

# The Skills Development Scotland Co. Limited

Annual Audit Plan 2017/18



 AUDIT SCOTLAND

Prepared for the Skills Development Scotland Co. Limited

November 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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# 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.

2. 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

3. Based on our discussions with staff, attendance at Audit and Risk Committee meetings and a review of supporting information, we have identified the following main audit risk areas for Skills Development Scotland (SDS). We have categorised these risks into financial and wider dimension risks. The key audit risks, which require specific audit testing, are detailed in [Exhibit 1](#).

## Exhibit 1

### 2017/18 key audit risks

Audit Risk	Source of assurance	Planned audit work
<b>Financial statement issues and risks</b>		
<p><b>1 Risk of management override of controls</b></p> <p>ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes the risk of management override of controls to change the position disclosed in the financial statements.</p>	<p>Due to the nature of this risk, assurances from management are not applicable in this instance.</p>	<p>Detailed testing of journal entries.</p> <p>Review of accounting estimates.</p> <p>Focused testing of accruals and prepayments.</p> <p>Detailed testing of transactions after the year end to confirm expenditure and income have been accounted for in the correct financial year.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p>
<p><b>2 Risk of fraud over income</b></p> <p>SDS received approximately £12 million or six per cent of income in 2016/17 from sources other than the Scottish Government. SDS expects this to increase by £8 million in 2017/18 due to an</p>	<p>Internal audit's review of the European Social Fund (ESF) income.</p>	<p>Review of SDS' anti-fraud arrangements. This will include monitoring SDS' progress with implementing the new fraud prevention arrangements.</p> <p>Walk-through of controls over</p>

Audit Risk	Source of assurance	Planned audit work
<p>expected increase in European funding. The extent and nature of this income means that, in accordance with ISA240, there is an inherent risk of fraud.</p>		<p>receivables.</p> <p>Analytical procedures on income streams.</p> <p>Detailed testing of income transactions focusing on the areas of greatest risk such as European income.</p> <p>Consideration of internal audit's review of ESF funding.</p>
<p><b>3 Risk of fraud over expenditure</b></p> <p>The Code of Audit Practice expands the ISA 240 assumption on fraud over income to expenditure. Most of SDS' operating expenditure (£119 million or 63 per cent in 2016/17) is on multi-year national training programmes. While these are contracted annually, SDS has a commitment to support them over several years. Due to the nature of SDS expenditure there is an inherent risk of fraud over expenditure.</p>	<p>Compliance team's annual checks of contracts for national training programmes.</p> <p>Compliance team's retrospective payments assurance.</p> <p>Internal audit's review of national training programmes on the Funding and Information Processing System (FIPS).</p> <p>Internal audit's review of whistleblowing.</p>	<p>Review of SDS' anti-fraud arrangements. This will include monitoring SDS' progress with implementing the new fraud prevention arrangements.</p> <p>Walk-through of controls over national training programmes, including the Corporate Training System (CTS) and FIPS.</p> <p>Walk-through of controls over payables.</p> <p>Analytical procedures on expenditure streams.</p> <p>Detailed testing of expenditure transactions focusing on the areas of greatest risk such as apprenticeship expenditure.</p> <p>Consideration of internal audit's review of whistleblowing and national training programmes on FIPS.</p>
<p><b>4 Pensions accounting</b></p> <p>SDS accounts for its participation in the Strathclyde Pension Fund and Highland Pension Fund in accordance with IAS 19 Retirement benefits, using a valuation report prepared by SDS' actuaries. There is an inherent risk with the determination of pension charges due to the extent of assumptions actuaries use in their calculations and the consequent impact on the financial statements.</p>	<p>Controls are in place to ensure accurate provision of data to actuaries.</p>	<p>Completion of 'review of the work of an expert' for the actuary.</p> <p>Focused testing of pension disclosures, including data that SDS provides to actuaries.</p>
<p><b>5 Data migration to FIPS</b></p> <p>As at November 2017, new modern apprenticeships, foundation apprenticeships and the Scotland's Employer Recruitment Incentive (SERI) are</p>	<p>Board oversight of FIPS implementation.</p> <p>Planning and user acceptance testing of data transfer.</p> <p>Data reconciliation and</p>	<p>Review of the implementation of the data transfer, including business continuity arrangements, review of Board papers and controls over data transfer.</p>

Audit Risk	Source of assurance	Planned audit work
<p>the only national training programmes processed through FIPS. SDS may transfer all national training programme data to FIPS by the end of March 2018. There is a risk that migration of data adversely affects information used to produce the financial statements.</p>	<p>sampling. Internal audit's review of national training programmes on FIPS.</p>	<p>Focused testing of national training programmes transactions such as modern apprenticeship payments. Consideration of internal audit's review of national training programmes on FIPS.</p>

### Wider dimension risks

<p><b>6 Financial sustainability</b></p> <p>SDS maintains a model which projects the financial position and identifies financial challenges over a five-year period. It shares these with the board and with the Scottish Government. Increasing expectations e.g. rising apprenticeships targets, new initiatives e.g. Work Able Scotland employability scheme and uncertainties over SDS' longer-term funding all present risks to financial sustainability.</p>	<p>Five-year financial plan in place with sensitivity analysis to identify the impact of potential spending review requirements. Risk recognised in the strategic risk register and discussed at board meetings and with the Scottish Government.</p>	<p>Review and assessment of any further scenario planning and how this feeds into the financial model. Review of robustness of any medium to long-term financial strategy and plans. Attendance at appropriate board meetings to observe financial sustainability discussions.</p>
<p><b>7 Financial management</b></p> <p>The approved budget for 2017/18 shows income and expenditure of £223 million. Income includes £179 million of core Grant-in-Aid from the Scottish Government and £22 million to be confirmed through the Autumn and Spring Budget Revisions. The board therefore approved the 2017/18 budget with a £22 million budget gap. As at November 2017, £4 million of funding is yet to be confirmed through the Spring Budget Revision. There is a risk that SDS will not receive sufficient funding to deliver its core services and fails to break even in 2017/18.</p>	<p>Continued discussions on affordability and programme delivery at board level and with the Scottish Government.</p>	<p>Review SDS' approach to managing in-year financial challenges. This will include regular review of budget monitoring reports and attendance at appropriate board meetings to observe discussions on programme delivery and affordability. Review of year-end outturn.</p>
<p><b>8 Enterprise and skills review - scrutiny and challenge by SDS board</b></p> <p>The enterprise and skills review introduced a strategic board to enhance joint working between SDS and other organisations. There is a risk of lack of clarity about roles, responsibilities and accountabilities as the new</p>	<p>On-going engagement with the Scottish Government including the Deputy First Minister and Cabinet Secretary for Education and Skills.</p>	<p>Review potential impact of the changes on SDS, including impact on the operation of the SDS board.</p>

Audit Risk	Source of assurance	Planned audit work
arrangements develop and a risk that this affects the effectiveness in SDS.		
<p><b>9 Openness and transparency</b></p> <p>In our 2016/17 annual audit report we recommended disclosure improvements in line with good practice and transparency principles. SDS agreed to monitor good practice and review disclosures in its 2017/18 financial statements as well as the availability of board and committee papers.</p>	<p>Plans to enhance publicly available annual review, including alignment of Finance and Strategy and Policy and Performance reporting with the Executive Leadership Group approval.</p>	<p>Consider SDS' review of the availability of board and committee papers and committee meeting minutes.</p> <p>Review disclosures in the 2017/18 financial statements.</p>
<p><b>10 Value for money</b></p> <p>Audit Scotland's Modern Apprenticeships report, published in 2014, set out recommendations for SDS including in relation to developing outcome-based measures and assessing the long-term benefits of modern apprenticeships. There is a risk that SDS has not made sufficient progress with addressing these recommendations.</p>	<p>Review of contracting strategy, including an oversight by the Finance and Operational Performance Committee.</p>	<p>Assess SDS' progress towards addressing the report's recommendations.</p>

## Reporting arrangements

**4.** Audit reporting is the main output from 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](http://www.audit-scotland.gov.uk).

**5.** 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.

**6.** We will provide an independent auditor's report to SDS, the Scottish Parliament and the Auditor General for Scotland setting out our opinions on the financial statements. We will also provide the 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.

## Exhibit 2

### 2017/18 Audit outputs

Audit Output	Target date	Audit Committee (or equivalent) Date
Interim Report	March 2018	15 March 2018
Annual Audit Report	June 2018	TBC
Independent Auditor's Report	July 2018	N/A

### Audit fee

**7.** The proposed audit fee for the 2017/18 audit of SDS is £XX (TBC). In determining the audit fee we have taken account of the risk exposure of SDS, the planned management assurances in place and the level of reliance on the work of internal audit. Our audit approach assumes receipt of the unaudited financial statements with a complete working papers package on 14 May 2018.

**8.** Where our audit cannot proceed as planned through, for example, late receipt of unaudited financial statements, delays in responding to our draft reports 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 Committee and Accountable Officer (or equivalents)

**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 Audit and Risk 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 and other specified information accompanying 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 SDS 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 SDS 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
- whether the information included in the directors' and strategic reports is consistent with the financial statements
- the regularity of the expenditure and income.

## Materiality

**15.** We apply the concept of materiality in planning and performing the audit. It is used in evaluating the effect of identified misstatements on the audit, and of any uncorrected misstatements, on the financial statements and in forming our opinion in the auditor's report.

**16.** We calculate materiality at different levels as described below. The calculated materiality values for SDS are set out in [Exhibit 3](#).



## Exhibit 3

### Materiality values

Materiality level	Amount
<b>Planning materiality</b> – 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 gross expenditure for the year ended 31 March 2018 based on the latest budget for 2017/18.	£2.24 million
<b>Performance materiality</b> – 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 60% of planning materiality.	£1.34 million
<b>Reporting threshold (i.e. clearly trivial)</b> – 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.	£20,000



17. We review and report on other information published with the financial statements including the strategic report, directors' report, remuneration report and annual governance statement. Any issue identified will be reported to the Audit and Risk Committee.

#### Timetable

18. To support the efficient use of audit resources, it is critical that a financial statements timetable is agreed for the production of the accounts for audit. An agreed timetable is included at [Exhibit 4](#) which takes account of submission requirements and planned Audit and Risk Committee dates:

## Exhibit 4

### Financial statements timetable

 Key stage	 Date
Consideration of unaudited financial statements by those charged with governance	May 2018
Latest submission date of unaudited annual accounts with complete working papers package	14 May 2018
Latest date for final clearance meeting with Director of Finance	TBC
Issue of letter of representation and proposed independent auditor's report	TBC
Agreement of audited unsigned annual accounts	TBC
Issue of Annual Audit Report including ISA 260 report to those charged with governance	TBC
Independent auditor's report signed	TBC

## Internal audit

**19.** 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 Scott Moncrieff.

### Adequacy of Internal Audit

**20.** There will be a formal review of the effectiveness of the internal Audit function to ensure it operates in accordance with Public Sector Internal Auditing Standards (PSIAS). Subject to completion of this review, we plan to place reliance on internal audit's work as outlined below.

### Areas of Internal Audit reliance

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

- National Training Programmes (including consideration of the impact of FIPs)
- ESF funding

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

- Validation of SDS' self-assessment of financial controls in support of SDS' business objectives
- Graduate and foundation apprenticeships
- Whistleblowing
- Workforce planning
- Major project governance
- IT review.

**23.** To ensure a joined-up approach, we are also planning to liaise with the Highlands and Islands Enterprise (HIE) and Scottish Enterprise (SE) auditors on internal audit arrangements for Enterprise Information Systems which deliver ICT services to SDS, HIE and SE. We will consider placing reliance on internal audit work in this area where possible.

## Audit dimensions

**24.** 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



Source: Code of Audit Practice

### Financial sustainability

**25.** As auditors we consider the appropriateness of the use of the going concern basis of accounting as part of the annual audit. We will also comment on SDS' financial sustainability in the longer term. We define this as medium term (two to five years) and longer term (longer than five years) sustainability. 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
- the appropriateness and effectiveness of arrangements in place to address any identified funding gaps.

### Financial management

**26.** 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 SDS has arrangements in place to ensure systems of internal control are operating effectively
- whether SDS can demonstrate the effectiveness of budgetary control system in communicating accurate and timely financial performance
- how SDS has assured itself that its financial capacity and skills are appropriate
- whether SDS has established appropriate and effective arrangements for the prevention and detection of fraud and corruption.

### Governance and transparency

**27.** 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 SDS can demonstrate that the 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

**28.** Value for money refers to using resources effectively and continually improving services. We will review, conclude and report on SDS' progress in addressing the recommendations set out in our Modern Apprenticeships report, published in 2014, including whether:

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

### Independence and objectivity

**29.** Auditors appointed by the Accounts Commission or Auditor General must comply with the Code of Audit Practice and relevant supporting guidance. 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 Director of Audit Services, who serves as Audit Scotland's Ethics Partner.

**30.** The engagement lead for SDS is Gordon Smail, Associate 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 SDS.

### Quality control

**31.** 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.

**32.** 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 (and relevant supporting guidance) 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.

**33.** 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.

## **Adding Value**

**34.** Through our audit work we aim to add value to SDS. We will do this by ensuring our annual audit report provides a summary of the audit work done in the year together with clear judgements and conclusions on how well SDS has discharged its responsibilities and how well it has demonstrated the effectiveness of its arrangements. Where it is appropriate, we will recommend actions that support continuous improvement and summarise areas of good practice identified from our audit work.

# The Skills Development Scotland Co. Limited

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