

The Skills Development Scotland Co. Limited

2017/18 Annual Audit Report



 AUDIT SCOTLAND

Prepared for Skills Development Scotland 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	22
Appendix 2 Significant audit risks identified during planning	26
Appendix 3 Summary of national performance reports 2017/18	30

Key messages

2017/18 annual report and financial statements

- 1 The financial statements of Skills Development Scotland Co. Limited (SDS) give a true and fair view of the financial position of the company and its group as at 31 March 2018 and of the group total comprehensive 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 financial statements is consistent with the accounts and prepared in accordance with legal requirements.

Financial management

- 4 SDS reported an overspend of £0.3 million, which represents 0.2 per cent of its 2017/18 budget. Overall, we concluded that financial management arrangements are effective.
- 5 We found that key controls in core financial systems operated as expected. There are inherent control risks in the national training programme systems which SDS recognises and actively manages. It is continuing to put in place additional controls to mitigate the risks further.

Financial sustainability

- 6 SDS has effective financial planning arrangements in place which include modelling for different scenarios. Although there is a significant forecast funding gap in the medium term, SDS' financial planning highlights this and facilitates both organisational awareness of the financial position and discussions with the Scottish Government.

Governance and transparency

- 7 The governance arrangements at SDS support effective oversight of the organisation's activities and its finances.
- 8 SDS has improved transparency through enhanced disclosures in the 2017/18 annual report and financial statements, with scope for further development. Openness and transparency can also be improved by making board and committee papers more accessible to the public.
- 9 SDS 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 SDS has an effective performance management framework in place.

Introduction

1. This report summarises the findings from our 2017/18 audit of Skills Development Scotland (SDS).
2. The scope of our audit was set out in our Annual Audit Plan presented to the 7 December 2017 meeting of the audit and risk committee (ARC). This report comprises the findings from:
 - an audit of the SDS' annual report and financial statements
 - 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 SDS' main financial systems
 - an audit of SDS' 2017/18 annual report and financial statements including the issue of an independent auditor's report setting out our opinions
 - consideration of the four audit dimensions.
4. SDS is responsible for preparing financial statements that give a true and fair view, for the accuracy of the other information in the annual report and financial

statements, and for establishing effective arrangements for governance, propriety and regularity that enable the board to successfully deliver its objectives.

5. 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.

6. As public sector auditors we give independent opinions on the annual report and financial statements. 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.

7. This report raises matters from the audit of the annual report and financial statements 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.

8. 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.

9. 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 this is reflected in the 2017/18 audit fee of £84,016 which has been agreed with SDS management. We are not aware of any relationships that could compromise our objectivity and independence.

Adding value through the audit

10. Our aim is to add value to SDS by increasing insight into, and offering foresight on, financial sustainability, risk and performance. Also, by identifying areas of improvement and by recommending and encouraging good practice. In so doing, we aim to help the board promote improved standards of governance, better management and decision making and more effective use of resources.

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

12. 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 SDS give a true and fair view of the financial position of the company and its group as at 31 March 2018 and of the group total comprehensive 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 financial statements is consistent with the accounts and prepared in accordance with legal requirements.

Audit opinions on the annual report and financial statements

13. The annual report and financial statements for the year ended 31 March 2018 were approved by the board 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 regular and in accordance with applicable enactments and guidance
- the other information in the annual report and financial statements is consistent with the financial statements and properly prepared in accordance with legal requirements.

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

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

Submission of annual report and financial statements for audit

15. We received the unaudited financial statements on 4 May 2018 in line with our agreed audit timetable.

16. The working papers provided with the unaudited financial statements were of a good standard and finance staff provided support to the audit team which helped ensure the final accounts audit process ran smoothly.

Risk of material misstatement

17. [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.

Materiality

18. Misstatements are material if they could reasonably be expected to influence the economic decisions of users taken 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.

19. Our initial assessment of materiality for the annual report and financial statements was carried out during the planning phase of the audit. On receipt of the draft annual report and financial statements we reviewed our materiality calculations and concluded that they remained appropriate. The overall materiality and reporting threshold remained at one per cent of gross expenditure and one per cent of overall materiality, respectively. Performance materiality also remained at 60 per cent of overall materiality. Materiality values are summarised in [Exhibit 2](#). Specifically, regarding the annual report and accounts we assess the materiality of uncorrected misstatements, both individually and collectively.

Exhibit 2

Materiality values on receipt of the annual report and financial statements

Materiality level	Amount
Overall materiality	£2.3 million
Performance materiality	£1.4 million
Reporting threshold	£20 thousand

Source: Audit Scotland

How we evaluate misstatements

20. There were no material adjustments to the unaudited financial statements arising from our audit. We found one monetary error relating to the employee benefits (untaken leave) accrual which is understated. The accrual in the accounts is based on salary costs and totals £1.5 million, but the relevant accounting standard (IAS 19) requires the entity to include the amounts it expects to pay as a result of the unused entitlement. In our view this includes related pensions and national insurance contributions.

21. Management accept that national insurance contributions should be included and estimate that if they had been, the accrual would have increased by £0.2M. In our view, the pensions element is required too. We estimate that this adds a further £0.1M to the accrual, bringing the overall misstatement to £0.3 million. This is below our materiality level and does not affect our opinion on the financial statements. The impact of this adjustment would be a decrease of £0.3 million in total comprehensive income in the consolidated statement of comprehensive income and an increase in the net liability balance of £0.3 million in both the group and company statements of financial position.

22. 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. Management do not propose to adjust for the item above as the amount is not considered material in the context of the financial statements.

Significant findings from the audit in accordance with ISA 260

23. 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.

24. These findings include our views about significant qualitative aspects of the SDS' accounting practices including:

- Accounting policies
- Significant financial statements disclosures
- The impact on the financial statements of any uncertainties
- Misstatements in the annual report and accounts
- Accounting estimates and judgements
- Timing of transactions and the period in which they are recorded
- 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. Intangible asset accounting policy</p> <p>From a review of the current accounting policy in relation to intangible assets, we found that it correctly identifies future economic benefit when recognising an asset, but does not define this as including cost savings or other benefits resulting from the use of the asset by the entity, as per IAS 38.</p>	<p>SDS has agreed to review the policy going forward.</p> <p> Recommendation 1 (refer appendix 1, action plan)</p>
<p>2. Employee benefits (untaken leave) accrual – NI and pension contributions</p> <p>Testing of the employee benefits accrual found that the calculation was based on basic pay only with no allowance made for national insurance (NI) and pension contributions. In our view, this does not comply with the relevant accounting standard (IAS 19).</p>	<p>Accepted as an unadjusted error below materiality, although precise value disputed on basis of interpretation of accounting standard. </p> <p>Recommendation 2 (refer appendix 1, action plan)</p>
<p>3. Employee benefits (untaken leave) accrual – flexi-time</p> <p>Audit testing of the employee benefits accrual found that it did not include flexi-time. This does not comply with the relevant accounting standard (IAS19) but management have provided sufficient detail to provide assurance that the amount involved is not material.</p>	<p>SDS management confirmed that supporting information is not available but is confident that the balance is likely to be low. SDS plans to address this in time for preparation of the 2018/19 accounts</p>

Issue	Resolution
	 Recommendation 2 (refer appendix 1, action plan)

Source: Audit Scotland

Other findings from the audit of the financial statements

25. Audit testing included a payment of £1.3 million in 2017/18 which related to laptop renewals. SDS does not capitalise such assets as on an individual basis the items are low value. While the relevant accounting standard does not require such items to be aggregated, it does allow for this. Capitalising such types of spend improves both financial reporting and financial planning as recurring and non-recurring items are separated. The policy in place at SDS is also not consistent with most other public bodies.



Recommendation 3

SDS should review its tangible asset policy to ensure that it is appropriate.

Follow up of prior year recommendations

26. We followed up actions agreed in 2016/17 to assess progress with implementation. We have reported progress of these prior year actions in [Appendix 1](#). They are identified by the prefix b/f (brought forward).

27. Five agreed actions were raised in 2016/17. Of these:

- two have been fully implemented
- three are not actioned or have only partly been actioned (see [Appendix 1](#)).

28. Overall SDS has made reasonable progress in implementing these actions. For actions not yet implemented, revised responses and timescales have been agreed with management, as set out in [Appendix 1](#).

Part 2

Financial management



Main judgements

SDS reported an overspend of £0.3 million, which represents 0.2% of its 2017/18 budget. Overall we concluded that financial management arrangements are effective.

We found that key controls in core financial systems operated as expected. There are inherent control risks in the national training programme systems which SDS recognises and actively manages. It is continuing to put in place additional controls to mitigate it further.

Finance team members have appropriate skills, capacity and capability to support SDS.

Financial performance in 2017/18

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

30. As shown in the new resource outturn analysis, SDS' total spend was £199.5 million in 2017/18, exceeding its overall resource budget by £0.3 million. This represents 0.2 per cent of the resource budget. We are satisfied that SDS has communicated this result to the Scottish Government. The financial performance against Departmental Expenditure Limits (DEL) is shown in [Exhibit 4](#).

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

Exhibit 4

Performance against DEL in 2017/18

Performance	Final budget £m	Actual outturn £m	Overspend/ (underspend) £m
Resource DEL	199.2	199.5	0.3

Source: Skills Development Scotland, Annual Report and Financial Statements 2017/18

Budgetary processes

31. We reviewed SDS' budgetary processes and budget monitoring arrangements. From our review of budget monitoring reports and committee papers we confirmed that senior management and board members receive regular, timely and up to date financial information on the financial position.

32. We concluded that SDS has effective budget monitoring and control arrangements that allow board members and officers to carry out effective scrutiny of its finances.

Systems of internal control

33. 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 SDS has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

34. Our findings were included in the Management Report presented to the ARC on 15 March 2018. We concluded that the key controls in the core financial systems were operating as expected.

35. We also identified that effective controls were in place for the national training programmes (NTP) processes, but there are known limitations in the current systems regarding making payments to providers. This represents an inherent control risk. Management recognise this and are content that other checks mitigate the risk. In response to the risk, we extended our testing and found no errors. Further checks are being introduced as part of the roll-out of the new funding information and processing system (FIPS) which provide further assurance.

ICT controls

36. ICT audit work this year focused on cyber resilience (reported at paragraphs 82 and 83) and following up points raised in last year's ICT overview report. There were four risks raised in the 2016/17 ICT overview report. Progress made against each of the four points can be summarised as:

- The project to complete documented procedures within Enterprise Information Systems (EIS) is still in progress.
- A single security policy across the partnership is not in place, although we note that work has progressed in some areas to unify security practices, such as a standardised approach to the Office 365 project across the partnership.
- EIS has engaged with the partners' business requirements to prepare an Information Technology strategy (the EIS strategy) and EIS development plan.
- EIS management has reported to the partnership board that the relationship with supplier CGI has improved with a noted decrease in service incidents. The service auditor reports a significant decrease in findings in 2018 compared to 2017.

Financial capacity

37. We carried out a review of the finance function and are satisfied that SDS has sufficient financial skills, capacity and capability. This is evidenced in, for example, the low level of error found in the financial statements and the existence of a robust financial model.

Part 3

Financial sustainability



Main judgements

SDS has effective financial planning arrangements in place which include modelling for different scenarios. Although there is a significant forecast funding gap in the medium term, SDS' financial planning highlights this and facilitates both organisational awareness of the financial position and discussions with the Scottish Government.

Financial planning and reporting would benefit from changes in capitalisation policies.

2017/18 financial position

38. The statement of financial position summarises what is owned and owed by SDS. This shows taxpayers' equity – an accounting measurement of the amount invested that has continuing public benefit.

39. The financial statements show that SDS:

- has group net liabilities of £34.1 million, a reduction in liabilities of £56.7 million since 2016/17
- has company net liabilities of £39.1 million, a reduction in liabilities of £57.3 million since 2016/17
- pension scheme remains in a liabilities position with obligations exceeding assets by £55.1 million.

Financial planning

40. In 2017/18 SDS received £19.0 million in additional funding through mid-year budget revisions, increasing the total resource allocation for the year to £199.2 million. SDS published its 2018/19 draft budget in March 2018 with a cash resource allocation of £192.8 million which is £13.7 million (7.6 per cent) more than the initial 2017/18 budget allocation. Current indications are that SDS will receive an additional £16.1 million in mid-year transfers in 2018/19, increasing the total allocation to £208.9 million, which is £10.9 million (5.5 per cent) higher than the total level of funding received in 2017/18.

41. SDS received £8.0 million of income from the European Structural Fund (ESF) in 2017/18, which was £5.2 million (39.6 per cent) less than the budget. The 2018/19 budget includes £19.1 million of European income, which is an increase of £5.8 million (43.4 per cent) on the budget for 2017/18. The programmes associated with this type of funding extend over several financial years and are based on areas of expenditure which meet eligibility criteria set out by the ESF. SDS is confident that it will be able to utilise the full level of funding available to it over the course of the programmes.

42. Total planned expenditure for 2018/19 of £241.7 million slightly exceeds total income by £0.050 million (0.02 per cent). This represents an increase of £18.9 million (8.5 per cent) on the 2017/18 budget, and £22.9 million (10.5 per cent) on the level of spend in 2017/18. The main movements include:

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.

- Increase in staff costs due to pay awards and progression payments totalling £5.6 million.
- Increase in national training programme expenditure of £9.4 million due to increased volumes in foundation and graduate apprenticeships.
- Increase of £3.7 million in ICT costs (including the EIS shared service arrangement). This includes continuation of Microsoft Office 365 roll-out, hardware update and investment in systems such as FIPS and the My World of Work (MyWoW) website.

New Financial Powers

43. Proposals have been made for changes to the Scottish Budget process with these likely to be introduced for the 2019/20 budget. Through our review of SDS' financial modelling we are satisfied that it allows for any changes through scenario planning.

44. The medium to longer term financial position may be affected by uncertainty around EU withdrawal and new financial powers. SDS will need to continue to refine and update its financial model to allow for any future changes.

Medium to long-term financial planning

45. We reviewed the financial planning model and assessed how effective it is in identifying and addressing risks to financial sustainability across the medium and long term.

46. We recognise that SDS is mainly funded from its Scottish Government budget allocation through Grant-in-Aid and this is determined on an annual basis by the Scottish Government. As reported in our Management Report, we are satisfied that SDS adequately prepares a medium to long-term financial plan which is underpinned by scenario planning and shared with the Scottish Government.

47. Our review also identified a significant increase in apprenticeship family expenditure as SDS works towards achieving the targets set by the Scottish Government. In our management report, we reflected that there remains a risk that, without a specific commitment from the Scottish Government for additional funding, SDS' longer term financial plans will continue to show a significant funding gap going forward.

48. Currently SDS does not have a capital plan. We have recommended that SDS reviews both its intangible and tangible assets policy. A consequence of the current policies is that SDS does not have any non-current assets on its balance sheet.

49. We recognise that SDS does not own any properties, vehicles or large equipment. SDS does hold a large amount of computer hardware and some software items at significant cost that provide a benefit to the organisation beyond the current financial year. The cost of replacing these items represent investment in the organisation, and do not recur annually.

50. Currently EIS holds an inventory list on these items but finance does not hold an asset register. Capitalising such types of spend improves both financial reporting and financial planning as recurring and non-recurring items are separated.

Ending of public sector pay cap

51. SDS has identified a current funding gap resulting from changes to the Scottish Public Pay Policy Guidelines, i.e. the public sector pay cap. SDS maintains a dialogue with the Scottish Government on this and all other aspects of its funding.

EU withdrawal

52. 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 – SDS currently employs a small number of highly skilled staff from outside the UK. Skills shortages could lead to increased competition and increased salaries for these specialist skills.
- Funding – SDS received £8 million in European income in 2017/18, which represented 3.7 per cent of total income. The 2018/19 budget includes £19.1 million of European income, representing 7.9 per cent of total income. These programmes run for a fixed period and should not be impacted by Brexit, but SDS will require to prepare for the period after their completion.
- Regulation – no specific risks have been identified in relation to SDS.

53. Owing to the level of uncertainty about the implications from Brexit, SDS monitors developments in this area but it does not have a specific item in the risk register. In our view, this is reasonable at the current time.

Part 4

Governance and transparency



Main judgements

The governance arrangements at SDS support effective oversight of the organisation's activities and its finances.

SDS has improved transparency through enhanced disclosures in the 2017/18 annual report and financial statements, with scope for further development. Openness and transparency can also be improved by making board and committee papers more accessible to the public.

SDS 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

54. SDS operates with a board and standing committees including the ARC and the finance and operating performance committee (FOP). At 31 March 2018 the board consisted of the Chief Executive, the Chair, eight non-executives and two co-opted members.

55. Last year we highlighted that several board members' appointments were coming to an end and emphasised the need for SDS to work with the Scottish Government to ensure that skills and expertise are maintained in the period of change. SDS has acted to ensure that succession arrangements are in place, including co-opting a further three members in 2018/19 to replace existing members whose terms are due to end in July and September 2018. This is an ongoing process as the chair is due to retire in September 2018 with a recruitment process currently underway.

56. The ARC met five times in 2017/18, in line with previous years. Agendas follow a standard format and papers are circulated around a week prior to the meetings allowing adequate time for ARC members to review. From attendance at committee meetings we are satisfied that members provide appropriate scrutiny of submitted reports.

57. In our 2016/17 report, we highlighted an internal audit finding that the monitoring of identified training sessions for the board and committees was an area for improvement. Internal audit are now satisfied that this action has been implemented.

Enterprise and Skills review

58. In May 2016, the First Minister announced a review of enterprise and skills bodies. 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.

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

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.

- 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.

60. The strategic board has met four times. It has an independent chair and a membership made up of the chairs of each of the enterprise and skills agencies as well as non-executive members. The strategic 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.

61. The review includes a skills alignment workstream. This aims to align relevant functions of SDS and the Scottish Funding Council (SFC). Outcomes of the workstream include:

- a joint team led by a single director (appointed in May 2018) reporting to the chief executives of both agencies
- a jointly delivered skills planning and provision model.

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

Transparency in governance and reporting

63. Transparency means that the public have access to understandable, relevant and timely information about how the board is taking decisions and how it is using resources such as money, people and assets. As we reported last year and in contrast to many other public bodies, SDS board meetings are not open to the public. Detailed board minutes are published on the SDS website but board and committee papers and committee meeting minutes are not available publicly.

64. While we appreciate that some items of business require to be discussed in private, we believe that there are some areas where SDS could improve current arrangements. For example, the release of board papers which are not confidential, such as budget monitoring and performance management reports. Committee minutes could also be made available, subject to any confidential items being withheld or redacted.

65. SDS has improved transparency in the annual report and financial statements. We reported at paragraph 29 that the statements now include an analysis of SDS' resource outturn position. Further improvement has been made to the strategic report around achievement of the corporate plan's five goals.

66. These goals capture SDS' ambitions for employers, individuals and for the organisation. A selection of the indicators from the corporate performance framework has been used to compile the strategic report. Areas for future improvement include use of trend analysis (as more data is accumulated) and greater use of targets.

Risk management

67. We reviewed SDS' risk management policy and guidance, corporate risk register, and risk management papers presented to the ARC. We confirmed that

the risk management arrangements in operation at SDS are effective and reporting arrangements are appropriate.

Internal audit

68. SDS' 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).

69. We reviewed SDS' 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.

70. We concluded that we planned to place reliance on aspects of internal audit work in the following areas - NTP (including consideration of the impact of FIPs) and ESF funding – for our financial statements responsibilities. Following review of this work, we confirmed that we could place reliance on these areas for our 2017/18 financial statements audit.

Governance Statement

71. Under the Companies Act, SDS is required to prepare an annual governance statement. Guidance is set out within the Scottish Public Finance Manual (SPFM) for the content of the governance statement which provides assurances around the achievement of the organisation's strategic objectives.

72. We reviewed the 2017/18 governance statement and concluded that it 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.

Quality of financial and performance reporting

73. Financial reports are regularly provided to both the board and FOP. These provide a clear position of the budget to date and the actual spend in comparison with variance analysis and explanations provided. They also provide committed spend and forecast outturn figures.

74. A year-end monitoring report was submitted to the board in May 2018. While the presentation differs slightly with the financial statements, the result is consistent with the operating deficit for the company of £1.0 million as presented in the strategic report in the draft accounts. This differs from the resource outturn position due to adjustments in relation to bank interest income, activities relating to its subsidiary (WBL Scotland) and a non-cash resource allocation to cover items such as depreciation.

75. Performance reporting follows a similar timetable and had a year-end report submitted to the board. There is a large amount of information provided in the performance reports submitted to the board and to the FOP allowing for appropriate scrutiny. More detail is provided in Part 5 regarding the indicators used and the level of reporting in the annual report and financial statements.

National Fraud Initiative

76. 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.

77. NFI activity is summarised in [Exhibit 5](#). 27,930 matches were identified and SDS has completed reviews for those 121 records recommended for investigation. Over and above this, SDS completed investigations into a further 56 matches with no issues identified.

Exhibit 5

NFI activity



27,930

Matches



121

Recommended
for investigation



167

Completed/closed
investigations

Source: NFI secure website: www.nfi.gov.uk

78. No frauds or errors were identified by SDS as part of the NFI exercise. A report was presented to the ARC on 21 September 2017 providing members with an overview of SDS' participation in the 2016-17 NFI exercise and the outputs resulting from it.

79. SDS has a high level of engagement with the NFI exercise. During the exercise, SDS made use of the AppCheck system provided by the Cabinet Office which utilised NFI databases enabling public sector organisations to prevent fraud or mistaken payments impacting on them. Based on evidence to date, we concluded that SDS is proactive in investigating matches and reporting outcomes of NFI activity.

Standards of conduct for prevention and detection of fraud and error

80. 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.

81. Based on our review of the evidence we concluded that SDS has appropriate arrangements in place for the prevention and detection of bribery corruption. We are not aware of any specific issues that we need to bring to your attention. During 2017/18 SDS has further strengthened anti-fraud arrangements by introducing prevention controls rather than retrospective detection with regards to NTP.

Cyber security

82. 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.

83. We concluded that SDS, through its sponsorship of the shared service arrangement (EIS), is actively reviewing and strengthening its cyber resilience arrangements and is participating in the cyber catalyst group of champions. EIS has undertaken a gap analysis of relevant information security standards which has been subject to review by internal audit (provided by a firm of accountants). This analysis identified that some remedial work is required in identified areas of non and partial compliance. This will require capacity in EIS to deliver, alongside business as usual commitments. SDS intends to attain cyber essentials accreditation in October 2018.

General Data Protection Regulation

84. The new General Data Protection Regulation (GDPR) came into force on 25 May 2018. It sets out more requirements than the previous Data Protection Act and has introduced new and significantly changed data protection concepts.

85. 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 SDS incurring significant fines.

86. SDS implemented a GDPR readiness project. This has been managed by a project board with updates provided to the ARC. The most recent update (in March 2018) reported that progress was being made against all deliverables. The covering report highlighted an issue regarding the Corporate Training System (CTS) which is being replaced by FIPS. The move to the new system will involve migrating data. The current timescale is for data to be migrated by September 2018.

Exit packages

87. During 2017/18, seven employees left SDS under voluntary severance with costs totalling £0.3 million. These costs mainly related to contributions to the pension fund to allow the individuals to access benefits earlier. Although SDS did not receive explicit approval for the scheme (in line with the Management Statement/ Financial Memorandum) we are content it was requested and that the Scottish Government was fully informed. SDS management have also confirmed that assurance was received from the Scottish Government that the scheme was in line with expectations.

Part 5

Value for money



Main judgements

SDS has an effective performance management framework in place.

Performance management

88. 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 SDS agree to undertake local work in this area.

89. The performance of SDS is monitored by the FOP against several performance targets (goals) which support the delivery of the Scottish Government's national performance framework. These goals and their plans are set out in SDS' 2015-2020 Corporate Plan which is supported by annual operating plans.

90. The board is kept well informed of performance across all areas of activity and responsibility for detailed review and scrutiny of performance lies with the FOP which meets quarterly. We review the committee papers to gain an insight into how well performance is scrutinised.

91. Each meeting of the FOP receives a performance report. Performance is reported using delivery and outcome indicators as defined in the corporate performance framework which are aligned with the five corporate goals. Performance reports contain detailed information for each goal including trend analysis (over months generally), specific performance issues and actions being taken to improve performance.

92. We concluded that SDS has an effective performance management framework in place which supports the achievement of value for money and continuous improvement in the way services are delivered.

National performance audit reports

93. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. Although there were no reports published in 2017/18 which were of direct interest to the SDS, there were others with some wider relevance. These are outlined in [Appendix 3](#).

94. Currently SDS does not have a process in place to consider and review national reports at board or committee level.

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

Appendix 1

Action plan 2017/18

2017/18 recommendations for improvement



No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p>Intangible asset policy</p> <p>The current intangible asset recognition policy does not define future economic benefit as including cost savings or other benefits resulting from the use of the asset (as per IAS 38).</p> <p>Risk</p> <p>There is a risk expenditure could be mis-classified due to the current intangible accounting policy.</p>	<p>SDS should revise the intangible asset recognition policy to ensure that future economic benefits are defined as including cost savings or other benefits arising from the use of the asset.</p> <p>Exhibit 3</p>	<p>SDS will undertake a review of this policy.</p> <p>Responsible officer – Senior Director – Enabling Services.</p> <p>Agreed date – 31 July 2018</p>
2	<p>Employee benefits (untaken leave) accrual</p> <p>Audit testing found that the employee benefits (untaken leave) accrual did not incorporate national insurance and pension contributions or flexi-time.</p> <p>Risk</p> <p>The accrual is not prepared in line with the accounting standard (IAS 19) and therefore constitutes a monetary error.</p>	<p>SDS should ensure that the employee benefit accrual includes national insurance and pension contributions and flexi-time in 2018/19.</p> <p>Exhibit 3</p>	<p>SDS will include national insurance contributions in future calculations, and will review and agree the position in regard to pension contributions</p> <p>Responsible officer – Senior Director – Enabling Services</p> <p>Agreed date – 31 July 2018</p>
3	<p>Tangible asset policy</p> <p>SDS currently opts not to aggregate some individually low value IT equipment purchases and there isn't currently a tangible asset policy. The accounting standard (IAS 16) allows for such aggregation but does not require it.</p> <p>Risk</p>	<p>SDS should review its tangible asset policy to ensure that it is appropriate.</p> <p>Paragraph 25</p>	<p>SDS will undertake a review of this policy</p> <p>Responsible officer – Senior Director – Enabling Services</p> <p>Agreed date – 31 July 2018</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	Investment in SDS' infrastructure is not separated from running costs in financial plans and accounts.		
Follow up of prior year recommendations			
b/f	<p>1. Recognised good practice in disclosures</p> <p>SDS has prepared its 2016/17 annual report and financial statements in line with the requirements of the Companies Act and the Scottish Public Finance Manual (SPFM) as appropriate. While some disclosures go beyond that required by the Companies Act and therefore also comply with the Financial Reporting Manual (FRoM), there are some areas where SDS could provide further disclosures in line with good practice and transparency principles for public bodies.</p> <p>Risk</p> <p>The SDS annual report and financial statements may not be in line with good practice and transparency principles for public bodies.</p>	SDS should consider providing further disclosures for 2017/18 annual report and financial statements, in line with good practice and transparency principles for public bodies.	<p>The Scottish Government has now confirmed that it is satisfied with SDS' treatment of grant-in-aid funding in the accounts with no changes required. The 2017/18 accounts include improvements such as the inclusion of a resource outturn analysis and improvements to the strategic report.</p> <p>SDS will continue to review the presentation of information in accordance with best practice and the advice of its board. This will be an explicit duty of the SDS Corporate Office from 2018/19.</p> <p>Partly actioned</p> <p>Director, Finance and Audit</p> <p>March 2019</p>
b/f	<p>2. Five-year financial model</p> <p>The financial model is used to inform the Executive Leadership Group's budget review. Elements of the model are shared with the board and the Scottish Government's sponsor department but not the model in full.</p> <p>Risk</p> <p>The board and the Scottish Government's sponsor department may not be aware of all challenges SDS faces in achieving financial sustainability.</p>	Presenting the financial model in full to the board and the Scottish Government's sponsor department would help promote a shared understanding of the SDS financial position and the challenges in achieving financial sustainability.	<p>During our work this year we confirmed that the model has been shared and discussed with the Scottish Government. We are also satisfied that the board is suitably informed of the results of the modelling.</p> <p>Actioned</p>
b/f	3. Board succession planning	SDS should work with the Scottish Government to ensure that board members' skills and	Three new board members were appointed in 2017/18, with three existing members



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>As at June 2017, the board was made up of seven Scottish Government appointees and three co-opted members. The terms for six board members, including the chair, will come to an end between September 2017 and September 2018. Recruitment of new board members has been deferred pending the completion of the Enterprise and Skills review. SDS agreed the temporary co-option of four board members with the Scottish Government.</p> <p>Risk</p> <p>Going forward, the board may have gaps in skills and expertise and there may be lack of scrutiny as a result.</p>	<p>expertise are maintained in this period of change. This will enable effective scrutiny to continue.</p>	<p>and the chair given extensions to ensure they remained in place for the remainder of the year. Looking ahead to 2018/19, three additional members have been co-opted to replace a group of three whose terms end by the September 2018. The chair is due to leave at the end of September and a recruitment process is currently ongoing.</p> <p>Actioned</p>
b/f	<p>4. ICT governance arrangements</p> <p>The Memoranda of Understanding between SDS and its partners for the shared service ICT function require updating to reflect the change from a single supplier to multiple suppliers as part of a new Service Integration and Management model. SDS has established components of an ICT strategy based on its strategy to 2016, and is now developing a new, over-arching ICT and Digital Strategy.</p> <p>Risk</p> <p>The SDS' governance arrangements do not support effective delivery of ICT services.</p>	<p>SDS should conclude updating the Memoranda of Understanding and complete its new, over-arching ICT and Digital Strategy to support effective governance of its ICT services.</p>	<p>A new memorandum of understanding has been drafted and was with legal advisers as at 14 June 2018. The draft was delayed in order to understand and reflect references to other, existent or emerging documents and legislative requirements, such as strategies and the General Data Protection Regulation. It is intended that this MoU will be adopted during 2018/19.</p> <p>An ICT strategy was agreed by the tri-party EIS Partnership Board, and a delivery plan produced in March.</p> <p>An EIS strategy is being developed through partner workshops in June and July 2018/19</p> <p>Partially actioned</p> <p>Senior Director, Enabling Services</p> <p>December 2018</p>
b/f	<p>5. Transparency</p> <p>The SDS board meetings are not open to the public and SDS does not publish board and committee papers and</p>	<p>With increasing public expectations for more openness in the conduct of public business, SDS should keep this area under review</p>	<p>SDS is committed to continued consideration of this matter, and to making improvements where considered appropriate and agreed by the SDS board.</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
	<p>committee meeting minutes on its website. SDS acknowledges that making these publicly available would increase transparency but considers the associated costs would be too high.</p> <p>Risk</p> <p>The board's commitment to transparency may not be in line with good practice principles.</p>	<p>and consider whether there is scope to enhance transparency. This could include, for example, reviewing the availability of board and committee papers and committee minutes.</p>	<p>The arrangements concerning board meetings and availability of board and committee papers remain unchanged since last year.</p> <p>Ongoing</p> <p>Senior Director, Enabling Services</p> <p>December 2018</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 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 to change the position disclosed in the financial statements.</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>Testing of journal entries, accruals and prepayments was satisfactory except for the employee benefits (untaken leave) accrual. Accounting estimates and key assumptions were reasonable. Testing of post year-end transactions did not find any errors. There were no significant transactions outside the normal course of business.</p> <p>Satisfactory</p>
<p>2 Risk of fraud over income</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 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>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 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>Walk-through testing of the receivables system found controls operated as expected.</p> <p>We were provided with satisfactory explanations for any movements/trends found from analytical procedures on income streams.</p> <p>Detailed testing of income transactions found no errors.</p> <p>We reviewed the processes and postings in place regarding European income and were satisfied that these are appropriate. This view is in line with the internal audit report which concluded that SDS has robust processes in place to ensure the effective management of ESF funds.</p> <p>Satisfactory</p>

Audit Risk	Assurance procedure	Results and conclusions
<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. 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>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>Walk-through testing of the NTP system (both CTS and FIPS) concluded that there is an inherent control risk over the payments to providers as SDS does not hold evidence at that point in time. In a sample test of payments to different providers we did not find any errors.</p> <p>Walk-through testing over payables did not find any control issues.</p> <p>We carried out analytical procedures in expenditure streams and found suitable explanations for any significant movements/trends.</p> <p>Detailed testing of a sample of expenditure items (over and above NTP payments) found no errors.</p> <p>Satisfactory</p>
<p>4 Pensions accounting</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>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>Testing found that pension disclosures were posted satisfactorily.</p> <p>Satisfactory</p>
<p>5 Data migration to FIPS</p> <p>As at November 2017, new modern apprenticeships, foundation apprenticeships and the Scotland's Employer Recruitment Incentive (SERI) are 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</p>	<p>Review of the implementation of the data transfer, including business continuity arrangements, review of Board papers and controls over data transfer.</p> <p>Focused testing of national training programmes transactions such as modern apprenticeship payments.</p> <p>Consideration of internal audit's review of national training programmes on FIPS.</p>	<p>The final date for migrating all data from CTS to FIPS has been delayed until September 2018.</p> <p>Ongoing</p>

Audit Risk	Assurance procedure	Results and conclusions
used to produce the financial statements.		
Risks identified from the auditor's wider responsibility under the Code of Audit Practice		
<p>6 Financial sustainability</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>Review and assessment of any further scenario planning and how this feeds into the financial model.</p> <p>Review of robustness of any medium to long-term financial strategy and plans.</p> <p>Attendance at appropriate board meetings to observe financial sustainability discussions.</p>	<p>Review of financial modelling found that it satisfactorily incorporated scenario planning and had been shared with both the Scottish Government and the board.</p> <p>The medium to long-term financial plan is robust. The model has identified a significant future funding gap which SDS has clearly communicated to the Scottish Government.</p> <p>Ongoing</p>
<p>7 Financial management</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>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.</p> <p>Review of year-end outturn.</p>	<p>The year-end outturn was an overspend of £0.3 million which has been appropriately communicated with the Scottish Government.</p> <p>Budget reports are clear and incorporate variance explanations and forecast outturn analysis.</p> <p>Satisfactory</p>
<p>8 Enterprise and skills review - scrutiny and challenge by SDS board</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 arrangements develop and a risk that this affects the effectiveness in SDS.</p>	<p>Review potential impact of the changes on SDS, including impact on the operation of the SDS board.</p>	<p>There has been limited impact to date, but the strategic board is working on a strategic plan which is likely to have some impact on the work of SDS.</p> <p>Ongoing</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>9 Openness and transparency</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>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>SDS has not amended its approach making board and committee papers and minutes available.</p> <p>Disclosures in the financial statements have improved. Main examples include the inclusion of the resource outturn analysis and improvements to the performance section of the strategic report.</p> <p>Ongoing</p>
<p>10 Value for money</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>Assess SDS' progress towards addressing the report's recommendations.</p>	<p>SDS has taken steps to implement the recommendations. It should be noted that, following publication of the report, its recommendations were overtaken by policy developments, including Developing Young Workforce and the Enterprise and Skills Review. We will continue to monitor developments as part of the annual audit process and through future audit work on skills.</p> <p>Satisfactory</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	

SDS relevant reports

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

[Early learning and childcare](#) – February 2018

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

The Skills Development Scotland Co. Limited

2017/18 Annual Audit Report

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