

# South of Scotland Enterprise

2020/21 Annual Audit Report



 AUDIT SCOTLAND

Prepared for South of Scotland Enterprise and the Auditor General for Scotland

August 2021

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# Key messages

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## 2020/21 annual report and accounts

- 1 The financial statements of South of Scotland Enterprise (SOSE) give a true and fair view of its financial position at 31 March 2021 and of the net expenditure for the period then ended.
- 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 and sustainability

- 4 SOSE has effective arrangements for financial management, and it operated within its budget for 2020/21.
- 5 SOSE's first year was dominated by the challenges of the Covid-19 crisis. Its arrangements were effective in issuing about £12.4 million of Covid-19 related business support grants in 2020/21.
- 6 SOSE has developed a five-year financial plan and intends to develop a longer-term financial strategy once its strategic action plan is in place.

## Governance and transparency

- 7 SOSE has made good progress in developing its governance and recognises the need to continue to embed its arrangements. It also recognises opportunities to enhance openness and transparency.
- 8 SOSE has operating plans for its initial years and is planning to prepare a three-year strategic action plan in April 2022, once the Regional Economic Strategy is finalised and to align with other enterprise and skills agencies.

## Value for money

- 9 SOSE has started developing its performance management framework and its arrangements to assess and demonstrate Best Value.
- 10 The performance report in SOSE's annual report and accounts provides a comprehensive overview of SOSE's performance. SOSE will continue to develop the performance report to reflect its progress as an organisation.

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# Introduction

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**1.** In June 2019 the Scottish Parliament passed the South of Scotland Enterprise Act 2019, establishing South of Scotland Enterprise (SOSE) as a non-departmental public body. After an initial six-month set up period, SOSE became fully operational from 1 April 2020. This report summarises the findings from our first audit of SOSE, covering the extended reporting period from 16 October 2019 to 31 March 2021.

**2.** The scope of our audit was set out in our annual audit plan presented to the March 2021 meeting of the Audit and Risk Committee (ARC). This report comprises the findings from:

- an audit of SOSE'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](#).

**3.** The main elements of our audit work in 2020/21 have been:

- an audit of the SOSE's annual report and accounts for the period from 16 October 2019 to 31 March 2021, including the issue of an independent auditor's report setting out our opinions
- a review of SOSE's key financial systems
- consideration of the four audit dimensions.

**4.** In common with all organisations, the coronavirus pandemic (Covid-19) has had a considerable impact on SOSE. In its first year of operation, SOSE predominantly focussed on responding to the impact of Covid-19 on businesses in the south of Scotland, whilst developing and embedding its governance arrangements. Our annual audit plan highlighted risks in relation to the administration of Covid-19 support funding and the impact of Covid-19 on the development of SOSE's governance arrangements, financial planning and performance management.

## Adding value through the audit

**5.** We add value to SOSE through the audit by:

- identifying and providing insight on significant risks, and making clear and relevant recommendations
- sharing intelligence and good practice through our national reports ([Appendix 3](#)) and good practice guides

- providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability.

## Responsibilities and reporting

6. SOSE has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts that is in accordance with the accounts direction from the Scottish Ministers.
7. SOSE is also responsible for establishing appropriate and effective arrangements for governance, propriety and regularity.
8. Our responsibilities as independent auditor are established by 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. As public sector auditors we give independent opinions on the annual report and accounts. Additionally, we conclude on the appropriateness and effectiveness of the performance management arrangements, the suitability and effectiveness of corporate governance arrangements, the financial position and arrangements for securing financial sustainability. Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.
9. This report raises matters from our audit. 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.
10. Our annual audit report contains an agreed action plan at [Appendix 1](#). It sets out specific recommendations, the responsible officers and dates for implementation.

## Auditor independence

11. Auditors appointed by the Auditor General for Scotland must comply with the Code of Audit Practice and relevant supporting guidance. When auditing the financial statements auditors must comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies.
12. 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 2020/21 audit fee of £95,000 as set out in our annual audit plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.
13. This report is addressed to both SOSE and the Auditor General for Scotland and will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk) in due course.

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

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# 1. Audit of 2020/21 annual report and accounts

The principal means of accounting for the stewardship of resources and performance

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## Main judgements

The financial statements of SOSE give a true and fair view of the state of its financial position at 31 March 2021 and of the net expenditure for the period then ended.

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.

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## Our audit opinions on the annual report and accounts are unmodified

**15.** The SOSE Board approved the annual report and accounts for the extended reporting period from 16 October 2019 to 31 March 2021 on 26 August 2021, after consideration by the ARC. As reported in the independent auditor's report:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- expenditure and income were regular and in accordance with applicable enactments and guidance issued by the Scottish Ministers
- the audited part of the remuneration and staff report was properly prepared in accordance with legal requirements
- the performance report and governance statement were consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

## The annual report and accounts were signed off in accordance with the agreed timescales

**16.** The unaudited annual report and accounts were received in line with the agreed audit timetable on 24 May 2021. The first version of the accounts did not include pension disclosures due to delays in SOSE obtaining this

information from the actuary. We received a full set of accounts, complete with pension disclosures, on 11 June 2021. In addition to our audit of the financial statements, we also reviewed the processes and controls in place for the payment of grant funding and key financial processes.

**17.** The working papers provided with the annual report and accounts were of a high standard and the audit team received good support from finance staff which helped ensure the audit process ran smoothly. We are pleased that our overall approach, and cooperation between finance team and the audit team, enabled completion of the audit in accordance with the agreed timetable.

## Overall materiality was £223,000

**18.** We carried out our initial assessment of materiality during the planning phase of the audit. On receipt of the unaudited annual report and accounts we reviewed our materiality calculations and concluded that they remained appropriate as shown in [Exhibit 1](#).

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### Exhibit 1 Materiality values

Materiality level	Amount
Overall materiality	£223,000
Performance materiality	£123,000
Reporting threshold	£11,000

Source: Audit Scotland

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## Appendix 2 identifies the main risks of material misstatement and our audit work to address these

**19.** [Appendix 2](#) provides our assessment of risks of material misstatement in the annual report and accounts and any wider audit dimension risks. These risks influenced our overall audit strategy, the allocation of staff resources to the audit and indicate how the efforts of the audit team were directed.

[Appendix 2](#) also identifies the work we undertook to address these risks and our conclusions from this work.

## Significant findings from the audit of the annual report and accounts

**20.** International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the body's accounting practices. The significant findings are summarised in [Exhibit 2](#). Where a finding has resulted in a recommendation to management, a cross-reference to the action plan at [Appendix 1](#) has been included.



## Exhibit 2

### Significant findings from the audit of financial statements

Issue	Resolution
<p><b>1. Accounting for start-up grant funding</b></p> <p>SOSE included its start-up grant funding from the Scottish Government of £255,000 as income in the Statement of Comprehensive Net Expenditure (SoCNE).</p> <p>In accordance with the 2020/21 Government Financial Reporting Manual (FReM), such funding should be recognised directly in the general reserve balance in the Statement of Changes in Taxpayers' Equity (SoCTE).</p>	<p>Management agreed to amend the accounts. The adjustment increased net expenditure in the SoCNE but there was no impact on the total general reserve balance.</p> <p>We are content with the amendment.</p>
<p><b>2. Impairment review</b></p> <p>International Accounting Standard 36 (IAS 36) - Impairment of Assets requires an assessment at the end of each reporting period as to whether the value of an asset may be impaired. If so, an estimation of the carrying value should be made, and an impairment charge applied.</p> <p>Due to the impact of Covid-19 on the prioritisation of business activities and lack of staff capacity, SOSE did not carry out a formal impairment review as at 31 March 2021.</p>	<p>Management advised that the condition of properties at the financial year end was considered with no impairment loss identified, but this process was not formally documented.</p> <p>SOSE's land and buildings transferred from Scottish Enterprise on 1 June 2020, following revaluation on 31 March 2020. We audited the transfer with no significant issues identified. We are unaware of any conditions that would result in the properties being impaired. We are content that there is no material impact on the accounts.</p> <p>Management agreed to undertake a formal impairment review next year.</p> <p><b>Recommendation 1</b></p> <p>(refer <a href="#">Appendix 1</a>, action plan)</p>
<p><b>3. Remuneration report</b></p> <p>During the period to 31 March 2021, two members of SOSE's Leadership Team were on secondment from other bodies. The Interim Chief Executive was seconded from NatureScot until February 2021 and the Director of Strategy, Partnerships and Engagement was seconded from the Scottish Government until being directly employed by SOSE in October 2020. The recharges to both bodies covered salary and pension costs.</p> <p>The FReM stipulates that the value of pension benefits should be included within the disclosure in the remuneration report, but there is flexibility</p>	<p>SOSE obtained pension information from NatureScot and the Scottish Government and made the required disclosures in the remuneration report.</p> <p>We are content that the disclosures meet the requirements.</p>

Issue	Resolution
<p>where secondments are concerned. The remuneration report in the accounts provided for audit did not report pension benefits for seconded directors in line with the FReM (capturing all pension earned in the period).</p>	

Source: Audit Scotland

**21.** It is our responsibility to request that all misstatements other than those below the reporting threshold are corrected, although the final decision lies with those charged with governance considering advice from senior officers and materiality. Management has adjusted misstatements above our reporting threshold and there are no unadjusted errors to report.

**22.** Identified misstatements totalled £305,000. This consists of the incorrect accounting for the start-up grant (£255,000, see [Exhibit 2](#)) and an incorrect classification of land and buildings transferred from Scottish Enterprise (£50,000). The adjustments increased net expenditure by £255,000 with a corresponding increase in the general reserve but there was no impact on the total general reserve balance.

**23.** We have reviewed the nature and causes of these misstatements and have concluded that they arose from issues that have been isolated and identified in their entirety rather than an indication of systemic error. As a result, we did not need to revise our audit approach despite the total adjustments exceeding materiality.

## Other matter arising from the audit of the annual report and accounts

**24.** The Parliamentary Accountability Report included in the unaudited accounts was not fully in accordance with the 2020/21 FReM as applied to Scottish bodies. Management improved the disclosures, and we are content that these meet the requirements of the FReM.

## 2. Financial management

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

### Main judgements

SOSE has effective arrangements for financial management, and it operated within its budget for 2020/21. The underspend of £1.8 million mainly related the Scottish Wedding Industry Fund, as agreed with the Scottish Government.

SOSE's first year was dominated by the challenges of the Covid-19 crisis. Its arrangements were effective in issuing about £12.4 million of Covid-19 related business support grants in 2020/21.

### SOSE operated within its budget for 2020/21 and developed effective budget processes in a challenging year

**25.** The main financial objective for SOSE is to ensure that the financial outturn for the year is within the budget allocated by Scottish Ministers. SOSE's expenditure is largely met by grant-in-aid from the Scottish Government, supplemented by a small amount of income generated from property owned by SOSE.

**26.** SOSE reported an outturn of £21.6 million against its overall budget for 2020/21, with an underspend of £1.8 million. The majority of this underspend (£1.4 million) related to lower than expected uptake of the Covid-related Scottish Wedding Industry Fund (SWIF). [Exhibit 3](#) shows SOSE's financial performance against Departmental Expenditure Limits (DEL).

### Exhibit 3 Performance against DEL in 2020/21

Performance	Initial budget £m	Final budget £m	Outturn £m	Over/(under) spend £m
Resource DEL	11.400	14.453	12.676	(1.777)
Capital DEL	8.400	8.945	8.948	0.003
Financial Transactions	5.000	-	-	-

<b>Total DEL</b>	<b>24.800</b>	<b>23.398</b>	<b>21.624</b>	<b>(1.774)</b>
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Source: South of Scotland Enterprise annual report and accounts for the period to 31 March 2021 and SOSE Budget Allocation and Monitoring letters (May 2020, October 2020 and March 2021)

**27.** SOSE's funding allocation included £5 million for Financial Transactions, generally used for purchasing shares and providing loans to private sector businesses. Given the necessary focus on responding to Covid-19 during 2020/21, SOSE agreed with the Scottish Government to have its Financial Transactions budget removed as part of the spring budget revision.

**28.** SOSE's resource and capital budgets increased as part of the Scottish Government's autumn and spring budget revisions. The additional funding largely related to Covid-19 related funding, including the Hotel Support Programme and the SWIF outlined in [Exhibit 4](#).

**29.** We found that SOSE provided regular, timely and up-to date information on the financial position. This allowed board members to monitor and scrutinise aspects of SOSE's finances and ultimately helped to ensure that SOSE remained within its overall resource allocation for the year.

## The financial statements recorded net assets of £544,000

**30.** The Statement of Financial Position summarises what is owned and owed by SOSE. 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 income and that which has resulted through the accumulation of physical assets.

**31.** The financial statements recorded net assets of £544,000 as at 31 March 2021. The most significant assets held are the land and property assets of £2.4 million transferred from Scottish Enterprise, and cash and cash equivalents of £1 million. These assets are offset by the retirement benefit obligation of £2.3 million, and trade and other payables of £0.9 million.

## SOSE issued about £12.4 million of Covid-19 related business support grants

**32.** SOSE was established as an economic and community development agency for the south of Scotland. A significant element of its work will involve grant funding and support to businesses. As SOSE was becoming established during the Covid-19 pandemic, its immediate priority was to support businesses and communities in its area. This was challenging and required SOSE to provide funding at pace, while establishing its business and building staff capacity.

**33.** Interim Letters of Guidance for 2020/21 from the Scottish Government asked SOSE to stop all but the most critical expected business as usual activity, re-prioritise and work collaboratively to meet the immediate challenges of the Covid-19 crisis.

**34.** SOSE issued about £12.4 million of Covid-19 related business support grants to businesses in the south of Scotland ([Exhibit 4](#)) to help them manage the financial impacts of the pandemic. It worked with other enterprise agencies including Scottish Enterprise and Highlands and Islands Enterprise to administer this funding. This included Scottish Enterprise paying out a further £12.1 million on SOSE's behalf.

**35.** The Covid-19 related business support grants included national funds such as the Hotel Support Programme and the SWIF, but SOSE also created and administered its own business and community support funds. Two of these, the Crisis Fund and the Adaptation and Diversification Fund involved payments of £9.8 million.

#### Exhibit 4 Covid-19 business support

	Total Funding Awarded (£m)	Number of businesses supported
Hotel Support Programme	0.848	7
Scottish Wedding Industry Fund	1.700	170
Crisis Fund*	3.767	88
Adaptation and Development Fund*	6.056	63
Pivotal Enterprise Resilience Fund (PERF)**	10.923	167
Creative, Tourism and Hospitality Enterprises Hardship Fund (Hardship)**	1.131	110

\* SOSE designed business support funds

\*\* PERF and Hardship administered and paid by Scottish Enterprise (payments not reflected in SOSE's expenditure)

Source: South of Scotland Enterprise annual report and accounts for the period to 31 March 2021

**36.** SOSE implemented adequate systems for recording and processing grant transactions and had appropriate measures in place to reduce the risk of fraudulent or erroneous payments. Internal audit's 'real-time' review of SOSE's Covid-19 response and Covid-19 grants provided assurance and allowed

SOSE to make changes while Covid-19 initiatives were still live. We relied on the work of internal audit on Covid-19 grants during our testing.

## Financial systems of internal control operated as expected

**37.** Skills Development Scotland (SDS) provides key financial systems to SOSE, under a service level agreement. These include the general ledger, payroll, payables, receivables and cash and banking. We obtained assurance from SDS' external auditors that the key controls within the core financial systems were operating as expected.

**38.** In addition, we reviewed the key financial controls operated by the SOSE finance team. We concluded that the 'local' controls were also appropriate and operated as expected. We noted that a grants tracker is maintained by the finance team, which lists grants committed and paid under each grant fund. While this is agreed to the ledger each month, this reconciliation is not formally documented or signed off.

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## Recommendation 2

SOSE should formally document the management check of the grants tracker, to evidence that grant expenditure is accurately recorded in the financial ledger.

[Appendix 1, Point 2](#)

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**39.** Internal audit's report on the key financial controls in November 2020 concluded that SOSE has implemented an effective financial controls environment.

**40.** We did not identify any significant internal control weaknesses which could affect SOSE's ability to record, process, summarise and report financial and other relevant data to result in a material misstatement in the financial statements.

**41.** We reviewed SOSE's internal audit arrangements in accordance with International Standard on Auditing (UK) 610 'Using the Work of Internal Auditors' and were able to take account of its findings as planned.

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

**42.** SOSE is responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption. Furthermore, the board is responsible for ensuring that its affairs are managed in accordance with proper standards of conduct by putting effective arrangements in place.

**43.** We have reviewed the arrangements in place to maintain standards of conduct. This included a review of the counter fraud policy, the staff handbook and the code of conduct. There are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.

**44.** We concluded that appropriate arrangements are in place for the prevention and detection of fraud, error and irregularities. We are not aware of any specific issues that we are required to bring to your attention.

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## 3. Financial sustainability

Financial sustainability looks to the medium and long term to consider whether a body is planning effectively to continue to deliver its services

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### Main judgements

SOSE expects that its increased budget allocation of £34.2 million for 2021/22 will enable it to increase economic and social development in the south of Scotland.

SOSE has developed a five-year financial plan and intends to develop a longer-term financial strategy once its strategic action plan is in place.

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### SOSE's budget allocation has increased in 2021/22

**45.** The 2021/22 SOSE budget was approved by the board in March 2021. It shows resource and capital DEL of £29.2 million in total, aimed at allowing SOSE to grow and continue to increase economic and social development in the south of Scotland. In addition to this, SOSE received £5 million for Financial Transactions and it expects to be able to spend this budget during the current financial year.

### SOSE has developed a five-year financial plan and intends to develop a longer-term financial strategy once its strategic action plan is in place

**46.** SOSE has developed a five-year financial plan, based on its future project commitments and plans for building capacity. The plan has been shared with the Board and SOSE is currently refining it in discussion with the Scottish Government.

**47.** Once it develops its first three-year strategic action plan (see paragraphs 54. and 55. ), SOSE intends to use scenario planning to develop a longer-term financial strategy, aligned with its priorities and outcomes. The financial impact of the Covid-19 on SOSE, as well as on businesses requiring support from the agency, is likely to extend over a number of years. The longer-term financial strategy should therefore include an assessment of the continued impact of Covid-19 on its business and finances.



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# 4. Governance and transparency

The effectiveness of scrutiny and oversight, and transparent reporting of information

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## Main judgements

SOSE has made good progress in developing its governance and recognises the need to continue to embed its arrangements. It also recognises opportunities to enhance openness and transparency by making further information publicly available.

SOSE has operating plans for its initial years and is planning to prepare a three-year strategic action plan in April 2022, once the Regional Economic Strategy is finalised and to align with other enterprise and skills agencies.

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## SOSE is bedding-in its governance arrangements

**48.** The South of Scotland Enterprise Act 2019 established SOSE as a public body. An interim framework document between the Scottish Government and SOSE sets SOSE's overall aims and the key roles and responsibilities which underpin the relationship between SOSE and the Scottish Government. SOSE's Chief Executive is the Accountable Officer and is directly accountable to Scottish Ministers for the performance of the organisation and the delivery of its functions.

**49.** SOSE's board is responsible for strategic direction and oversight of SOSE's activities. The board is supported by the Audit and Risk Committee (ARC) and the Remuneration and Nominations and Human Resources Committee (RNHR).

**50.** Internal audit's review of corporate governance concluded that SOSE's arrangements were appropriate, effective and aligned with best practice in the context of a new organisation facing the challenges from Covid-19. Internal audit's opinion in its annual report 2020/21, which informs SOSE's governance statement, confirmed that an 'overall good level of assurance' could be placed on SOSE's framework of governance, risk management and management control.

**51.** Internal control checklists and certificates of assurance provided to the Accountable Officer by members of the Senior Leadership Team also support the governance statement. While these are aligned with the Scottish Public Finance Manual (SPFM) requirements, we suggest that SOSE also considers whether formally requesting assurances over the services provided by partner

bodies such as SDS could further strengthen the assurances available at year end.

**52.** SOSE has made good progress in developing its governance in its first year. It recognises that it will need to do more work to continue to embed its arrangements, including its committee structure and finalisation of its framework agreement with the Scottish Government. We recommend that SOSE reviews its governance periodically during its first years of operation to confirm that governance is working as intended, and is effective.

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### Recommendation 3

SOSE should review its governance arrangements periodically during its first years of operation to confirm that governance is working as intended, and is effective. [Appendix 1, Point 4](#)

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**53.** We concluded that the governance statement in SOSE annual report and accounts appropriately reflects SOSE's developing governance arrangements and the impact of Covid-19 on SOSE business during 2020/21.

### SOSE is planning to prepare its first three-year strategic action plan in April 2022 to align its planning cycle with other agencies

**54.** The draft framework document between the Scottish Government and SOSE states that SOSE should have a three-year action plan in place, supplemented by an operating plan for each financial year. The plan should reflect SOSE's strategic aims and objectives, indicative budgets and any priorities set by the Scottish Ministers. These plans should also demonstrate how SOSE contributes to achievement of sustainable economic growth and its alignment with the Scottish Government's National Performance Framework (NPF).

**55.** SOSE agreed with the Scottish Government that the first three-year strategic action plan would be finalised and published in April 2022. This is to allow for the finalisation of the Regional Economic Strategy and to align SOSE's planning and reporting cycle with other enterprise and skills agencies such as Scottish Enterprise, and Highlands and Islands Enterprise. An annual Operating Plan was in place for 2020/21, and the 2021/22 Operating Plan is publicly available on the SOSE website.

### SOSE recognises opportunities to enhance openness and transparency

**56.** Openness and transparency in how a body operates and makes decisions is key to supporting understanding and scrutiny. 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. The Scottish Government's [On Board guidance for members of statutory boards](#) states that the Board should consider holding

Board meetings in public unless there is a good reason not to and publishing summary reports and/or minutes of meetings.

**57.** We note that, in contrast to some other public bodies, SOSE board meetings are not open to the public. Certain board minutes are published on the SOSE website, but board and committee papers are not publicly available. While it is for individual organisations to determine what papers are made available, we hold the view that budget and performance monitoring reports as well as committee minutes should be published where it is reasonable to do so. SOSE recognises the opportunity to enhance openness and transparency by making further information publicly available.

## **SOSE developed effective risk management arrangements**

**58.** SOSE has established effective risk management arrangements including a risk management framework, Risk and Internal Audit Policy and risk appetite statement setting out the level of exposure SOSE considers tolerable and justifiable.

**59.** The Audit and Risk Committee reviews strategic corporate risks on a regular basis. This includes deep dive reviews of risks at each meeting of the committee. The Senior Leadership Team regularly reviews and updates key operational risks, with escalation to the Board as required.

## **Arrangements for cyber security continue to improve**

**60.** Public bodies should have good provision for managing data and monitoring information security. They should also have demonstrable capacity and capability for responding to the increasing cyber security risks. Threats are increasing due to the growing number of cyber activities and organisations using the wide-ranging devices that use the internet to interact with the organisation's network. Public bodies should have risk assessment processes in place for recording activities and learning including the cost impact of responding to a cyber-attack.

**61.** Information technology services for SOSE are mostly managed by the Enterprise Information Services (EIS). The EIS Partnership Board provides the strategic oversight of the EIS partnership (also involving Skills Development Scotland, Scottish Enterprise, and Highlands and Islands Enterprise).

**62.** An internal audit report on the EIS's cyber security in September 2019 was graded 4 (the second highest priority for attention) with a recommendation to carry out a cyber maturity assessment. All but one of the recommendations from this report were implemented by March 2021. The final recommendation relating to the development of a long-term strategy was completed by the end of April 2021.

**63.** Internal audit carried out further work in this area in 2020/21 with an assurance map and a report on the EIS security. The latter received a grading of 3 (medium risk) and resulted in seventeen recommendations, one of which was rated as critical.

**64.** EIS carried out a Cyber Essentials internal assessment and obtained certificates for this in February 2021 and May 2021. The partnership was also

assessed externally and obtained Cyber Essentials Plus certification in June 2021.

**65.** Internal audit will continue to maintain an interest in cyber preparedness. The risk and potential impact from cyber activity and related penetration actions will continue to challenge organisations and EIS should ensure that it continues to make improvements to its cyber security arrangements.

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# 5. Value for money

Using resources effectively and continually improving services

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## Main judgements

SOSE has started developing its performance management framework and its arrangements to assess and demonstrate Best Value.

The performance report in SOSE's annual report and accounts provides a comprehensive overview of SOSE's performance. SOSE will continue to develop the performance report to reflect its progress as an organisation.

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## SOSE has started developing its performance management framework

**66.** The 2021/22 Operating Plan noted that SOSE was actively developing a performance measurement framework that would enable:

- the assessment of short and medium-term impacts of SOSE's work
- the establishment of indicators to demonstrate how SOSE has achieved those impacts and
- the creation of an effective mechanism for capturing the required data across the organisation.

**67.** Progress in this area was understandably delayed as the organisation focused on mitigating the impact of Covid-19 on businesses in the south of Scotland in its first year. SOSE should now develop a suite of measurable performance indicators against which it can monitor and report its performance. The performance indicators should have a clear link to the Scottish Government's National Performance Framework (NPF), clearly demonstrating SOSE's contribution to the national priorities.

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## Recommendation 4

SOSE should develop a suite of measurable performance indicators. These should have a clear link to the Scottish Government's National Performance Framework, clearly demonstrating SOSE's contribution to the national priorities.

[Appendix 1, Point 4](#)

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## SOSE has begun developing arrangements to assess and demonstrate Best Value

**68.** [Ministerial guidance to Accountable Officers](#) for public bodies and the [Scottish Public Finance Manual](#) (SPFM) set out the Accountable Officer's duty to ensure that arrangements are in place to secure Best Value. The guidance sets out the key characteristics of Best Value and states that compliance with the duty of Best Value requires public bodies to take a systematic approach to self-evaluation and continuous improvement.

**69.** The SOSE draft framework document notes that the Accountable Officer is responsible for ensuring that the resources of SOSE are used economically, efficiently and effectively and that appropriate arrangements are in place to secure Best Value and deliver value for money for the public sector.

**70.** As indicated, SOSE's main focus during its establishment period was on responding to the impact of Covid-19. Management is now considering how to measure and monitor the impact of SOSE's activities and how Best Value through these activities can be achieved and demonstrated. SOSE's planned approach in this area is to look at the economic, social and environmental impact of SOSE's activities, and how these link into the Scottish Government's overarching aims.

**71.** Partnership working and a joined-up approach with other public bodies will be key for SOSE to deliver its aims while ensuring value for money. The regional economic strategy, which is currently in draft, and the South of Scotland Enterprise Act 2019 are the foundations for achieving these aims.

**72.** We note the approach taken by SOSE to progress and develop a framework to assess and demonstrate Best Value and will review this area as part of our future audits.

## The performance report met the FReM requirements

**73.** In addition to the opinion on the performance report covered in Part 1 of this report, we also consider the qualitative aspects of SOSE's performance report included in the annual report and accounts. The performance report should provide information on the organisation, its main objectives and strategies, and the principal risks it faces. It is required to provide a fair, balanced and understandable analysis of performance, and is essential in helping stakeholders understand the financial statements. The performance report is therefore an opportunity for the organisation to 'tell its story' and enhance openness and transparency.

**74.** The Interim Letter of Guidance from the Scottish Government for 2020/21 and SOSE's 2020/21 Operating Plan set out that SOSE's immediate priorities were recovery from Covid-19, developing the organisation, developing an ambition for the region, and establishing a set of investment priorities to underpin the priorities noted above. The performance report included in the annual report and accounts sets out a high-level review of performance against each of these priorities.

**75.** We concluded that SOSE's performance report met the requirements of the FReM. We highlighted to management that more detailed performance

information should be included in future years, as SOSE develops its performance management framework.

**76.** SOSE made improvements to the performance report as a result of the audit process including greater use of cross-referencing and linkage between individual sections of the annual report and accounts. We have also provided management with Audit Scotland's good practice note on [\*Improving the quality of central government annual report and accounts – performance reports\*](#) and management is committed to continue developing the performance report in future years.

### **National performance audit reports**

**77.** Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. In 2020/21 a number of reports were published which may be of direct interest to SOSE. These are outlined in [Appendix 3](#).

# Appendix 1: Action plan 2020/21

## 2020/21 recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p><b>1. Impairment review</b></p> <p>SOSE did not carry out a formal impairment review as at 31 March 2021, due to the impact of Covid-19 on the prioritisation of business activities and lack of staffing capacity.</p> <p><b>Risk:</b> There is a risk that land and property assets are recognised at a value in excess of their carrying amount, overstating the asset values in the accounts.</p>	<p>Regular review of the condition of assets should be carried out, with a formal impairment review undertaken at the end of each financial year.</p> <p><a href="#">Exhibit 2, Point 1</a></p>	<p>Agreed.</p> <p>Director of Finance and Corporate Resources</p> <p>31 March 2022</p>
<p><b>2. Grants tracker reconciliation</b></p> <p>SOSE maintains a grants tracker which lists commitments and payments under each grant fund. While this is agreed to the ledger each month, this reconciliation is not formally documented or signed off.</p> <p><b>Risk:</b> There is a risk that the financial ledger does not correctly record grants committed and paid.</p>	<p>SOSE should formally document the reconciliation between the grants tracker and the ledger to evidence that grant expenditure is accurately recorded in the financial ledger.</p> <p><a href="#">Paragraph 38</a></p>	<p>Agreed.</p> <p>Director of Finance and Corporate Resources</p> <p>August 2021</p>
<p><b>3. Periodic review of governance arrangements</b></p> <p>SOSE has established governance arrangements including an interim framework document</p>	<p>SOSE should review its governance arrangements periodically during its first years of operation to confirm that governance is working as intended, and is effective.</p>	<p>Agreed.</p> <p>Director of Finance and Corporate Resources</p> <p>Ongoing</p>



Issue/risk	Recommendation	Agreed management action/timing
<p>between the Scottish Government and a committee structure. Internal audit concluded that SOSE's arrangements were appropriate in the context of a new organisation facing the challenges from Covid-19.</p> <p><b>Risk:</b> As SOSE develops the governance arrangements may require to be amended to ensure that that they are still effective.</p>	<p><a href="#">Paragraph 52</a></p>	
<p><b>4. Performance measurement</b></p> <p>SOSE has started developing a performance measurement framework but progress was delayed as SOSE focused on responding to the impact of Covid-19.</p> <p><b>Risk:</b> There is a risk that SOSE cannot demonstrate its contribution to Scottish Government priorities.</p>	<p>SOSE should develop a suite of measurable performance indicators. These should have a clear link to the Scottish Government's National Performance Framework, clearly demonstrating SOSE's contribution to the national priorities.</p> <p><a href="#">Paragraphs 66-67</a></p>	<p>Agreed.</p> <p>Director of Planning, Strategy and Engagement</p> <p>31 March 2022</p>

# Appendix 2: Significant audit risks

The table below sets out the audit risks we identified on the 2020/21 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 financial statements and those relating to our wider responsibility under the [Code of Audit Practice 2016](#).

## Risks of material misstatement in the financial statements

Audit risk	Assurance procedure	Results and conclusions
<p><b>1. Risk of management override of controls</b></p> <p>International Auditing Standards (ISAs) require that audits are planned to consider the risk of material misstatement in the financial statements caused by fraud, which is presumed to be a significant risk in any audit. This includes the risk of fraud due to the management override of controls.</p>	<p>Testing of journal entries.</p> <p>Review of accounting estimates.</p> <p>Testing of accruals and prepayments.</p> <p>Cut-off testing, to confirm expenditure and income is accounted for in the correct financial period.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p> <p>Focused testing of the regularity and cut-off assertions during the financial statements audit.</p>	<p><b>Results:</b> Our testing did not identify any issues.</p> <p>We did not identify any significant transactions outwith the normal course of business.</p> <p><b>Conclusion:</b> Satisfactory</p>
<p><b>2. Risk of fraud over expenditure</b></p> <p>As most public-sector bodies are net spending bodies, the risk of fraud is more likely to occur in expenditure than income. Most of SOSE's expenditure is on business support grants. In 2020/21, SOSE forecasts to spend £15.8 million in this area,</p>	<p>Review of SOSE's anti-fraud arrangements.</p> <p>Obtain service auditor assurance on controls over payables.</p> <p>Assessment of the key controls in place over COVID-19 grants.</p> <p>Analytical procedures on expenditure streams.</p>	<p><b>Results:</b> We concluded that SOSE had appropriate anti-fraud arrangements in place.</p> <p>We confirmed that key controls over payables operated as expected.</p> <p>With the exception of the accounting treatment of government grant funding, our testing of expenditure</p>

Audit risk	Assurance procedure	Results and conclusions
<p>representing 68 per cent of the total forecast expenditure for 2020/21. Most of these grant payments are COVID-19 grants such as the Scottish Wedding Industry Fund and the Hotel Support Programme. Given the extent, nature and complexity of grant payments, there is a risk that expenditure may be misstated resulting in a material misstatement in the financial statements.</p>	<p>Consideration of initial transactions made regarding the establishment of SOSE.</p> <p>Detailed testing of expenditure transactions focusing on areas of greatest audit risk, including:</p> <ul style="list-style-type: none"> <li>• cut-off testing to ensure that expenditure has been recognised in the correct financial period</li> <li>• focussed testing of grant payments to confirm that grants are only paid when the grant conditions have been met.</li> </ul> <p>Review of accounting entries/disclosures in relation to areas such as COVID-19 grants.</p> <p>Consideration of internal audit's work on COVID-19 response.</p>	<p>transactions, including expenditure relating to Covid-19 related grants, did not identify any issues.</p> <p>We concluded that SOSE implemented adequate systems for recording and processing Covid-19 grants. The accounting treatment of these was also appropriate.</p> <p><b>Conclusion:</b> Satisfactory</p>
<p><b>3. Accounting estimation and judgements</b></p> <p>There is a significant degree of subjectivity in the measurement and valuation of material account areas, including accruals, pensions and non-current asset valuations. The subjectivity and judgement involved in the valuation of these areas represents an increased risk of material misstatement in the financial statements.</p>	<p>Assessment of management's controls and procedures over the use of estimations and judgements.</p> <p>Review of the work of management's experts used in the preparation of the annual report and accounts including a review of actuarial assumptions.</p> <p>Review of management's assessment of the appropriateness of the assumptions used in the valuations.</p> <p>Review of information provided by SOSE to management experts.</p> <p>Testing of period-end balances and related disclosures, including accruals and valuations.</p>	<p><b>Results:</b> Our review of SOSE's actuaries did not identify any issues.</p> <p>We were content with the information provided by SOSE to the actuary and pension disclosures in the accounts.</p> <p>Our year-end testing of accruals did not highlight any issues. No provisions were recognised in the accounts.</p> <p><b>Conclusion:</b> Satisfactory</p>

## Risks identified from the auditor's wider responsibility under the Code of Audit Practice

Audit risk	Assurance procedure	Results and conclusions
<p><b>4. Governance arrangements, financial planning and performance management framework</b></p> <p>SOSE is a new organisation which is bedding-in its governance and overall corporate arrangements. At the same time, Covid-19 has had an impact on SOSE's ability to fully establish these arrangements and operations during its first full year. Due to Covid-19, SOSE has an interim framework agreement in place with the Scottish Government and has yet to fully establish its committee structure and delegated authority levels. Covid-19 has also had an impact of SOSE's ability to recruit staff. In addition, SOSE delayed the preparation of its strategic plan until April 2022 to align with the planning cycle of the other enterprise and skills agencies such as Scottish Enterprise. As a result, it has yet to fully develop its longer-term financial planning, workforce planning and performance targets and reporting.</p> <p>While this delay in establishing SOSE's governance and accountability arrangements is understandable in the circumstances, there is a risk to effective governance and resource planning until these arrangements are fully developed.</p>	<p>Assessment of the effectiveness of governance arrangements in place and progress with developing these further.</p> <p>Review of disclosures in the performance report and governance statement in the annual report and accounts.</p> <p>Consideration of internal audit's work on governance arrangements.</p>	<p><b>Results:</b> We assessed the effectiveness of the governance arrangements in place at SOSE. Work continues to develop a performance measurement framework, and SOSE is planning to prepare a longer-term financial strategy once its strategic action plan is in place. We acknowledge good progress in SOSE's first year and the impact of Covid-19 on the progress in these areas.</p> <p><b>Conclusion:</b> Work is progressing to embed and further develop SOSE's governance arrangements.</p>
<p><b>5. Governance over Covid-19 related support funding</b></p> <p>SOSE has had a key role in Scotland's response to Covid-19, supporting jobs and</p>	<p>Review of the extent and nature of COVID-19 grants distributed by SOSE to businesses.</p>	<p><b>Results:</b> We carried out a detailed review of the governance arrangements, processes and key controls for administering Covid-19</p>

Audit risk	Assurance procedure	Results and conclusions
<p>businesses. This includes distributing Covid-19 grants to businesses. Decision-making in a fast-moving environment presents a number of challenges for SOSE and other public bodies. These include maintaining good governance and controls while making decisions quickly, adapting performance measures and ensuring that anti-fraud arrangements remain robust at a time when the risk of fraud is increased.</p>	<p>Consideration of the governance and accountability arrangements for distributing COVID-19 grants, including the level of scrutiny and steps taken to minimise fraud and error.</p> <p>Assessment of the key controls in place over COVID-19 grants.</p> <p>Focussed testing of grant payments to assess whether grants are only paid when the grant conditions have been met.</p> <p>Review of performance targets for the efficiency and effectiveness of COVID-19 funding.</p> <p>Consideration of internal audit's work on COVID-19 response.</p>	<p>related grant payments. We considered the work of internal audit on Covid-19 grants and relied on their work during our testing.</p> <p>We concluded that SOSE had appropriate arrangements in place over Covid-19 related business support funding. We also confirmed that during SOSE acted as the principal in issuing this funding during 2020/21.</p> <p><b>Conclusion:</b> Satisfactory</p>
<p><b>6. Governance of cyber security</b></p> <p>Organisations are increasingly threatened by cyber-attacks as evidenced by recent incidents affecting public bodies. This risk is heightened due to the impact of Covid-19 such as home-working. SOSE has a shared Enterprise Information Service (EIS) IT arrangement with Scottish Enterprise, Highlands and Islands Enterprise and Skills Development Scotland. In its assurance map for EIS IT oversight and assurance activities, internal audit highlighted scope for strengthening cyber security controls. There is a risk that a cyber-attack could disrupt SOSE systems, including key financial systems.</p>	<p>Assess progress towards improving cyber security including achieving Cyber Essentials+ accreditation.</p> <p>Consider disclosure of cyber security risk in the governance statement within the annual report and accounts.</p>	<p><b>Results:</b> EIS partner bodies (including SOSE) achieved Cyber Essentials+ accreditation in June 2021. While this is a positive development, this is an area requiring ongoing attention with an internal audit report on the new security operations centre raising 17 new recommendations.</p> <p><b>Conclusion:</b> Satisfactory, but further work is required to address internal audit recommendations and to maintain good arrangements to offset the threat of a cyber-attack.</p>

# Appendix 3: Summary of 2020/21 national performance reports

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## April

[Affordable housing](#)

## June

[Highlands and Islands Enterprise: Management of Cairngorm mountain and funicular railway](#)

[Local government in Scotland Overview 2020](#)

## July

[The National Fraud Initiative in Scotland 2018/19](#)

## January

[Digital progress in local government](#)

[Local government in Scotland: Financial overview 2019/20](#)

## February

[NHS in Scotland 2020](#)

## March

[Improving outcomes for young people through school education](#)

# South of Scotland Enterprise

## 2020/21 Annual Audit Report

Audit Scotland's published material is available for download on the website in a number of formats. For information on our accessibility principles, please visit:

[www.audit-scotland.gov.uk/accessibility](http://www.audit-scotland.gov.uk/accessibility)



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