

Scottish Funding Council

2017/18 Annual Audit Report



 AUDIT SCOTLAND

Prepared for the Scottish Funding Council and the Auditor General for Scotland

June 2018

Who we are

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

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



About us

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

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

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

Contents

Key messages	4
Introduction	5
Part 1 Audit of 2017/18 annual report and accounts	7
Part 2 Financial management	11
Part 3 Financial sustainability	13
Part 4 Governance and transparency	16
Part 5 Value for money	21
Appendix 1 Action plan 2017/18	23
Appendix 2 Significant audit risks identified during planning	26
Appendix 3 Summary of national performance reports 2017/18	29

Key messages

2017/18 annual report and accounts

- 1 The financial statements of the Scottish Funding Council (SFC) give a true and fair view of its financial position as at 31 March 2018 and its expenditure and income for 2017/18.
- 2 The expenditure and income in the financial statements were incurred or applied in accordance with applicable enactments and guidance.
- 3 The other information in the annual report and accounts is consistent with the financial statements and prepared in accordance with legal requirements.

Financial management

- 4 SFC effectively managed its finances in 2017/18.
- 5 Systems of internal control operated effectively in 2017/18.

Financial sustainability

- 6 SFC should work to complete medium to longer-term financial plans closely linked to the objectives set out in its new strategic plan.
- 7 SFC is managing the resource implications of non-recovery of European funding and reflects this in its financial plans. SFC should work with the Scottish Government and colleges to ensure clear expectations on the standard of documentation required to support funding claims.

Governance and transparency

- 8 SFC has effective governance arrangements.
- 9 SFC recognises the challenges and opportunities presented by the Scottish Government's enterprise and skills review. There is evidence of a shared commitment to take forward the review's recommendations.

Value for money

- 10 SFC has implemented a performance management framework including an annual performance report clearly aligned to the objectives of its strategic plan.

Introduction

1. This report summarises the findings from our 2017/18 audit of the Scottish Funding Council (SFC).
2. The scope of our audit was set out in our Annual Audit Plan presented to the March 2018 meeting of the Audit and Compliance Committee. This report comprises the findings from:
 - an audit of SFC's annual report and accounts
 - consideration of the four audit dimensions that frame the wider scope of public audit set out in the [Code of Audit Practice 2016](#) as illustrated in [Exhibit 1](#).

Exhibit 1

Audit dimensions



Source: *Code of Audit Practice 2016*

3. The main elements of our audit work in 2017/18 have been:
 - a review of SFC's main financial systems
 - an audit of SFC's 2017/18 annual report and accounts including the issue of an independent auditor's report setting out our opinions
 - consideration of the four audit dimensions.
4. SFC has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing annual report and accounts that are in

accordance with the accounts direction from the Scottish Ministers. SFC's annual report and accounts includes the following:

- Performance Report
- Accountability Report (which includes the Corporate Governance Report, Remuneration and Staff Report and Parliamentary Accountability Report)
- Financial statements and supporting notes.

5. SFC is also responsible for establishing effective arrangements for governance, propriety and regularity that enable its Board to successfully deliver its objectives.

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

7. As public sector auditors we give independent opinions on the annual report and accounts. We also review and provide conclusions on the effectiveness of the performance management arrangements, suitability and effectiveness of corporate governance arrangements, and financial position and arrangements for securing financial sustainability. In doing this we aim to support improvement and accountability. Further details of the respective responsibilities of management and the auditor can be found in the *Code of Audit Practice 2016* and supplementary guidance.

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

9. Our annual audit report contains an agreed action plan at [Appendix 1](#). It sets out specific recommendations, responsible officers and dates for implementation. It also includes outstanding actions from last year and the steps being taken to implement them.

10. 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 2017/18 audit fee of £71,500 set out in our Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

Adding value through the audit

11. Our aim is to add value to SFC by identifying areas of improvement and recommending and encouraging good practice. By doing this, we aim to help the SFC promote improved standards of governance, better management and decision making and more effective use of resources.

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

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

Part 1

Audit of 2017/18 annual report and accounts



Main judgements

The financial statements of the Scottish Funding Council give a true and fair view of its financial position as at 31 March 2018 and its expenditure and income for 2017/18.

The expenditure and income in the financial statements were incurred or applied in accordance with applicable enactments and guidance.

The other information in the annual report and accounts is consistent with the financial statements and prepared in accordance with legal requirements.

Audit opinions on the annual report and accounts

14. The annual report and accounts for the year ended 31 March 2018 will be presented to SFC's Board for approval on 21 June 2018. We reported within our independent auditor's report that in our opinion:

- the financial statements give a true and fair view and were properly prepared
- expenditure and income were incurred in accordance with applicable enactments and guidance
- the performance report, governance statement and remuneration and staff report were all consistent with the financial statements and properly prepared in accordance with the accounts direction.

15. Additionally, we have nothing to report in respect of misstatements in the other information presented with the financial statements, the adequacy of accounting records and the information and explanations we received.

Submission of annual report and accounts for audit

16. We received the unaudited annual report and accounts on 3 May 2018 in line with our agreed audit timetable.

17. The working papers provided with the unaudited annual report and accounts were of a good standard and finance staff helped ensure the final accounts audit process ran smoothly.

Risk of material misstatement

18. [Appendix 2](#) provides a description of those assessed risks of material misstatement that were identified during the planning process. These risks had the greatest effect on the overall audit strategy, the allocation of staff resources to the audit and directing the efforts of the audit team. Also included within the appendix are wider audit dimension risks, how we addressed these and conclusions.

The annual report and accounts are the principal means of accounting for the stewardship of resources and performance in the use of those resources.

Materiality

19. Misstatements are material if they could reasonably be expected to influence the economic decisions of users based on the financial statements. The assessment of what is material is a matter of professional judgement. It involves considering both the amount and nature of the misstatement.

20. Our initial assessment of materiality for the annual report and accounts was carried out during the planning phase of the audit. Specifically, regarding the annual report and accounts we assess the materiality of uncorrected misstatements, both individually and collectively.

21. On receipt of the annual report and accounts we reviewed our materiality calculations and revised them accordingly. These are summarised in Exhibit 2.

Exhibit 2

Materiality values

Materiality level	Amount
Overall materiality	£17.8 million
Performance materiality	£13.4 million
Reporting threshold	£180,000

Source: Audit Scotland

How we evaluate misstatements

22. There were no material adjustments to the unaudited financial statements arising from our audit.

23. It is our responsibility to request that all misstatements other than those below the reporting threshold are corrected. The final decision on this lies with those charged with governance considering advice from senior officers and materiality. There were no misstatements which exceeded out reporting threshold.

Significant findings from the audit in accordance with ISA 260

24. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance. These are summarised in [Exhibit 3](#). Where a finding has resulted in a recommendation to management, a cross reference to the Action Plan in [Appendix 1](#) has been included.

25. These findings include our views about significant qualitative aspects of SFC's accounting practices including:

- Accounting policies
- Accounting estimates and judgements
- Significant financial statements disclosures
- Timing of transactions and the period in which they are recorded

- The impact on the financial statements of any uncertainties
- Misstatements in the annual report and accounts
- The effect of any unusual transactions on the financial statements
- Disagreement over any accounting treatment or financial statements disclosure

Exhibit 3

Significant findings from the audit of financial statements

Issue	Resolution
<p>1. Financial transactions</p> <p>In 2017/18 SFC awarded interest free loans totalling £16.2 million to universities to support carbon reduction projects. These were funded from its financial transactions budget allocation. The value of these loans has been recorded in the accounts at the transaction cost rather than the discounted cashflow value. SFC has disclosed that this would not be materially different from cost.</p> <p>SFC will receive significantly higher levels of financial transactions funding in 2018/19. It should review its accounting treatment of financial transactions funded loans to ensure it remains appropriate.</p>	<p>Officers have provided evidence which supports SFC's view that the discounted cash flow value of the loans is not materially different from cost.</p> <p> Recommendation 1 (refer appendix 1, action plan)</p>

Source: Audit Scotland

Other findings

Performance Report

26. The performance report section of the annual report and accounts has been prepared in line with the minimum requirements of the Government Financial Reporting Manual (the FReM). We have, however, identified some improvements which could be made to the performance analysis and financial commentary.

27. The FReM requires the performance analysis to explain the link between performance indicators, risk and uncertainty. SFC's performance analysis could better explain the risks and uncertainty affecting each of its performance measures.

28. To ensure that SFC provides a fair and balanced performance analysis, and in the interests of enhanced transparency, there is scope to provide a clearer analysis of how SFC spends its funding and what is achieved.



Recommendation 2

SFC should consider the content of its 2018/19 performance report to ensure it provides users of the annual report and accounts with a more understandable analysis of its performance.

Fixed asset register

29. In 2016/17 we reported differences between the asset values recorded in SFC's fixed asset register and the corresponding values recorded in its financial ledger. SFC has updated its fixed asset register to ensure asset values are accurately recorded.

30. We did not note any issues with the accuracy of the asset values recorded in the 2017/18 accounts. However, during this year's audit testing we identified some issues with how accurately individual assets are recorded in the fixed asset register. These included missing asset numbers, incorrect asset locations and disposals not written off in a timely manner.



Recommendation 3

SFC should review its fixed asset register to ensure data is complete and accurate.

Follow up of prior year recommendations

31. We have followed up actions agreed in 2016/17 to assess progress with implementation. SFC has made progress in implementing these actions. The actions not yet fully implemented are reflected in the recommendations set out in [Appendix 1](#).

Part 2

Financial management



Main judgements

SFC effectively managed its finances in 2017/18.

Systems of internal control operated effectively in 2017/18.

Financial performance in 2017/18

32. The main financial objective for SFC is to ensure that the financial outturn for the year is within the budget allocated by Scottish Ministers.

33. SFC's financial performance against Departmental Expenditure Limits (DEL) is shown in [Exhibit 4](#). SFC underspent its DEL budget by £21.6 million, however no opportunities were lost to the sectors. The main areas of underspend are:

- £6.0 million from colleges repaying loans agreed before April 2014 which do not score as resource expenditure
- £17.4 million slippage on capital projects.

Exhibit 4

Performance against DEL in 2017/18

Performance	Final budget £m	Actual outturn £m	Overspend/ (underspend) £m
Resource DEL	1,664.5	1,661.9	(2.6)
Capital DEL	92.9	74.6	(18.3)
Financial transactions	16.9	16.2	(0.7)
Total DEL	1,774.3	1,752.7	(21.6)

Source: Scottish Funding Council resource return

34. SFC's running costs grant-in-aid budget for 2017/18 was £7.2 million. SFC's actual spend in 2017/18 was £7.4 million. This was mainly due to bringing forward funding of the final component of the office refurbishment costs, carried out in 2017/18, which had Scottish Government approval.

35. SFC monitors its financial position for higher and further education throughout the year through resource returns to the Scottish Government. SFC manages its

budget through an annual re-profiling exercise to re-allocate funds between its higher education, further education and running costs budgets. The Scottish Government approved total re-profiling of £18.3 million, which equates to 1% of the total grant-in-aid budget from the Scottish Government.

Budgetary processes

36. We reviewed SFC's budgetary processes and budget monitoring arrangements. From our review of budget monitoring reports, review of committee papers and attendance at committees we confirmed that senior management and members receive regular, timely and up to date financial information on the financial position.

37. We concluded that SFC has satisfactory budgetary monitoring and control arrangements that allow members of the Finance Committee and officers to scrutinise its finances.

Systems of internal control

38. As part of our audit we identify and inspect the key internal controls in those accounting systems which we regard as significant to produce the financial statements. Our objective is to gain assurance that SFC has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

39. We followed up the three actions agreed in our 2016/17 Interim Audit Report to assess SFC's progress. We found that two actions have been fully implemented and further work is required in one area. In 2016/17 we recommended that senior officers periodically review the access rights of users of the SunAccounts system to ensure they remain appropriate. The SunAccounts system is used to process invoices, create purchase orders, generate payments and print remittances. Officers confirmed that the recommendation has been implemented but we found no evidence to confirm the review was performed.

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



Recommendation 4

Senior officers should retain evidence to confirm they have reviewed the access rights of users of the SunAccounts system on a periodic basis.

40. The findings of our interim testing allowed us to conclude that the controls tested were operating effectively. We did not identify any significant internal control weaknesses which could affect SFC's ability to record, process, summarise and report financial and other relevant data to result in a material misstatement in the financial statements.

Part 3

Financial sustainability



Main judgements

SFC should work to complete medium to longer-term financial plans closely linked to the objectives set out in its new strategic plan.

SFC is managing the resource implications of non-recovery of European funding and reflects this in its financial plans. SFC should work with the Scottish Government and colleges to ensure clear expectations on the standard of documentation required to support funding claims.

Financial planning

41. SFC received its draft budget allocation from the Scottish Government in April 2018. The total budget allocation is £1,808 million. This covers the funding SFC distributes to higher and further education institutions and its own running costs.

42. SFC announced indicative funding allocations to universities and colleges in February 2018. It announced final outcome agreement funding allocations in May 2018 based on the budget allocation from the Scottish Government. The final allocations were broadly unchanged from the indicative allocations.

2017/18 financial position

43. The Statement of Financial Position summarises what is owned and owed by SFC. This shows taxpayers' equity – an accounting measurement of the amount invested that has continuing public benefit. It shows how much of this has arisen from the application of revenues and that which has resulted through changes over time in the value of physical assets.

44. SFC's net expenditure for 2017/18 was £1,760.0 million. The SFC is funded from Scottish Government grant-in-aid and other Scottish and UK Government grants. This funding totalled £1,774.7 million in 2017/18 which resulted in an accounting surplus of £14.8 million. This surplus arises from an excess of income over expenditure mainly due to the accounting treatment of the financial transactions funding SFC received from the Scottish Government.

45. The financial statements show that SFC has net assets of £23.9 million, an increase of £14.8 million from last year. This is mainly attributable to SFC issuing new loans to universities in 2017/18 funded from its financial transactions budget.

Medium to long-term financial planning

46. We reviewed SFC's financial planning systems and assessed how effective they are in identifying and addressing risks to financial sustainability across the medium (two to five years) and long-term (five to ten years). We recognise that SFC is mainly funded through grant-in-aid and this is set on an annual basis by the Scottish Government.

Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

47. SFC's financial plans only cover a one-year period. It is developing longer-term financial plans for its running costs and higher and further education budgets aligned with its strategic plan. SFC is using sensitivity analysis and scenario planning to ensure its financial plans account for the impact of significant developments such as:

- the outcome of national bargaining for teaching and support staff pay
- the Scottish Government's policy objective to widen access to higher education
- the new Scottish Government medium term financial plan
- the UK's exit from the European Union (EU).

48. SFC recognises that further work is required before longer term financial plans are in place. It is part of strategic futures groups for further and higher education. These groups include representation from colleges and universities and the Scottish Government. Ministers also attend meetings. The groups aim to ensure a shared approach to long term financial planning and risk management. The higher education strategic futures group is focusing on the financial implications of EU withdrawal, including the impact on universities of a reduction of EU funded student places and research funding.



Recommendation 5

SFC should work to complete medium to longer-term financial plans which measure the likely financial impact of major developments affecting the higher and further education sectors. These plans should be linked closely to the objectives set out in its new strategic plan.

European funding

49. SFC is the lead partner for two European Social Fund (ESF) programmes; the Youth Employment Initiative (YEI) and Developing Scotland's Workforce (DSW). YEI aims to integrate young people not in employment, education or training into the labour market and to reduce youth unemployment in South West Scotland. DSW aims to address regional skill gaps and shortages associated with key employment sectors. SFC provides funding to colleges to support these programmes and claims match European funding through the Scottish Government.

50. At the end of 2016/17 SFC submitted claims to the Scottish Government, managing authority for ESF, for £11.5 million in respect of ESF funding for the 2015/16 academic year. These claims were rejected due to insufficient evidence in support of the claims. SFC submitted a second claim for YEI which was rejected in January 2018 and it is currently preparing a third claim. SFC's second claim for DSW is being reviewed by the Scottish Government. SFC cannot submit claims for 2016/17 and 2017/18 activity until the 2015/16 claims have been settled.

51. SFC is working with colleges to gather evidence on all 2015/16 students and conducting 100% documentation checks to support its third YEI claim. SFC will need to carry out the same exercise for DSW if its second claim is rejected. Performing the required checks is time consuming for staff and SFC will need to manage the resource implications of this work.

52. SFC's Finance Committee considers regular reports from officers on the progress of the ESF claims. SFC reflects the implications of non-recovery of European funding in its financial plans and has been able to fund the YEI and DSW

programmes from its existing resources. SFC needs to consider whether it can continue to support these programmes if further claims are unsuccessful.

53. There has been a lack of clarity between SFC, the Scottish Government and colleges on the rules of the ESF programme and the standard and level of documentation required to support claims. SFC has held discussions with the Scottish Government to understand what its expectations are.



Recommendation 6

SFC should work with the Scottish Government and colleges to ensure clear expectations on the standard of documentation required to support ESF claims.

EU withdrawal

54. There remains significant uncertainty about the detailed implications of EU withdrawal (i.e. Brexit). It is critical that public sector bodies are working to understand, assess and prepare for the impact on their business in three broad areas:

- Workforce – the extent to which changes to migration and trade policies are likely to affect the availability of skilled and unskilled labour
- Funding – the extent to which potential changes to funding flows are likely to affect the finances of the organisation and the activity that such funding supports
- Regulation – the extent to which potential changes to regulation across a broad range of areas overseen at an EU level are likely to affect the activities of the organisation.

55. SFC has included Brexit as a medium level risk in its risk register. It has identified a risk that it is unable to mitigate the most significant financial and other direct and indirect impacts on colleges and universities of leaving the European Union. In response to this risk, SFC has developed its existing briefing material to include a deeper analysis of the direct and indirect impacts of Brexit, and potential responses and scenarios that mitigate the effects.

Part 4

Governance and transparency



Main judgements

SFC has effective governance arrangements.

SFC recognises the challenges and opportunities presented by the Scottish Government's enterprise and skills review. There is evidence of a shared commitment to take forward the review's recommendations.

Governance arrangements

56. The corporate governance framework within SFC is centred around the Board, supported in its role by seven committees including the Audit and Compliance Committee and the Finance Committee. The Board is responsible for establishing the strategic processes within SFC and arrangements for ensuring the proper conduct of the affairs of SFC. The Board delegates responsibility for scrutiny to the Audit and Compliance Committee which meets quarterly.

57. Each year the Audit and Compliance Committee undertakes a self-assessment exercise. The Audit and Compliance Committee members demonstrate a clear understanding of their responsibilities, and of the respective roles of management, internal audit and external audit. Members participate in development opportunities on an ongoing basis to ensure their skills adapt to changing demands and put their skills and experience to good use in contributing to the committee's work. We concluded that SFC has effective governance, decision making and scrutiny arrangements in place which support good governance and accountability.

Risk management

58. We reviewed the risk management processes within SFC. SFC's risk strategy is implemented through a risk management framework which helps identify, assess and manage risk effectively. SFC maintains a corporate risk register which is regularly reviewed by the senior management team.

59. SFC has further developed its approach to risk management during 2017/18 by completing an annual review of its risk management strategy and by holding a workshop on risk tolerance and risk appetite. SFC has developed a statement of risk appetite using a six-point scale.

Internal audit

60. SFC's internal audit function is carried out by a firm of accountants. Each year we consider whether we can rely on internal audit work to avoid duplication of effort. When we plan to place reliance on internal audit work we carry out an assessment of the internal audit function to ensure that it is sufficient in terms of documentation standards, reporting procedures, quality, and is performed in accordance with Public Sector Internal Audit Standards (PSIAS). Internal audit has plans in place for an external quality assessment in early 2018.

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.

61. We reviewed SFC's internal audit arrangements in accordance with International Standard on Auditing (UK) 610 (Using the Work of Internal Auditors) to determine the extent we could rely on the work of internal audit. We concluded that it operates in accordance with the PSIAS and has sound documentation standards and reporting procedures in place.

62. In 2017/18 we reviewed and placed reliance on the findings of internal audit's Grant Funding Distribution report for our financial statements responsibilities. In respect of our wider dimension audit responsibilities we reviewed and considered the findings of the following internal audit reports:

- Corporate Governance
- Performance Management
- Procurement
- Monitoring of Institutions.

Governance Statement

63. HM Treasury's Financial Reporting Manual (the FReM) requires an annual governance statement within the annual report and accounts. Guidance is set out within the Scottish Public Finance Manual (SPFM) for the content of the governance statement and provides assurances around the achievement of the organisation's strategic objectives.

64. The SPFM does not prescribe a format for the annual governance statement but sets out minimum requirements for central government bodies. The process undertaken by the senior management team included conducting an assurance mapping process which underpinned the preparation of the governance statement.

65. We concluded that the 2017/18 governance statement complies with the guidance issued by the Scottish Ministers and, based on our knowledge and work performed, presents a comprehensive picture of governance arrangements and matters.

National Fraud Initiative

66. The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise coordinated by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify 'matches' that might suggest the existence of fraud or irregularity.

67. We completed a review of NFI work in February 2018 and found that SFC is pro-active in investigating matches and has investigated and closed all required matches.

68. SFC has not identified any frauds or errors during 2017/18 and the results of NFI activity were reported to the March 2018 meeting of the Audit and Compliance Committee.

Standards of conduct for prevention and detection of fraud and error

69. We have reviewed the arrangements in place to maintain standards of conduct including the staff handbook and civil service and members' codes of conduct. There are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.

70. Based on our review of the evidence we concluded that SFC has appropriate arrangements in place for the prevention and detection of bribery and corruption. We are not aware of any specific issues that we need to bring to your attention.

Framework document

71. SFC's management statement and financial memorandum were agreed with the Scottish Government in January 2006, shortly after SFC was established. Since then, the most significant change in accountability and governance arrangements is the reclassification of incorporated colleges by the Office of National Statistics and the regionalisation of colleges. SFC has been developing a replacement framework document with the Scottish Government which reflects these changes and developments in governance and financial management as a result of the Post-16 Education (Scotland) Act 2013.

72. A draft framework document has been reviewed by the Board and is still to be finalised with the Scottish Government. Once the document is finalised it will reflect the current governance and financial accountability arrangements.

Cyber security

73. The Scottish Government issued a Public Sector Action Plan on Cyber Resilience in November 2017. This requires all public sector bodies to carry out a review to ensure their cyber security arrangements are appropriate.

74. We reported a risk in our 2017/18 Annual Audit Plan that SFC's ICT strategy is still in draft. The ICT strategy currently remains in draft and has not yet been finalised however SFC has redrafted its information management framework to take account of the new General Data Protection Regulation (GDPR) implementation and Cyber Security Essentials.

75. SFC is actively strengthening its cyber resilience arrangements. The recommendations required to achieve Cyber Essentials certification are already in place and they are aiming to achieve Cyber Essentials Plus certification by October 2018.

General Data Protection Regulation (GDPR)

76. GDPR came into force on 25 May 2018. This replaced the UK Data Protection Act 1998 (DPA). As a regulation, all EU member states must implement it in the same way. GDPR sets out more requirements than the DPA and has introduced new and significantly changed data protection concepts.

77. GDPR introduces a wide range of new rights for individuals in respect of their personal data. These include the right to be forgotten, the right to object to certain processing activities and to decisions taken by automated processes. Failure to comply with new GDPR data handling arrangements could result in significant fines.

78. SFC processes large volumes of personal data, including the data of college students, university and college staff and its own staff. SFC also shares data with third parties including other public sector organisations and the private sector. SFC was pro-active in identifying the implications of the new regulation and the changes required. It developed a project plan which identified the actions needed to achieve compliance.

Transparency

79. Transparency means that the public have access to understandable, relevant and timely information about how SFC is taking decisions and how it is using resources such as money, people and assets.

80. Agendas, minutes and papers of Board and committee meetings are published on the SFC website. In our 2016/17 Annual Audit Report we reported that SFC uses the Freedom of Information Act to withhold publication of a wide range of papers. We recommended that SFC could consider opportunities to further enhance transparency by reviewing how it applies the Freedom of Information guidance.

81. SFC is making more financial information publicly available through publication of parts of Finance Committee papers. It also now makes a wider range of Audit and Compliance Committee papers available on its website. It has developed an action plan to help improve its compliance with Freedom of Information legislation. It intends to use this as an opportunity to further review the information it publishes.

Enterprise and skills review

82. In May 2016, the First Minister announced a review of enterprise and skills support. This aims to ensure public agencies are delivering the support Scotland's young people, universities, colleges, training providers, businesses and workers need. The report on the first phase of the review was published in October 2016. It contained recommendations to significantly improve enterprise and skills support to help increase Scotland's productivity, equality, wellbeing and sustainability.

83. Phase two of the review commenced in November 2016. Key actions include:

- creating a Strategic Board to support the co-ordination of agency activities around shared priorities, and help improve performance
- creating a new enterprise agency for the South of Scotland
- developing a more coherent, collaborative and streamlined system of business support
- piloting a £500,000 College Innovation Fund to support colleges to work with businesses on innovation activity.

84. The Strategic Board has met three times. It has an independent Chair and a membership drawn from the Chairs of each of the enterprise and skills agencies as well as non-executive members. The Board's priority has been to develop a strategic plan and a framework for measuring performance. The strategic plan will set out areas of shared focus for the agencies and actions to boost growth and productivity. It is due to be completed later this year. SFC is waiting to put together its own new strategy so that it is aligned with the strategic plan. It has put in place a one year holding strategy in the interim.

85. The review includes a skills alignment workstream. This aims to align relevant functions of SFC and Skills Development Scotland (SDS). Outcomes of the workstream include:

- a skills committee of the Strategic Board which informs joint delivery by both agencies and provides a joint decision-making forum
- a joint team led by a single director reporting to the Chief Executives of both agencies
- a jointly delivered skills planning and provision model.

The Scottish Government, SFC and SDS are in the early stages of implementing these actions which strengthen the joint working arrangements already in place.

86. The SFC Board has been kept up to date with developments through regular reporting to Board meetings. Board members and senior officers have started working to implement the review's recommendations. This has included exploring potential areas for joint working with the other enterprise and skills agencies.

Groups of employees from each of the agencies have met to talk about the implications of the review and identify opportunities to work together. SFC has also held discussions with universities and colleges to ensure they recognise their opportunity to influence the outcome of the review.

87. The review gives SFC a chance to shape the future of enterprise and skills support and improve outcomes for universities, colleges and learners. Realising the review's ambitious aims will be challenging. It will require SFC to work effectively with others to develop shared priorities which make a difference across the enterprise and skills sector. SFC also needs to manage the expectations of the Strategic Board, ministers and its own Board. It should ensure its new strategy is aligned with the vision and actions of the strategic plan alongside its other business objectives.

88. SFC recognises these challenges and the opportunities offered by the enterprise and skills review. We see evidence of a shared commitment to take forward the review's recommendations. There is consensus that closer working can help the agencies to build on their individual achievements to ensure the enterprise and skills system provides the support users need.

89. We understand the significance of the enterprise and skills review for SFC, the other enterprise and skills agencies, and their partners. We will continue to monitor progress locally and at a national level.

Part 5

Value for money



Main judgements

SFC has implemented a performance management framework including an annual performance report clearly aligned to the objectives of its strategic plan.

Best Value

90. Accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value. The Auditor General may require that we consider whether accountable officers have put in place appropriate arrangements to satisfy their corresponding duty of Best Value. Where such requirements are not specified we may, in conjunction with SFC, agree to undertake local work in this area.

91. SFC assesses its compliance with the principles of Best Value by carrying out periodic self-assessment exercises. The last exercise was carried out in 2017. The self-assessment measures SFC against the Best Value characteristics an organisation should be able to demonstrate, as identified by the Scottish Government. Senior officers identified nine actions for improvement from the self-assessment. These have been used to form a Best Value improvement plan.

92. SFC reported its progress with improvement plan actions to the Audit and Compliance Committee in June 2018. SFC is making progress with its nine improvement actions. We are encouraged that SFC has been proactive in acting to ensure it has appropriate arrangements for securing Best Value in place.

Value for money is concerned with using resources effectively and continually improving services.

Performance management

93. The performance of SFC is monitored by the Board against several performance targets which support the delivery of the Scottish Government's national performance framework. These targets are set out in SFC's strategic plan. SFC expects to publish a new strategic plan later this year which will cover the five-year period 2018-23. SFC prepares an annual performance report which includes a range of measures of inputs, activity, outputs and outcomes linked to the strategic plan.

National performance audit reports

94. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. In 2017/18 several reports were published which are of direct interest to SFC. These are outlined in [Appendix 3](#).

95. SFC is working with Audit Scotland to finalise the Scotland's colleges 2018 report which is due to be published in June 2018. The 2017 Scotland's colleges report included specific recommendations for SFC and it has made good progress in addressing these. We will consider the recommendations of the 2018 report when planning our 2018/19 audit work.

96. The Audit and Compliance Committee considers and reviews the SFC recommendations in the Scotland's colleges reports and monitors progress made by SFC.

Appendix 1

Action plan 2017/18

2017/18 recommendations for improvement



No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p>Financial transactions</p> <p>In 2017/18 SFC awarded interest free loans totalling £16.2 million to universities to support carbon reduction projects. The value of the loans has been recorded in the accounts at the transaction cost rather than discounted cashflow value. SFC has disclosed that this would not be materially different from cost.</p> <p>Risk</p> <p>SFC will receive significantly higher levels of financial transactions funding in 2018/19. This may result in its accounting policy no longer being appropriate.</p>	<p>Officers should review the accounting treatment of financial transactions funded loans to ensure it remains appropriate.</p> <p>Paragraph 25</p>	<p>Agreed. It is normal practice to review all accounting policies on an annual basis.</p> <p>Director of Finance</p> <p>March 2019</p>
2	<p>Performance report</p> <p>We have identified some improvements which could be made to the performance analysis and financial commentary. These include better explaining the risks and uncertainty affecting SFC's performance measures and a clearer analysis of how it spends its funding and what is achieved.</p> <p>Risk</p> <p>SFC does not provide users of the annual report and accounts with a clear analysis of its performance.</p>	<p>SFC should consider the content of its 2018/19 performance report to ensure it provides users of the annual report and accounts with a more understandable analysis of its performance.</p> <p>Paragraph 28</p>	<p>Agreed</p> <p>Assistant Director - Strategy</p> <p>September 2018</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
3	<p>Accuracy of asset register</p> <p>We did not note any issues with the accuracy of the asset values recorded in the 2017/18 accounts. However, during audit testing we identified some issues with how accurately individual assets are recorded in the fixed asset register. These included missing asset numbers, incorrect asset locations and disposals not written off in a timely manner.</p> <p>Risk</p> <p>SFC does not have an accurate record of its assets.</p>	<p>SFC should review its fixed asset register to ensure data is complete and accurate.</p> <p>Paragraph 30</p>	<p>Agreed</p> <p>Assistant Director - Finance</p> <p>September 2018</p>
4	<p>Access to financial systems</p> <p>In 2016/17 we recommended that senior officers periodically review the access rights of users of the SunAccounts system to ensure they remain appropriate. Officers confirmed that the recommendation has been implemented but we found no evidence to confirm the review was performed.</p> <p>Risk</p> <p>There is a risk that fraudulent payments are made by individuals who should not have access to the system.</p>	<p>Senior officers should retain evidence to confirm they have reviewed the access rights of users of the SunAccounts system on a periodic basis.</p> <p>Paragraph 39</p>	<p>Agreed</p> <p>Assistant Director - Finance</p> <p>August 2018</p>
5	<p>Medium to long-term financial planning</p> <p>SFC's financial plans only cover a one-year period. It is developing longer-term financial plans for its running costs and higher and further education budgets aligned to its strategic plan.</p> <p>Risk</p> <p>SFC does not have the information available to support a longer-term view of its financial position and its options for future funding.</p>	<p>SFC should work to complete medium to longer-term financial plans which measure the likely financial impact of major developments affecting the higher and further education sectors. These plans should be linked closely to the objectives set out in its new strategic plan.</p> <p>Paragraph 48</p>	<p>Agreed</p> <p>Director of Finance</p> <p>March 2019</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
6	<p data-bbox="256 416 488 448">European funding</p> <p data-bbox="256 461 628 763">The Scottish Government has rejected SFC's claims for ESF funding for the 2015/16 academic year due to insufficient evidence in support of the claims. SFC cannot submit claims for 2016/17 and 2017/18 activity until the 2015/16 claims have been settled.</p> <p data-bbox="256 786 320 815">Risk</p> <p data-bbox="256 831 628 920">SFC does not receive the expected level of ESF funding from the Scottish Government.</p>	<p data-bbox="657 416 1002 600">SFC should work with the Scottish Government and colleges to ensure clear expectations on the standard of documentation required to support ESF claims.</p> <p data-bbox="657 613 820 645">Paragraph 53</p>	<p data-bbox="1054 416 1145 448">Agreed</p> <p data-bbox="1054 461 1422 521">Chief Funding and Information Officer</p> <p data-bbox="1054 535 1313 568">June 2018 (on-going)</p>

Appendix 2

Significant audit risks identified during planning

The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the annual report and accounts and those relating to our wider responsibility under the [Code of Audit Practice 2016](#).

Audit Risk	Assurance procedure	Results and conclusions
Risks of material misstatement in the financial statements		
<p>1 Risk of management override of controls</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 in order to change the position disclosed in the financial statements.</p>	<p>Reviewed the appropriateness of journal entries and other adjustments recorded in the general ledger and financial statements.</p> <p>Reviewed accounting estimates for biases.</p> <p>Evaluated significant transactions that are outside the normal course of business.</p> <p>Focussed testing of the regularity and cut-off assertions during the financial statements audit.</p>	<p>We concluded from our audit testing that all 2017/18 journal entries, accounting estimates and judgements, and significant transactions that we reviewed were appropriate.</p>
<p>2 Risk of fraud over income</p> <p>SFC receive a significant amount of income from European funding in addition to Scottish Government funding. The extent and complexity of income means that, in accordance with ISA240, there is an inherent risk of fraud.</p>	<p>Analytical procedures on income streams.</p> <p>Detailed testing of revenue transactions focusing on the areas of greatest risk.</p>	<p>We did not identify any significant issues from our detailed testing of grant income.</p> <p>We confirmed through audit testing that revenue had been recognised appropriately in the financial statements.</p>
<p>3 Risk of fraud over expenditure</p> <p>The Code of Audit Practice expands the ISA 240 assumption on fraud over income to expenditure. Due to the extent and complexity of SFC's expenditure in funding colleges and universities there is an inherent risk of fraud over expenditure.</p>	<p>Analytical procedures on expenditure streams.</p> <p>Detailed testing of expenditure transactions focusing on the areas of greatest risk.</p> <p>Review actions taken in respect of NFI data matches.</p>	<p>We found no significant issues from our detailed testing of running costs expenditure.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>4 Grants paid to colleges and universities</p> <p>The main activity of SFC is the award and payment of grants to colleges and universities. Due to the complexities around different year end dates and re-profiling of budgets, there is a risk that grants paid to institutions are incorrectly recorded in the financial statements.</p>	<p>Review Internal Audit's Grant Funding Distribution report.</p> <p>Focused substantive testing of formula based grant awards to individual bodies.</p> <p>Sample testing of grant commitments at the year end.</p>	<p>We reviewed Internal Audit's Grant Funding Distribution report and could place reliance on their findings.</p> <p>We found no misstatements of grant payments to institutions from our sample testing of in year grant payments, commitments relating to the remainder of the academic year 2016/17 and funding clawbacks.</p>
<p>5 European Social Fund and financial transactions funding</p> <p>SFC receives significant funding from the European Social Fund and financial transaction funding from the Scottish Government. Management judgements are required to determine the accounting treatment of this income.</p> <p>There is the risk that the judgements made are incorrect and result in incorrect accounting treatment.</p>	<p>Review appropriateness of accounting treatment to ensure it is correct.</p>	<p>We reviewed the evidence provided in support of the accounting treatment for European Social Fund and financial transactions funding.</p> <p>We are satisfied the accounting treatment of European Social Fund funding is appropriate.</p> <p>See recommendation 1 in the action plan (Appendix 1) for financial transactions.</p>
<p>Risks identified from the auditor's wider responsibility under the Code of Audit Practice</p>		
<p>6 Financial sustainability</p> <p>SFC's Strategic Plan for 2015-18 contains high level objectives on the use of resources and only has financial plans for higher education and further education covering a one year period.</p> <p>There is the risk that with no financial plans extending beyond one year it will be difficult to identify the challenges ahead and to take action to manage the future impact on SFC's financial position.</p>	<p>We reviewed SFC's progress on drafting medium to long term financial plans.</p> <p>Consider SFC's arrangements for monitoring and reporting on the financial health of institutions.</p>	<p>SFC is developing medium to long term financial plans for its running costs, higher education and further education budgets.</p> <p>See recommendation 5 in the action plan (Appendix 1).</p>
<p>7 Governance and effectiveness</p> <p>The Enterprise and Skills Review introduced a strategic board to enhance joint working between SFC and other organisations. These changes have led to delays in</p>	<p>Review potential impact of the changes on SFC, including impact on the operation of SFC's board.</p> <p>Monitor the progress with the new Framework document between SFC and the Scottish</p>	<p>SFC recognises the challenges and the opportunities offered by the enterprise and skills review and there is evidence of a shared commitment to take forward the review's recommendations.</p> <p>SFC's Framework document is still to be finalised.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>developing and enhancing governance arrangements at SFC resulting in deferrals in areas that we would have expected to see progress.</p> <p>There is a risk of lack of clarity about roles, responsibilities and accountabilities as the new arrangements develop and a risk that this affects the effectiveness of the organisation.</p>	<p>Government and review this once published.</p>	
<p>8 IT strategy – cyber security</p> <p>SFC is currently finalising its ICT strategy and the risk of cyber attacks will be included within this.</p> <p>Cyber incidents pose an increasing threat to public sector bodies. In late 2017, the Scottish Government issued ‘A Cyber Resilience Strategy for Scotland: Public sector action plan 2017-2018’ which details a number of key actions which SFC will be required to complete throughout 2018. These include preparing cyber incident response plans, a cyber security strategy and resilience training.</p> <p>There is a risk that a cyber attack could disrupt SFC’s key financial systems and may lead to data loss and financial and/or reputational loss.</p>	<p>Consider SFC’s progress in developing its ICT strategy and its reference to cyber security.</p>	<p>SFC’s ICT strategy is still in draft however cyber security has been included in its redrafted information management framework. SFC is making good progress towards achieving Cyber Essentials Plus certification by October 2018.</p>

Appendix 3

Summary of national performance reports 2017/18

		 2017/18 Reports	
		Apr	
		May	
Common Agricultural Policy Futures programme: further update		Jun	 Scotland's colleges 2017
		Jul	 NHS workforce planning
Self-directed support: 2017 progress report		Aug	
Equal pay in Scottish councils		Sept	
Transport Scotland's ferry services		Oct	 NHS in Scotland 2017
Local government in Scotland: Financial overview 2016/17		Nov	
		Dec	
		Jan	
Early learning and childcare		Feb	
Managing the implementation of the Scotland Acts		Mar	

The following reports may be of particular relevance to SFC:

[Scotland's colleges 2017](#) – June 2017

[Managing the implementation of the Scotland Acts](#) – March 2018

Scottish Funding Council

2017/18 Annual Audit Report

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