targets to support the achievement of improved outcomes. Non essential areas should be stopped.

The Performance Report within the Consolidated Accounts should be further developed

140. The 2022/23 Consolidated Accounts include a performance report and an accountability report in line with the basic requirements of the Government Financial Reporting Manual (FReM).

141. 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.

142. The performance overview section sets out the National Performance Framework together with progress towards eleven National Outcomes. Eighty-one national performance indicators have been assessed with 18 improving, 30 maintaining, and 13 worsening. No performance was reported against 20 indicators as they were either in development (6) or the data was not comparable to previous years (14). The presentation of this summary information is welcomed, however no information is provided in respect of the reasons underpinning the worsening indicators nor of any action to be taken.

143. We also note the reference to internal performance reporting and the alignment to the Bute House agreement, the Programme for Government and the Policy Prospectus. The refreshed national outcomes which are currently being developed should reflect the agreed priorities. We are concerned by the number of indicators for which progress is not being reported five years after the first national outcomes were agreed.

144. The performance analysis section provides the reader with a range of information on each portfolio's key priorities, performance against key targets and indicators, the key success, challenges and forward look.

145. While we recognise some improvements have been made to the reporting in 2022/23, the information provided requires to be refined further to ensure greater accessibility and transparency to the reader. It remains difficult to form an overall picture of the performance of the Scottish Government from the information presented. The reader will be unable to assess whether the Scottish Government is delivering on its contribution to the national outcomes.

146. The performance report needs to be shorter, more concise and more transparent with a golden thread linking all aspects of performance and providing an overall view of progress. The narrative should be carefully selected to tell the full story and should include positive and negative aspects. We are particularly aware that there has been limited continuity in the unit responsible for this element of the annual report which is reflected by the limited improvement to this important element of public reporting.

Recommendation 9

The Scottish Government should ensure greater accessibility and transparency of its performance reporting within the Consolidated Accounts. The performance report needs to present clear targets and progress towards achieving priority outcomes. Further there should be continuity of corporate knowledge and experience to ensure continuous improvement.

Arrangements for climate change continue to develop

147. The Scottish Government has a legally binding target of becoming net zero by 2045, five years earlier than the rest of the UK. Interim targets have been set which include a 75 per cent reduction in greenhouse gas emissions by 2030 (compared with 1990). The public sector in Scotland as a whole has a key role to play in ensuring these targets are met and in adapting to the impacts of climate change.

148. Responsibility for leading the Scottish Government's effort on supporting the delivery of net zero targets and adaptation outcomes lies with Director General - Net Zero. It is recognised that while the Director General - Net Zero leads, it requires all other portfolio areas to contribute and are expected to embed climate change considerations into their financial and policy decision-making processes. Climate change mitigation and adaptation are both recorded on the corporate risk register and feature amongst the highest risks.

149. The Scottish Government has established the Global Climate Emergency (GCE) Programme Board to provide oversight and assurance for climate change action at the corporate level and encourage a cross-government approach, with membership from across government. A Deputy Director Network has also been established, as well as various policy delivery boards, to support the work of the GCE Programme Board.

150. The Scottish Government's 'Update to the Climate Change Plan' 2020 includes a 'pathway to 2032' and 'vision for 2045' and contains a number of policies and proposed actions for each of the outcomes in the Climate Change Plan. The Scottish Government publishes climate change performance information on its website. The most recent Annual Monitoring Report was published in May 2023 and includes policy outcome indicators which relate to the outcomes in the Climate Change Plan. As at May 2023, of the 43 indicators, 21 were reported to be on track, 9 off track, and 13 too early to say. It is, however, difficult to ascertain the direct contribution from the Scottish Government to the overall climate change targets.

151. The Scottish Government reports annually on their compliance with their climate change duties by completing the Public Sector Report on Climate Change Duties. Regular updates are also provided to Assurance Boards and the performance report also provides an update from the Net Zero Energy and Transport portfolio.

152. The Auditor General reported in April 2023 on How the Scottish Government is set up to deliver climate change goals. Recommendations were made in relation to improving governance and risk management arrangements. In response, in September 2023, the Director General - Net Zero reported that action had been taken to address a number of the issues raised around risk management which would help to identify, focus and mitigate risk more easily. Governance arrangements are continuing to develop.

153. The Scottish Government published details of a proposed Deposit Return Scheme (DRS) in 2019 following a public consultation. The policy was then developed with support from The Deposit Return Scheme Implementation Advisory Group whose members provided a range of industry experience of relevance to the operation of the scheme.

154. The legal framework for the scheme was created by the Deposit and Return Scheme for Scotland Regulations 2020, which were passed by the Scottish Parliament in May 2020. However, following the decision by the UK Government not to grant a full exclusion from the Internal Market Act, the regulations were amended in 2023 which delayed the launch date of DRS until October 2025 which will align with schemes in the rest of the UK. As a result, it is likely elements of Scotland's scheme will need to be redesigned to be fully inter-operable with the UK.

155. As at May 2023, the Scottish Government reported, in response to a freedom of information request, that the costs associated with the setting up of the DRS since 2018 totalled £219,000. This included the costs associated with consultation, publication of regulations and associated documents, evaluations, independent reviews and assurance. Funding for the Scottish Environment Protection Agency (SEPA) and Zero Waste Scotland (ZWS) in their role implementing DRS was separately agreed with the Scottish Government as part of the annual budget process.

156. In May 2022, the Scottish National Investment Bank committed £9 million to Circularity Scotland Limited, a company set up to administer the DRS. Due to the delay in implementation, Circularity Scotland Limited are now in administration and the full repayment of the loan is unlikely.

Appendix 1. Action plan 2022/23

2022/23 recommendations

Issue / risk	Recommendation	Agreed management action / timing
1. Completeness of unaudited accounts The unaudited core schedules and consolidated accounts were incomplete when provided to audit. In particular, the Lochaber provision and cash flow statements were not provided until very late on in the audit process. Risk – The audit process cannot be efficiently delivered impacting on the overall timeline.	All information should be available at the time of presenting the core schedules and consolidated accounts for audit. Paragraph 17	The Scottish Government will continue to take steps to reduce accounts closure timeframes via the Accounts timetable, which will require to be agreed in line with a detailed Audit Plan. Deputy Director Corporate Finance 30 June 2024
2. Retained monies The Scottish Government retained monies that should have been returned to SCF, and UK Consolidated Fund, during 2022/23. Risk – The incorrect treatment impacts on the regularity audit opinion.	The Scottish Government should strengthen arrangements the funding flows, including introducing more robust year end reconciliations. Exhibit 2, Issue 6	The Scottish Government will review and strengthen its reconciliation processes. Head of Treasury and Banking 31 March 2024
3. Consolidated public sector information The Scottish Government committed to producing a consolidated account to cover the devolved public sector in Scotland, but this has not been progressed. Risk – The lack of transparency of the financial	The Scottish Government needs to agree its approach to the provision of consolidated information for the Scottish public sector and agree a timetable for completion as a matter of priority. Paragraph 73	The Scottish Government remains committed to agreeing a workable approach to the provision of consolidated information with Audit Scotland, recognising the significant delays with the UKG WGA process due to the extended financial reporting and audit periods of public bodies. Work has continued on stage 1

Issue / risk	Recommendation	Agreed management action / timing
position across the Scottish public sector impacts on decision making.		consolidation (that does not rely on the UKG WGA process) as planned and this is available for Audit Scotland to review. The further engagement that is needed on the Stage 2 process can take place now that the Consolidated process is concluded. Deputy Director Risk, Control and Assurance December 2023
4. Public service reform Scotland cannot afford the public services that are currently being delivered. Risk – Services are not financially sustainable and do not deliver the outcomes for the people of Scotland.	The Scottish Government must develop a clear roadmap of how the design and delivery of public services will be transformed to be financially sustainable. Paragraph 92	The Scottish Government will continue to work collaboratively with public service bodies to identify barriers and enablers for reform opportunities, and to establish what actions and decisions would be required and convene a collective programme of action. Public service reform will take time and there is a need to balance short term efficiencies, to assist the challenging immediate financial situation, with longer term transformation aimed at achieving sustainability though better outcomes for the people of Scotland leading to reduced demand. Director General - Communities June 2024
5. Workforce reform Workforce reform is a core part of public service reform given the workforce costs involved and the current pay pressures being experienced. Risk – Without clear and structured workforce reform, public services cannot be delivered in a financially sustainable way.	The Scottish Government needs a cohesive workforce strategy that factors in the impact of growth in the NHS. Paragraph 97	Workforce reform will be a key enabler of public service reform as per recommendation 4, with workforce strategies and governance to be developed alongside that programme.

Issue / risk	Recommendation	Agreed management action / timing
6. Governance arrangements There are well established governance and assurance arrangements in place, however the volume of meetings and papers is significant. Risk – Governance arrangements are ineffective in providing the necessary scrutiny and challenge.	A review of governance and assurance arrangements within the Scottish Government should be complete to ensure they are efficient and effective. Paragraph 107	The Scottish Government keeps governance arrangements under regular review, honouring the six good governance principles as defined within the Scottish Government Corporate Governance Manual Board Secretary 31 March 2024
7. Corporate transformation The current HR and financial ledger systems are not fit for purpose, but the corporate transformation programme to replace them is experiencing increasing timelines and costs. Risk – Current systems present additional IT risks and are inefficient.	The Scottish Government should provide some clarity on how it will implement the Shared Services Programme in the face of increasing costs, while also ensuring that the constraints to delivery are addressed in order to avoid additional delays. Paragraph 118	As part of corporate transformation, the Shared Services Programme will continue to be funded from the Scottish Government's Corporate Running Costs budget. This is set as part of the wider budget-setting process. The Scottish Government has refreshed the original Full Business Case for the Shared Services Programme which includes the latest schedule, risks and costs of the programme capturing inflation other sources of increased cost pressures. The costs will be subject to ongoing review as part of good financial management practice. Following a Programme reset in early 2023, the Programme now has strengthened governance and PMO capability, a better informed Programme plan and clearer focus on scope and milestones that together are beginning to drive further progress. Director of Corporate Transformation and Workplace 31 March 2024

Issue / risk	Recommendation	Agreed management action / timing
8. Priorities and outcomes The Policy Prospectus highlights three critical missions supported by 100 policy outcomes, however there are many other indicators and activities captured in other key strategies. Risk – The complicated landscape of priorities could impact on the achievement of outcomes.	The Scottish Government needs to clarify its priorities and have measurable targets to support the achievement of outcomes. Non essential areas should be stopped. Paragraph 139	We are redesigning internal Scottish Government performance reporting to track progress against the three Missions set out in the policy prospectus and to drive evidence-based decision making at a senior level, including tracking performance against targets set out in the strategic delivery plans. The First Minister has also issued mandate letters to each Cabinet Secretary, setting out how the priority commitments in the Policy Prospectus will be delivered. The mandate letters are underpinned by strategic delivery plans for each portfolio, which will support an improved approach to delivery and performance monitoring. The mandate letters also identify the cross-portfolio contributions and collaboration needed to effectively deliver the priorities within and across budgets, consistent with the necessary fiscal discipline required. We will consider this recommendation as part of this work. Director Performance, Delivery & Resilience April 2024
9. Performance report The performance report does not clearly present measurable targets and the progress being made to achieve priority outcomes. The performance report needs to be more concise, balanced and transparent with a golden thread linking all aspects of performance and providing an overall view of progress.	The Scottish Government should ensure greater accessibility and transparency of its performance reporting within the Consolidated Accounts. The performance report needs to present clear targets and progress towards achieving priority outcomes. Further there	Improvements in internal SG performance reporting (see action 8, above) will inform the performance analysis for the Consolidated Accounts in future years. This will enable clearer reporting on progress against the three missions and their key supporting outcomes (plus progress against targets where these have been set), replacing portfolio-by-portfolio reporting

Issue / risk	Recommendation	Agreed management action / timing
Changes in the staffing structure within the performance delivery unit has impacted progress. Risk – The performance report does not tell the story around the Scottish Government's contribution to the delivery of the National Outcomes.	should be continuity of corporate knowledge and experience to ensure continuous improvement. Paragraph 146	and leading to a more succinct and focused assessment. We will ensure the experience of reporting this year drives future improvement. The statutory Review of the National Outcomes is ongoing and is expected to conclude in spring 2024. There will be an opportunity then, depending on the outcome of the review, to consider the connection to performance reporting and whether there are opportunities to strengthen this. Alongside the review we are considering how to measure our contribution to the delivery of the National Outcomes. Director for Performance, Delivery & Resilience August 2024

Follow-up of prior year recommendations

Issue / risk	Recommendation	Update
b/f 1. Strategic approach to financial interventions	The Scottish Government should further develop the framework for investment in private companies by, for example, strengthening financial control over interventions and expanding commercial outcomes. The framework should also make a direct link between risk tolerance and risk appetite for investment while considering the financial capacity of the Scottish Government.	**Progressed** The strategic approach to financial interventions has been strengthened during 2022/23. This will continue to be a feature of our audit work.
b/f 2. Capital and resource borrowing	In order to support better parliamentary scrutiny of its capital investment programme, the Scottish Government should increase transparency over its capital borrowing plans.	**Progressed** Opportunities for further enhancements will be explored alongside the consolidated public sector information.

Issue / risk	Recommendation	Update
b/f 3. Financial sustainability	The Scottish Government should continue to strengthen its focus on longer-term financial sustainability. In doing so, it should ensure its policy choices and spending commitments are fully costed and transparently reported, particularly where there are funding implications for the wider public sector.	**Ongoing** Financial sustainability continues to be a significant challenge. The Scottish Government published its strategy for improving medium-term fiscal sustainability in the May 2023 MTFS. **Recommendation 3**
b/f 4. Scotland Reserve	The Scottish Government should increase transparency with the consolidated accounts about the balances held within the Scotland Reserve and the movements of funds within it. This will provide Parliament and the public with a better understanding of the Reserve's purpose, its application in supporting spending plans and its limitations.	**Progressed** The 2021-22 Final Outturn reported included additional disclosures to increase transparency which will be replicated once the 2022-23 outturn is finalised. The consolidated accounts also sets out the overall differences between the Scotland Reserve balances and the Annual Accounts.
b/f 5. Public sector accounts	The Scottish Government should fulfil its commitments to producing public sector consolidated accounts as soon as possible.	**Ongoing** There have been productive discussions on how to take this forward given emerging issues with original plans. A proposal is due to be presented to audit for consideration. **Recommendation 2**
b/f 6. Workforce strategy	The Scottish Government should develop a comprehensive workforce strategy to ensure that its approach to staffing levels is appropriately planned and coordinated across the organisation.	**Ongoing** Workforce reform is a core part of the public services reform agenda with workforce plans being further developed. We have seen a focus on the assurance processes

Issue / risk	Recommendation	Update
		around workforce capacity and wellbeing. **Recommendation 4**
b/f 7. Governance arrangements	A review of governance arrangements should be undertaken to consider risks of duplication, inefficiency, or unclear lines of responsibility within its governance structure.	**Ongoing** New approaches are being piloted and assessed. We will revisit this as part of our 2023/24 audit. **Recommendation 5**
b/f 8. Corporate transformation	The Scottish Government should provide clarity over how the corporate transformation project will be funded and when it is expected to be fully implemented. The Scottish Government should ensure that the essential human resources and financial planning systems are implemented effectively, to time and to budget, and include plans to ensure their successful delivery for each of its clients.	**Ongoing** Corporate transformation is recognised as a key corporate priority and the risks are being managed. **Recommendation 6**
b/f 9. Information and Communications Technology	Business continuity plans should be updated to highlight new processes due to hybrid working and routinely tested to ensure their effectiveness in the event of an incident. In addition, the Scottish Government should routinely test and restore key systems' recovery to ensure that data can be recovered should systems be interrupted.	**Progressed** The review of business continuity plans has been progressed and is due to conclude shortly.
b/f 10. Performance reporting	In order to strengthen accountability and scrutiny, the Scottish Government should review the performance report to ensure it reflects clear targets and progress towards achieving them. An assessment should also be made of the achievement towards priority outcomes and strategic objectives	**Ongoing** There has been some limited improvement, but we expect a step change next year. **Recommendation 8**

Appendix 2. Summary of uncorrected misstatements

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	Statement of Comprehensive Net Expenditure		Statement of Financial Position	
	Dr	**Cr**	**Dr**	**Cr**
	£000	**£000**	**£000**	**£000**
NHS unadjusted errors	55,890	55,323	91,272	95,479
Agency unadjusted errors	157	2,398	2,398	157
SG Core unadjusted errors				
Student loans deferred income			3,131	3,131
JESSICA/SPRUCE historical difference			1,636	1,636
Understatement in fixed asset register			7,770	7,770
Understatement in depreciation balance	905			905
Payables overstatement			507	507
Receivables overstatement			11,213	11,213
Assets incorrectly disclosed as held for sale			1,534	1,534
Mis-posting in respect of EU advances			7,683	7,683
Total	56,952	57,721	127,144	130,015
NHS unadjusted errors – other comprehensive I&E	*3,640*			

If these errors had been adjusted, the net impact would have been to decrease net expenditure by £0.8 million and decrease net assets by £2.9 million.

Scottish Government

2022/23 Annual Audit Report

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