

Scottish Government

Annual Audit Plan 2016/17



 AUDIT SCOTLAND

Prepared for the Scottish Government

March 2017

Who we are

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

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



About us

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

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

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

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Audit risks and planned work

1. This annual audit plan contains an overview of the planned scope and timing of our audit and is carried out in accordance with International Standards on Auditing (ISAs), the [Code of Audit Practice](#), and any other relevant guidance. This plan identifies our audit work to provide an opinion on the financial statements and related matters and meet the wider scope requirements of public sector audit. The wider scope of public audit contributes to conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability.

Audit risks

2. Based on our discussions with staff, attendance at committee meetings and a review of supporting information we have identified the following main risk areas for our 2016/17 audit of the Scottish Government. We have categorised these risks into financial audit risks and wider dimension audit risks. The key audit risks, which require specific audit testing, are detailed in [Exhibit 1](#).

Exhibit 1

Audit Risk	Management assurance	Planned audit work
Financial statement risks		
<p>1 EU funding</p> <p>There are material balances and transactions in the consolidated accounts relating to EU funding:</p> <ul style="list-style-type: none"> European Structural Funds 2014-20 programme: the Scottish Government intends to make payments to lead partners in 2016/17. expenditure and income of £445 million relating to European Agricultural Fund schemes. <p>This audit risk requires us to ensure that EU funding balances and transactions are reflected appropriately in the accounts.</p>	<ul style="list-style-type: none"> System of internal control in place to support the Scottish Government's role as managing authority. 	<ul style="list-style-type: none"> Test expenditure and accrued income balances at the year end for structural funds. Engage with local auditors to join up information and analysis on structural funds. Engage with internal audit (as the audit authority for structural funds) and seek assurances where possible. Seek assurances from the auditors of the European Agricultural Fund on the control environment and supplement with targeted substantive testing. Test accrued expenditure and income balances at the year end for European Agricultural funding.

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<p>2 EU structural funds: potential losses and penalties</p> <p>The 2015/16 consolidated accounts included a provision for a loss of income of £14 million in relation to the 2007-13 structural fund programmes. This amount may change as the audit authority (internal audit) reviews and reports on closure reconciliations, due to be completed by 31 March 2017.</p> <p>This audit risk requires us to ensure that the provisions and balance appropriately reflect the associated liability.</p>	<ul style="list-style-type: none"> • Programme Board in place to manage the closure of programmes. • Internal audit is the audit authority for the European Structural Funds and audits the closure process. 	<ul style="list-style-type: none"> • Test a sample of closure reconciliations and the calculation of any related provisions for penalties for accuracy and completeness. • Review the extent of recoveries where projects are withdrawn or de-committed and consider if there are any state aid implications. • Review internal audit's reports and supporting work on the closure process and consider whether the accounting and disclosures in the accounts (including the governance statement) are appropriate.
<p>3 Common Agricultural Policy (CAP) Futures</p> <p>The Common Agricultural Policy Futures programme is a five-year business change and IT programme to deliver CAP reform. This programme has proved significantly more complex and challenging than the Scottish Government anticipated.</p> <p>Two CAP Basic Payment loan schemes were launched during 2016/17. The loan schemes are an interim measure until the control environment and CAP Futures IT system are established.</p> <p>This audit risk requires us to ensure that the loans and EU payments are accounted for appropriately.</p>	<ul style="list-style-type: none"> • Well established budget monitoring and financial reporting procedures. 	<ul style="list-style-type: none"> • Analyse cost information and SEAS transactions. • Substantive testing of loan advances and repayments. • Targeted substantive testing and cut-off testing of debtors and creditors to verify timing of transactions and associated accounting. • Consider the completeness and accuracy of the accounting for loan transactions. • Engage with CAP Futures performance audit work and consider the findings from the upcoming Section 23 report on CAP Futures.
<p>4 Estimation and judgements</p> <p>There are significant degrees of management estimation in the measurement, valuation and disclosures of the material account areas of student loans and contingent liabilities, including the valuation and completeness of financial guarantees provided by the Scottish Government.</p> <p>This audit risk requires us to ensure amounts and disclosures in the accounts are appropriate.</p>	<ul style="list-style-type: none"> • Non-statutory guarantees or indemnities in excess of £1 million require approval of the Scottish Parliament. • A record of all contingent liabilities, guarantees, indemnities and letters of comfort is maintained, updated and reviewed by management. • Evaluation of guarantees involves financial modelling to uncertainly sources of comfort and specific risks. 	<ul style="list-style-type: none"> • Further review of the student loans model (assumptions and application). • Focused substantive testing. • Review the identification of and record of contingent liabilities, guarantees, indemnities and letters of comfort. • Test assumptions in contingent liability financial modelling. • Review the disclosure of contingent liabilities, guarantees etc.

Audit Risk	Management assurance	Planned audit work
<p>5 Risk of management override of controls</p> <p>ISA 240 requires that auditors consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls in order to change the position disclosed in the financial statements.</p>	<ul style="list-style-type: none"> Owing to the nature of this risk, assurances from management are not applicable in this instance. 	<ul style="list-style-type: none"> Detailed testing of journal entries. Review of accounting estimates. Focused testing of accruals and prepayments. Evaluation of significant transactions that are outside the normal course of business. Review of internal audit reports. Consider the results of controls testing.
<p>6 Risk of expenditure recognition</p> <p>ISA 240 presumes a risk of fraud in regard to revenue recognition in the financial statements in any audit. This can be extended to include expenditure recognition in some public sector bodies.</p>	<ul style="list-style-type: none"> Systems of internal control in place. Sound budgetary control and monitoring arrangements. Internal audit reviews. Oversight by the Executive Board. Wider counter-fraud arrangements including the Scottish Government Counter-Fraud Strategy. 	<ul style="list-style-type: none"> Test key internal controls. Test significant transactions, particularly around the financial year-end. Carry out analytical procedures. Monitor budgetary process and reporting. Review of counter fraud arrangements. Consider internal audit findings.
Wider dimension risks		
<p>7 Financial sustainability Office for National Statistics (ONS) classification</p> <p>The Office for National Statistics (ONS) assesses transactions to decide how they should be treated in the National Accounts.</p> <p>ONS decisions on certain capital projects do not change the accounting treatment but do affect the capital budget. The expected impact on the capital DEL budget in 2016/17 is estimated as £398 million.</p> <p>The Scottish Government is managing its capital budget charges in the context of its overall capital programme.</p> <p>This audit risk requires us to review how the Scottish Government delivers the capital programme and how transparently the impact of the ONS decisions are reported.</p>	<ul style="list-style-type: none"> Sound financial monitoring arrangements. Capital borrowing powers introduced by the Scotland Act 2012. 	<ul style="list-style-type: none"> Keep up to date with developments as part of our wider code of practice responsibilities to consider financial management and sustainability. Review Scottish Government reporting on the capital budget, including disclosures in the consolidated accounts. Review other ONS decisions that may affect the Scottish Government's financial position in 2016/17 and beyond.

Audit Risk	Management assurance	Planned audit work
<p>8 Workforce capacity</p> <p>Financial devolution under the 2012 and 2016 Scotland Acts brings increased responsibility for financial management at a time of increasing pressures on resources.</p> <p>This audit risk requires us to review actions taken by Scottish Government to ensure it has sufficient capacity and resources to effectively manage its increased financial responsibilities and implement the new financial powers, alongside business as usual.</p>	<ul style="list-style-type: none"> • Planning processes are focused around capacity and capability. • Internal review of the Scottish Government's finance function. 	<ul style="list-style-type: none"> • Our performance audit report on Managing New Financial Powers (spring 2017) will provide an assessment of the steps the Scottish Government is taking to manage pressures on capacity, including in the finance function and the potential impact on financial management and reporting. • Review of overtime expenditure, payments in lieu of holidays and use of contractors/agency staff.
<p>9 CAP Futures</p> <p>The loan scheme for farmers involves around £285 million. It is funded from the financial transactions (FT) budget (£80 million) and budgeted loan recovery (£205 million). The Scottish Government's overall FT budget for 2016/17 is £327 million.</p> <p>The EU payments due to farmers will not start until February 2017 at the earliest and may impact on the repayment of loans.</p> <p>This audit risk requires us to consider the implications for the FT budget and any related impact on the Scottish Government budget overall.</p>	<ul style="list-style-type: none"> • Well established budget monitoring and financial reporting procedures. • Oversight by governance boards which include independent external members. 	<ul style="list-style-type: none"> • Review of cash flow management procedures and controls. • Review and analysis of financial transaction budget and reporting of loans and other FT transactions. • Review the impact of these developments on the FT budget and other loan schemes planned. • Review of internal audit work. • Update to the CAP Futures performance audit report will be published before the Scottish Parliament's 2017 summer recess.
<p>10 National Fraud Initiative</p> <p>The Scottish Government's payroll recommended matches from the 2014/15 NFI exercise were not timeously investigated.</p> <p>This audit risk requires us to assess the potential for undetected fraud or error in payroll records.</p>	<ul style="list-style-type: none"> • Proactive engagement of NFI and follow up of recommended matches. 	<ul style="list-style-type: none"> • Completion of 2016/17 NFI questionnaire.
<p>11 New governance structure</p> <p>The Scottish Government implemented new governance arrangements during 2016/17 designed to better support the assurance requirements of the Principal Accountable Officer. This involved significant changes</p>	<ul style="list-style-type: none"> • Corporate governance manual. • Planned review of new governance arrangements, led by the Crown Agent and Director of Internal Audit. 	<ul style="list-style-type: none"> • Attend meetings, review of papers and discussions with staff and non-executive directors. • Follow up of the principles contained in national 'Role of Boards' report (published in 2010). • Consider the findings of the

Audit Risk	Management assurance	Planned audit work
<p>to governance structures and new ways of working, including internal assurance processes.</p> <p>This audit risk requires us to review the revised governance arrangements and assess whether they provide effective oversight and assurances.</p>		<p>planned review of governance arrangements.</p>
<p>12 Developing financial reporting</p> <p>Significant changes were made to the presentation of the consolidated accounts in 2015/16 with further changes planned in 2016/17. This is part of the Scottish Government's programme of work to review and broaden its financial reporting in the context of new financial powers.</p> <p>The Permanent Secretary confirmed in a response to the Scottish Parliament's Public Audit and Post-legislative Scrutiny Committee in November 2016 that the Scottish Government is also planning to produce a 'tailored-for-Scotland' 2016/17 consolidated accounts.</p> <p>This audit risk requires us to assess progress in this area.</p>	<ul style="list-style-type: none"> • Commitment from Permanent Secretary that reporting will be developed. • Timeline set out for developing financial reporting. • Open Government National Action Plan - commitment to openness, transparency and citizen participation. 	<ul style="list-style-type: none"> • Review preparations and progress against proposed timetable. • Continue to report on the progress as part of the 2016/17 audit.
<p>Value for money</p> <p>13 Following the public pound</p> <p>The Scottish Government provides many different forms of funding streams and grants to a wide range of third parties.</p> <p>This audit risk requires us to consider the Scottish Government's arrangements and the steps it takes to ensure that public money is used for the purposes intended.</p>	<ul style="list-style-type: none"> • Updated corporate grant guidance with more comprehensive due diligence procedures. 	<ul style="list-style-type: none"> • As part of our substantive testing, we will confirm on a sample basis, evidence of monitoring by the Scottish Government to ensure funds are used for the purposes intended. • Follow up of conclusions from our 'T in the Park' work conducted in 2015/16. • Review of the newly created Attainment Fund, including review of the controls, oversight and accountability arrangements between the Scottish Government and local authorities/schools.

Reporting arrangements

3. Audit reporting is the visible output for the annual audit. All annual audit plans and the outputs as detailed in [Exhibit 2](#), and any other outputs on matters of public interest will be published on our website: www.audit-scotland.gov.uk.

4. Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft management reports will be issued to the relevant officer(s) to confirm factual accuracy.
5. The Auditor General will provide an independent auditor's report to the Scottish Parliament. We will provide the Principal Accountable Officer and Auditor General for Scotland with an annual report on the audit containing observations and recommendations on significant matters which have arisen in the course of the audit.
6. Under the Public Finance and Accountability (Scotland) Act 2000 there is a requirement for the audited financial statements of the Scottish Government to be presented to Parliament within nine months of the financial year-end i.e. 31 December. The Scottish Government's target is to present the audited financial statements to Parliament by the end of September.

Exhibit 2

2016/17 Audit outputs

Audit Output	Target date	SGAAC* date
Review of Internal Audit	15 June 2017	22 June 2017
Interim Report	26 May 2017	22 June 2017
Annual Audit Report including ISA 260 requirements	14 September 2017	28 September 2017
Signed Independent Auditor's Report	22 September 2017	N/A
Public Report on the 2016/17 audit of the Scottish Government consolidated accounts	29 September 2017	N/A
Assurance statement on Whole of Government Accounts	29 September 2017	N/A

*Scottish Government Audit & Assurance Committee

Audit fee

7. The audit fee for the 2016/17 audit, including our work on Whole of Government Accounts, is £1,063,750. This represents a 0.8% increase compared with the fee notified for the equivalent audit work in 2015/16. In determining the audit fee we have taken account of the risk exposure of the Scottish Government, the planned management assurances in place and the level of reliance we plan to take from the work of internal audit. Our audit approach assumes receipt of the core schedules and working papers on 9 June 2017 and consolidated accounts and working papers on 28 July 2017.

8. Where our audit cannot proceed as planned through, for example, late receipt of unaudited financial statements or being unable to take planned reliance from the work of internal audit, a supplementary fee may be levied. An additional fee may also be required in relation to any work or other significant exercises outwith our planned audit activity.

Responsibilities

Audit and Assurance Committee and Principal Accountable Officer

9. Audited bodies have the primary responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance, propriety and regularity that enable them to successfully deliver their objectives.

10. The audit of the financial statements does not relieve management or the Scottish Government Audit and Assurance Committee, as those charged with governance, of their responsibilities.

Appointed auditor

11. Our responsibilities as independent auditor are established by the Public Finance and Accountability (Scotland) Act 2000 and the Code of Audit Practice, and guided by the auditing profession's ethical guidance.

12. Auditors in the public sector give an independent opinion on the financial statements. We also review and report on the arrangements within the audited body to manage its performance, regularity and use of resources. In doing this, we aim to support improvement and accountability.

Audit scope and timing

Financial statements

13. The statutory financial statements audit will be the foundation and source for the majority of the audit work necessary to support our judgements and conclusions. We also consider the wider environment and challenges facing the public sector. Our audit approach includes:

- understanding the business of Scottish Government and the associated risks which could impact on the financial statements
- assessing the key systems of internal control, and establishing how weaknesses in these systems could impact on the financial statements
- identifying major transaction streams, balances and areas of estimation and understanding how Scottish Government will include these in the financial statements
- assessing the risks of material misstatement in the financial statements
- determining the nature, timing and extent of audit procedures necessary to provide us with sufficient audit evidence as to whether the financial statements are free of material misstatement.

14. We will give an opinion on the financial statements as to:

- whether they give a true and fair view of the financial position of the audited bodies and their expenditure and income
- whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements
- the regularity of the expenditure and income.

Materiality

15. Materiality defines the maximum error that we are prepared to accept and still conclude that our audit objective has been achieved. It helps assist our planning of the audit and allows us to assess the impact of any audit adjustments on the financial statements. We calculate materiality at different levels as described below. The calculated materiality values for Scottish Government are set out in [Exhibit 3](#).



Exhibit 3

Materiality values

Materiality level	Amount
<p>Planning materiality - This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It has been set at 1% of budgeted expenditure for the year ended 31 March 2017 based on the Autumn Budget Revision for 2016/17.</p>	£336m
<p>Performance materiality - This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality this would indicate that further audit procedures should be considered. Using our professional judgement we have calculated performance materiality at 20% of planning materiality.</p> <p>However, given the specific nature of the Scottish Government audit and the lower materiality levels in respect of individual errors identified, we apply judgement and consider the nature and circumstances of each error identified. Therefore, in practice, we are working to much lower materiality levels and any individual error in the range £10 million to £20 million and above may be material depending on its nature and impact.</p>	£67m
<p>Reporting threshold - We are required to report to those charged with governance on all unadjusted misstatements in excess of the 'reporting threshold' amount. This has been calculated at 1% of planning materiality but capped at £100k.</p>	£100k

16. We review and report on other information published with the financial statements including the performance report, governance statement and the remuneration and staff report. Any issue identified will be reported to the Scottish Government Audit and Assurance Committee.

Timetable

17. To support the efficient use of resources it is critical that a financial statements timetable is agreed with us for the production of the unaudited accounts. An agreed timetable is included at [Exhibit 4](#) which takes account of submission requirements and planned SGAAC dates:

Exhibit 4

Financial statements timetable

 Key stage	 Date
Latest submission date of core schedules with complete working papers package	9 June 2017
Latest submission date of unaudited consolidated financial statements with complete working papers package	28 July 2017
Latest date for final clearance meeting with DG Finance	8 September 2017
Agreement of audited unsigned financial statements; issue of Annual Audit Report including ISA 260 report to those charged with governance	14 September 2017
Independent auditor's report signed	22 September 2017
Latest date for signing of WGA return	29 September 2017

Internal audit

18. Auditing standards require internal and external auditors to work closely together to make best use of available audit resources. We seek to rely on the work of internal audit wherever possible and as part of our planning process we carry out an assessment of the internal audit function. Internal audit is provided by Scottish Government Internal Audit Directorate (IAD).

Assessment of Internal Audit

19. We carry out an annual assessment of internal audit to determine the extent to which we can place reliance on its work. We have previously concluded that the Scottish Government's IAD operates in accordance with the Public Sector Internal Audit Standards (PSIAS) and has sound documentation standards and reporting procedures in place. 2016/17 is a transitional year for IAD and our work in this area is on-going. In addition to the Scottish Government's revised governance arrangements and the implementation of the recommendations from the strategic review of IAD, an internal assessment is being carried out by IAD. We intend to present our Overview of Internal Audit report to the SGAAC meeting on 22 June 2017.

Areas of reliance

20. To support our audit opinion on the financial statements we plan to place formal reliance on the following planned internal audit reviews:

- DG Finance: Scottish Procurement and Commercial Division: Electronic procurement cards (data analytics)
- DG Learning and Justice: Grant Funding of Third Sector Bodies.

21. In respect of our wider dimension audit responsibilities we also plan to consider other areas of internal audit work including:

- ISIS: Cyber, Information and IT Security
- performance monitoring
- review of programme and project management and independent assurance process.

Audit dimensions

22. Our audit is based on four audit dimensions that frame the wider scope of public sector audit requirements as shown in [Exhibit 5](#).

Exhibit 5

Audit dimensions



Financial sustainability

23. As auditors we consider the appropriateness of the use of the going concern basis of accounting as part of our annual audits, taking account of the context in which individual organisations operate. We will also comment on the body's financial sustainability in the longer term. We define this as medium term (two to five years) and longer term (longer than five years) sustainability. As part of our audit of the Scottish Government, we will carry out work and conclude on:

- the effectiveness of financial planning in identifying and addressing risks to financial sustainability in the short, medium and long term
- whether the Scottish Government can demonstrate the affordability and effectiveness of funding and investment decisions it has made
- the Scottish Government's progress in developing its approach to strategic financial management in the context of new financial powers.

Financial management

24. Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively. We will review, conclude and report on:

- whether the Scottish Government has arrangements in place to ensure systems of internal control are operating effectively
- whether the Scottish Government can demonstrate the effectiveness of the budgetary control system in communicating accurate and timely financial performance information
- how the Scottish Government has assured itself that its financial capacity and skills are appropriate
- whether the Scottish Government has established appropriate and effective arrangements for the prevention and detection of fraud and corruption
- how the Scottish Government is progressing in meeting its requirements under the National Fraud Initiative.

Governance and transparency

25. Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision-making and transparent reporting of financial and performance information. We will review, conclude and report on:

- whether the Scottish Government can demonstrate that the new governance arrangements in place are appropriate and operating effectively
- whether there is effective scrutiny, challenge and transparency on the decision-making and finance and performance reports
- the quality and timeliness of financial and performance reporting.

Value for money

26. Value for money refers to using resources effectively and continually improving services. We will review, conclude and report on whether:

- the Scottish Government can provide evidence that it is demonstrating value for money in the use of its resources
- the Scottish Government can demonstrate that there is a clear link between money spent, output and outcomes delivered
- the Scottish Government can demonstrate that outcomes are improving
- there is sufficient focus on improvement and the pace of it.

27. Our approach to the Scottish Government integrates the annual audit work and our wider programme of national performance audits. Together, these provide a strong basis for us to assess the Scottish Government's position in relation to each of the four audit dimensions and to maximise the value of our audit reports.

Independence and objectivity

28. Auditors appointed by Audit Scotland must comply with the Code of Audit Practice. When auditing the financial statements auditors must also comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies. These standards impose stringent rules to ensure the independence and objectivity of auditors. Audit Scotland has in place robust arrangements to ensure compliance with these standards including an annual "fit and proper" declaration for all members of staff. The arrangements are overseen by the Assistant Auditor General, who serves as Audit Scotland's Ethics Partner.

29. The engagement lead for the Scottish Government is Stephen Boyle, Assistant Director. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. We are not aware of any such relationships pertaining to the audit of the Scottish Government.

Quality control

30. International Standard on Quality Control (UK and Ireland) 1 (ISQC1) requires that a system of quality control is established, as part of financial audit procedures, to provide reasonable assurance that professional standards and regulatory and legal requirements are being complied with and that the independent auditor's report or opinion is appropriate in the circumstances.

31. The foundation of our quality framework is our Audit Guide, which incorporates the application of professional auditing, quality and ethical standards and the Code of Audit Practice issued by Audit Scotland and approved by the Auditor General for Scotland. To ensure that we achieve the required quality standards Audit Scotland

conducts peer reviews, internal quality reviews and is currently reviewing the arrangements for external quality reviews.

32. As part of our commitment to quality and continuous improvement, Audit Scotland will periodically seek your views on the quality of our service provision. We welcome feedback at any time and this may be directed to the engagement lead.

Scottish Government

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