

Scottish Funding Council

2021/22 Annual Audit Report



 AUDIT SCOTLAND

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

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Key messages

2021/22 annual report and financial statements

- 1 Our audit opinions on the annual report and financial statements are unmodified.
- 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 The Scottish Funding Council (SFC) operated within its revised fiscal resource budget, reporting an underspend of £6.2 million.
- 5 SFC has appropriate and effective financial management in place including regular budget monitoring and reporting.
- 6 Controls within SFC's main financial systems are operating adequately and it has appropriate arrangements for prevention and detection of fraud.
- 7 Funding distributed by SFC to colleges and universities during the Covid-19 pandemic helped stabilise the sectors' financial position. SFC and the institutions it funds face a challenging financial environment.
- 8 SFC should continue to develop its reporting on financial sustainability in the college and university sectors.

Governance, transparency, and value for money

- 9 Governance arrangements are appropriate and support oversight of SFC's activities and finances.
- 10 SFC is taking action to improve its governance of cyber security.
- 11 SFC should continue to develop arrangements to help it achieve and demonstrate Best Value.
- 12 Recommendations from the SFC review of coherent provision and sustainability in tertiary education and research need to be implemented at the earliest opportunity.

Introduction

1. This report summarises the findings from our 2021/22 audit of the Scottish Funding Council (SFC).
2. The scope of our audit was set out in our Annual Audit Plan presented to the 3 March 2022 meeting of the Audit and Compliance Committee. This report comprises the findings from:
 - an audit of SFC's annual report and accounts
 - consideration of the four audit dimensions that frame the wider scope of public audit set out in the [Code of Audit Practice 2016](#).
3. The main elements of our audit work in 2021/22 have been:
 - an audit of SFC's 2021/22 annual report and accounts including the issue of an independent auditor's report setting out our opinions
 - a review of SFC's key financial systems
 - consideration of the four audit dimensions.

Adding value through the audit

4. We add value to SFC through the audit by:
 - identifying and providing insight on significant risks, and making clear and relevant recommendations
 - providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability
 - sharing intelligence and good practice through our national reports ([Appendix 2](#)) and good practice guides.

Responsibilities and reporting

5. SFC has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts that are in accordance with the accounts direction from the Scottish Ministers.
6. In addition, SFC is responsible for establishing appropriate and effective arrangements for governance, propriety, and regularity.
7. 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.

8. 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.

9. Further details of the respective responsibilities of management and the auditor can be found in the Code of Audit Practice 2016 and supplementary guidance.

10. 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.

11. Our annual audit report contains an agreed action plan at [Appendix 1](#). It sets out specific recommendations, the responsible officers, and dates for implementation. It also includes any outstanding actions from last year and progress against these.

Auditor Independence

12. Auditors appointed by the Accounts Commission or Auditor General must comply with the Code of Audit Practice and relevant supporting guidance. When auditing the financial statements auditors must comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies.

13. 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 the 2021/22 audit fee of £77,250 as set out in our 2021/22 Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

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

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

Audit appointment from 2022/23

16. The Auditor General for Scotland is responsible for the appointment of external auditors to central government bodies. External auditors are usually appointed for a five-year term either from Audit Scotland's Audit Services Group or a private firm of accountants.

17. The current appointment round was due to end in 2020/21 but was extended for a year so that 2021/22 is the last year of the current appointment round.

18. The procurement process for the new round of audit appointments was completed in May 2022. From financial year 2022/23 Mazars will be the appointed auditor for SFC. We will work closely with the new auditors to ensure a well-managed transition.

19. A new [Code of Audit Practice](#) applies to public sector audits for financial years starting on or after 1 April 2022. It replaces the Code issued in May 2016.

20. We would like to thank Board members, Audit and Compliance Committee members, Executive Directors, and other staff, particularly those in finance, for their co-operation and assistance over the last six years.

1. Audit of 2021/22 annual report and accounts

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

Main judgements

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

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.

Our audit opinions on the annual report and accounts are unmodified

21. The Board approved the annual report and accounts for the year ended 31 March 2022 on 2 September 2022. As we report 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
- the audited part of the performance report, governance statement and remuneration and staff report were all consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

The annual audit report and accounts were submitted on time

22. We received the unaudited annual report and accounts on 13 June 2022. This was in line with the timetable set in our annual audit plan.

23. The working papers provided to support the accounts were generally of a good standard. We received good support from finance staff which helped ensure the audit ran smoothly.

Overall materiality is £20.2 million

24. Our initial assessment of materiality was carried out during the planning phase of the audit. We revised this after receiving the unaudited annual report and accounts and it is summarised in [Exhibit 1](#). The revised materiality had no impact on our audit approach.

Exhibit 1 Materiality values

Materiality level	Amount
Overall materiality	£20.2 million
Performance materiality	£15.2 million
Reporting threshold	£250,000

Source: Audit Scotland

25. The overall scope of our audit reflects the significant risks of material misstatement described in [Exhibit 3](#). These risks influenced how we resourced the audit and where our work was directed.

We have significant findings to report on the annual report and accounts

26. 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 SFC's accounting practices.

27. 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 in [Appendix 1](#) has been included.

Exhibit 2

Significant findings from the audit of financial statements

Issue	Resolution
<p>1. Financial transactions - accounting</p> <p>The annual report and accounts provided for audit did not reflect the adoption of International Financial Reporting Standard 9, Financial Instruments (IFRS 9). IFRS 9 specifies how an entity should classify and measure financial assets and financial liabilities.</p> <p>SFC assessed the impact and concluded that the IFRS 9 adjustments and disclosures for its financial transaction balances are not material in the context of its accounts. On this basis, it did not apply IFRS 9 in preparing the accounts.</p>	<p>We confirmed that accounting for IFRS 9 would not have a material impact on the 2021/22 annual report and accounts.</p> <p>Management has agreed to review its accounting policy for financial transactions annually and assess whether to apply IFRS 9 in future.</p> <p>Recommendation 1 (Refer Appendix 1, action plan)</p>
<p>2. European Social Fund income - accounting</p> <p>SFC is a lead partner for two European Social Fund (ESF) programmes: the Youth Employment Initiative (YEI) and Developing Scotland's Workforce (DSW). SFC provides funding to colleges to support these programmes and claims matched European funding through the Scottish Government. The YEI programme has now ended and SFC has submitted all material claims. It is working to clear remaining audit queries from the managing authority.</p> <p>SFC's accounts are prepared on an accruals basis but it continues to account for ESF income on a cash basis. This is because in SFC's view the timing and receipt of this income is uncertain.</p> <p>In 2021/22 SFC received £11.7 million of ESF funding. No further amounts have since been received, as the claims process is still ongoing.</p>	<p>We have confirmed that accounting for ESF income on a cash basis does not have a material impact on the 2021/22 annual report and accounts.</p> <p>In our view, SFC's accounting treatment of ESF income is no longer appropriate due to the increased number of claims approved.</p> <p>SFC has confirmed it has received no further ESF income after the year end.</p> <p>Management has agreed to carry out an annual assessment of the accounting treatment of ESF funding to ensure it is in accordance with the FReM.</p> <p>Recommendation 2 (Refer Appendix 1, action plan)</p>

Source: Audit Scotland

28. [Exhibit 3](#) sets out the significant risks of material misstatement to the financial statements we identified in our 2021/22 Annual Audit Plan. It summarises the further audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

Exhibit 3

Significant risks of material misstatement in the financial statements

Audit risk	Assurance procedure	Results and conclusions
<p>1. Management override of controls</p> <p>As stated in International Standard on Auditing 240, management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise are operating effectively.</p>	<p>Assessed the design and implementation of controls over journal entry processing.</p> <p>Made inquiries of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries and other adjustments.</p> <p>Tested journals at the year-end and post-closing entries and focus on significant risk areas.</p> <p>Considered the need to test journal entries and other adjustments during the period.</p> <p>Evaluated significant transactions that are outside the normal course of business.</p> <p>Assessed the adequacy of controls in place for identifying and disclosing related party relationship and transactions in the financial statements</p> <p>Assessed any changes to the methods and underlying assumptions used to prepare accounting estimates compared to the prior year.</p> <p>Substantive testing of income and expenditure transactions around the year-end to confirm they are accounted for in the correct financial year.</p> <p>Focussed testing of accounting accruals and prepayments.</p>	<p>We found controls over journal entry processing to be operating satisfactorily.</p> <p>We reviewed a sample of journal entries and found no errors.</p> <p>We found no significant transactions outside the normal course of business.</p> <p>We found that SFC has adequate arrangements for identifying and disclosing related party relationships and transactions.</p> <p>We assessed SFC's methodology for accounting estimates and concluded that its approach is reasonable.</p> <p>We tested a sample of income and expenditure items and found no errors.</p> <p>We tested a sample of accruals and prepayments and found no errors.</p> <p>Conclusion: Satisfactory</p>

Other areas of audit focus

29. We identified one other area in our 2021/22 Annual Audit Plan where we consider there are also risks of material misstatement to the financial statements. Based on our assessment of the likelihood and magnitude of the risk, we did not consider this to represent a significant risk.

30. The main activity of SFC is the award and payment of grants to colleges and universities. Due to the complexities around different year end dates and re-profiling of budgets, there is a risk that SFC incorrectly records grants in the financial statements.

31. We kept this area under review throughout our audit and, based on the findings of our audit procedures, there are no matters we need to bring to your attention.

Officers made an adjustment of £1.2 million to the accounts

32. It is our responsibility to request that all misstatements, other than those below the reporting threshold, are corrected, although the final decision on making the correction lies with those charged with governance considering advice from senior officers and materiality. There are no unadjusted errors to report.

33. There was one adjustment to the annual accounts of £1.2 million. The adjustment was made to recognise clawback income and update the corresponding grant expenditure.

34. We have reviewed the nature and cause of the adjustment and have concluded that it arose from issues that have been isolated and identified in their entirety and do not indicate further systemic error. We did not need to review our audit approach.

35. Adjustments made in the audited accounts increased income and expenditure in the Statement of Comprehensive Net Expenditure by £1.2 million. There was no impact on the Statement of Financial Position.

Good progress was made on prior year recommendations

36. SFC has made good progress in implementing our prior year audit recommendations. For actions not yet implemented, revised responses and timescales have been agreed with management, and are set out in [Appendix 1](#).

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

SFC operated within its revised fiscal resource budget, reporting an underspend of £6.2 million.

SFC has appropriate and effective financial management in place including regular budget monitoring and reporting.

Controls within SFC's main financial systems are operating adequately and it has appropriate arrangements for prevention and detection of fraud.

SFC operated within its budget in 2021/22

37. SFC's main financial objective is to ensure its financial outturn for the year is within the budget allocated by Scottish Ministers.

38. SFC's budget management process is complex, with the application of a financial year budget to an academic year along with the need to manage budget pressures and commitments. SFC manages its budget through an annual re-profiling exercise to allocate funds among the colleges, universities, and running costs budget.

39. SFC reported an outturn of £1,968 million against its overall budget for 2021/22 with an underspend of £6.2 million. Its financial performance against fiscal resource budget is shown in [Exhibit 4](#).

40. SFC's budget processes operated appropriately. Senior management and the Board continued to receive regular and accurate financial information on SFC's financial position during the year.

Exhibit 4

Performance against fiscal resource in 2021/22

Performance	Final budget £m	Outturn £m	Over/(under) spend £m
Resource	1,592.0	1,589.6	(2.4)

Capital	380.4	378.6	(1.8)
Financial transactions	5.2	3.2	(2.0)
Total	1,977.6	1,971.4	(6.2)

Source: Scottish Funding Council resource return

Financial systems of internal control are operating adequately

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

42. We tested key controls in the general ledger and grant distribution systems and found that, overall, controls were operating as expected.

43. We identified one area where documentation of general ledger controls could be strengthened. We reviewed sub-ledger reconciliations, which reconcile feeder system output to the main financial system, and found one reconciliation with no evidence of review by a senior officer. We are satisfied that this control was being performed, but recommend that evidence of approval is fully documented.

Internal audit

44. SFC has an internal audit function which operates as a wider shared service across five public sector bodies.

45. We reviewed SFC's internal audit arrangements in accordance with International Standard on Auditing (UK) 610 (Using the Work of Internal Auditors) and were able to use its work as planned.

46. We placed reliance on internal audit's work on key financial controls and grant funding distribution. We also reviewed a range of other internal audit reports to inform our wider dimension audit work.

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

47. SFC is responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery, and corruption. The Board is responsible for ensuring that its affairs are managed in accordance with proper standards of conduct by putting effective arrangements in place.

48. We have reviewed the arrangements in place to maintain standards of conduct including the Board and staff code of conduct and register of interests. There are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.

49. The National Fraud Initiative (NFI) is a counter-fraud exercise across the UK public sector which aims to prevent and detect fraud. We reviewed SFC's NFI arrangements and concluded that it is pro-active in investigating matches and reporting outcomes. Reports are presented to the Audit and Compliance Committee to update members on progress with the NFI exercise.

SFC is working to ensure it has sufficient capacity to deliver its objectives

50. We have previously reported on the need for SFC to ensure it is adequately resourced to carry out its core functions, and meet the objectives set out in its strategic framework.

51. SFC is working to ensure it has sufficient capacity to deliver its objectives. During 2021/22 SFC appointed several deputy directors as part of its new organisational structure. This included three new deputy director posts within finance.

52. SFC has agreed an increase in running costs budget for 2022/23 to allow further recruitment at various levels. This reflects the commitment from the Scottish Government to increase SFC's capacity to deliver its strategic objectives.

3. Financial sustainability

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

Main judgements

Funding distributed by SFC to colleges and universities during the Covid-19 pandemic helped stabilise the sectors' financial position. SFC and the institutions it funds face a challenging financial environment.

SFC should continue to develop its reporting on financial sustainability in the college and university sectors.

We have obtained audit assurances over the wider audit dimension risks relating to financial sustainability identified in our 2021/22 Annual Audit Plan

53. [Exhibit 5](#) sets out the significant risks of material misstatement we identified in our 2021/22 audit, our assurance procedures and the results and conclusions from our work. These risks influenced our overall audit strategy, the allocation of staff resources to the audit and informed where the efforts of the team were directed.

Exhibit 5

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

Audit risk	Assurance procedure	Results and conclusions
<p>Financial sustainability</p> <p>SFC and the colleges and universities it funds continue to face financial challenges including the impact of Covid-19, rising pay, pension and running costs, and the loss of European funding streams.</p> <p>SFC uses financial forecast returns from colleges and universities to build a picture of the financial health of the sectors. Last year we reported that SFC had</p>	<p>The outcome agreement process and related guidance.</p> <p>College and university financial forecast returns.</p> <p>SFC monitoring of the financial position of individual institutions.</p>	<p>SFC is making better use of the financial information it receives from colleges and universities to report publicly on the financial sustainability of both sectors.</p> <p>These reports help to support transparency and understanding of the financial position in these key sectors, and we would encourage SFC to continue to develop its reporting in this area.</p>

Audit risk	Assurance procedure	Results and conclusions
<p>reduced the time period these forecasts cover to reflect uncertainty over the longer-term impact of Covid-19.</p> <p>There is a risk that SFC does not have enough information to form a longer-term view of its finances, and that of the sectors, and its options for future funding.</p>		<p>Conclusion: SFC should continue working with colleges and universities to produce longer-term financial plans.</p> <p>See Appendix 1, action plan point 3.</p>

Funding distributed by SFC to colleges and universities during the Covid-19 pandemic helped stabilise the sectors' financial position but SFC and the institutions it funds face a challenging financial environment

54. Throughout 2021/22, SFC continued to support colleges and universities in responding to the impact of Covid-19 and to help manage associated risks to financial sustainability.

55. Covid-19 funding distributed by SFC contributed to the college and university sectors reporting a healthier than expected financial position in 2020/21. However, the additional Covid-19 support funding is non-recurring and the financial position of both sectors is forecast to decline over the following two academic years (2021/22 and 2022/23).

56. The college sector ended academic year 2020/21 with an adjusted operating surplus of £19.7 million. However, the sector is forecasting an adjusted operating deficit of £8.5 million in 2021/22. The university sector reported an underlying operating surplus of £274 million in 2020/21, which is forecast to increase to £293 million in 2021/22.

57. In May 2022, the Scottish Government announced its multi-year spending plans up to 2026/27. This shows a flat cash settlement for the SFC over the next four years, equating to an eight per cent reduction in real terms.

58. Reductions in funding, alongside inflationary pressures and rising costs, presents a challenging financial environment for the SFC and the institutions it allocates funding to.

SFC should continue to develop its reporting on financial sustainability in the college and university sectors

59. In the context of growing financial challenges, medium-term financial planning is more important than ever. It is important that SFC supports colleges and universities to develop realistic medium term financial plans and forecasts, and uses them to build a picture of the financial health of both sectors. This will help to inform its own financial plans, within the parameters of the Scottish Government's medium-term spending plans.

- 60.** SFC reduced the time period covered by financial forecast returns from colleges and universities to reflect uncertainty over the longer-term impact of Covid-19. SFC has requested that colleges provide longer-term financial forecasts by October 2022, and will be engaging with universities to extend current reporting periods in 2023.
- 61.** The Auditor General's latest report on [Scotland's Colleges 2022](#) notes that change is needed to ensure the long term financial sustainability of the college sector.
- 62.** The report highlights the need for SFC, in partnership with the college sector and Scottish Government, to determine the most appropriate model for funding colleges. This includes the targets underpinning the model that will allow colleges to deliver national policies and priorities and contribute to their long term financial sustainability.
- 63.** SFC is making better use of the financial information it receives from colleges and universities to report publicly on the financial sustainability of both sectors. Its most recent report on this, [Financial Sustainability of Colleges and Universities in Scotland](#), was published in March 2022.
- 64.** These reports help to support transparency and understanding of the financial position in these key sectors, and we would encourage SFC to continue to develop its reporting in this area.

Recommendation 3

SFC should continue working with colleges and universities to produce longer-term financial plans.

4. Governance and transparency

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

Main judgements

Governance arrangements are appropriate and support oversight of SFC's activities and finances.

SFC is taking action to improve its governance of cyber security.

SFC has appropriate governance arrangements and controls in place

65. The corporate governance framework within SFC centres on the Board, supported in its role by six committees including the Audit and Compliance Committee and the Finance Committee.

66. The Board is responsible for establishing the strategic processes within SFC and arrangements for ensuring the proper conduct of the affairs of SFC.

67. SFC maintained its governance arrangements throughout 2021/22 and these remain appropriate.

68. The external auditor of South Lanarkshire College (SLC) reported significant governance weaknesses as a result of the 2020/21 audit. An SFC Board member, who is also the chair of the SLC Board, voluntarily stepped back from all SFC duties in July 2021 while reviews of SLC are ongoing. They received their full remuneration during 2021/22.

69. This arrangement was agreed by the chair of the SFC Board. SFC have included details of this issue within the Governance Statement in the annual report and accounts.

The performance report met statutory requirements

70. In addition to the opinion on the performance report covered in Part 1 of our Annual Audit Report, we also consider the qualitative aspects of SFC's performance report.

71. The performance report should provide information on SFC's main objectives and the principal risks it faces. It should provide a fair, balanced and understandable analysis of SFC's performance as well as helping stakeholders understand the financial statements.

72. In 2019/20 and 2020/21 SFC used the dispensation in the Financial Reporting Manual (FReM) to omit a performance analysis from the performance report. This dispensation was not available in 2021/22 and SFC has included a performance analysis within the annual report and accounts.

73. SFC's performance report complies with FReM requirements, but reporting on performance could be clearer. The performance analysis section could be improved by:

- making it more concise and accessible
- including more clearly defined performance measures and targets linked to strategic objectives
- telling a clearer story about how SFC managed its budget.

Recommendation 4

SFC should work to further improve the content and presentation of its performance report.

SFC is taking action to improve its governance of cyber security

74. Public bodies should ensure they have the capacity and capability to respond to increasing risks to cyber security. They should have risk assessment processes in place for recording activities and learning including the cost impact of responding to a cyber attack.

75. In 2020/21 we identified the risk that a cyber attack could disrupt SFC's key financial systems and lead to a loss of data with financial and reputational consequences. SFC has taken action to mitigate this risk and has achieved Cyber Essentials Plus accreditation.

76. SFC has identified areas where it needs additional resource to further develop its use of technology. It is planning to build capacity through recruitment within the IT team.

77. Last year we highlighted SFC's plan to introduce an IT risk register as part of improvements to cyber security arrangements. This followed an internal audit on IT Risk Assessment in December 2020 which identified some internal and external vulnerabilities. Cyber security currently forms part of SFC's main risk register, but a separate IT risk register is not yet in place.

Recommendation 5

SFC should continue work to review and improve its governance of cyber security.

5. Value for money

Using resources effectively and continually improving services

Main judgements

SFC should continue to develop arrangements to help it achieve and demonstrate Best Value.

Recommendations from the SFC review of coherent provision and sustainability of tertiary education and research need to be implemented at the earliest opportunity.

SFC has developed an appropriate Best Value framework

78. [Ministerial guidance to Accountable Officers](#) for public bodies and the [Scottish Public Finance Manual](#) (SPFM) sets out the accountable officer's duty to ensure arrangements are in place to secure Best Value.

79. The guidance sets out the key characteristics of Best Value. Compliance with the duty of Best Value requires public bodies to take a systematic approach to self-evaluation and continuous improvement.

80. SFC assesses its compliance with the principles of Best Value by carrying out periodic self-assessment exercises. The self-assessment measures SFC against the Best Value characteristics an organisation should be able to demonstrate, as identified by the Scottish Government. The 2021 exercise identified 14 actions to improve areas identified as under developed.

81. SFC presented a Best Value progress update report to the August 2022 meeting of the Audit and Compliance Committee. Two of the 14 actions are now complete and progress has been made to address the remaining actions. SFC is planning to incorporate Best Value characteristics into key areas of its 2022-2027 operating plan. This will enable more regular monitoring of progress.

Recommendations from the SFC's review of coherent provision and sustainability of tertiary education and research need to be implemented at the earliest opportunity

82. In July 2021, SFC published the final [report](#) on its review of coherent provision and sustainability of tertiary education and research in Scotland. The report is wide-ranging and includes over 50 recommendations. In October 2021, the Scottish Government [broadly accepted](#) the SFC's recommendations.

83. SFC and the Scottish Government are starting to take forward the recommendations from the review. SFC is prioritising the development of a new National Impact Framework, which is intended to better demonstrate the impact colleges and universities have for Scotland, and to provide the context for

institutional engagement and sector improvement activity. It expects to finalise this in time for the start of the 2023/24 academic year in August 2023.

84. In response to a recommendation in the SFC review, the Scottish Government is due to set out the [purpose and principles](#) for the education, skills and research system in May 2023. It is important that SFC considers how best to support colleges and universities to prepare and plan for change now, ahead of the longer-term implementation of the principles being set out in 2023.

SFC has a key role in delivering the national economic strategy's programme on a skilled workforce

85. The Scottish Government published its [National Strategy for Economic Transformation](#) (NSET) in March 2022. It includes five policy programmes, including one on the importance of a skilled workforce.

86. SFC has a key role in ensuring that colleges and universities continue to make a significant contribution in supporting people into employment with the skills that individuals and businesses need. The Scottish Government's 2022/23 [letter of guidance](#) to SFC sets out its expectation that SFC will contribute towards relevant objectives in the NSET.

87. SFC and SDS worked with the Scottish Government to develop a [Shared Outcomes Framework](#), published in March 2022. It sets out how SFC and SDS will monitor and report on collaborative projects that contribute to skills outcomes set by the NSET. In particular, the Shared Outcomes Framework provides:

- Clarity on the areas where both SFC and SDS are working collaboratively to achieve greater alignment between economic demand and skills provision.
- Detail on the impacts and outcomes that individual projects will deliver including clear timescales and milestones.
- The basis from which detailed monitoring, reporting and assurance can be provided.

SFC is developing a new strategic plan

88. SFC's current strategic framework covers the three year period 2019-2022 and sets out its strategic objectives. It is developing a new strategic plan covering an extended period from 2022 to 2027 to align with the Scottish Government's spending review. A final draft is due to be submitted to the September 2022 Board meeting for approval.

89. The strategic plan will set out how SFC will support the NSET objectives and reflect the recommendations from the SFC's review of coherent provision and sustainability in tertiary education and research. SFC should ensure that the strategic plan and annual operating plan include key performance indicators and targets to measure performance.

Recommendation 6

SFC should ensure it sets clear performance targets and measures in its new strategic plan.

A national audit report on skills recommended action by SFC

90. In January 2022, Audit Scotland published a national performance audit report on [Planning for skills](#) on behalf of the Auditor General for Scotland. This assessed how effectively SFC, SDS and the Scottish Government work together to ensure that Scotland's skills system responds to the needs of individuals and employers.

91. The report concluded that the Scottish Government has not provided the necessary leadership for progress and that current arrangements are unlikely to achieve the ambitions for skills alignment at the pace required. It found that differences between the Scottish Government, SFC and SDS on the approach to skills alignment have prevented effective joint working. It also reported that the capacity of SFC has limited its contribution to skills alignment.

92. The report recommended that the Scottish Government, SFC and SDS should agree how they will work together to deliver shared outcomes for skills. It also recommended that SFC and SDS should work together to:

- implement solutions to overcome obstacles to joint working, including collectively using data to inform skills planning
- provide timely, regular reports about their progress on skills alignment to the Scottish Government and others with governance and oversight responsibilities.

SFC has made progress against the recommendations of the Planning for Skills report

93. Since the Planning for Skills report was published, SFC has taken action to implement the recommendations that apply to it. There has been formal engagement between SFC, SDS and the Scottish Government with all three being represented at the Shared Outcomes Agreement Group (SOAG).

94. The main aim of the SOAG is to provide collective and collaborative leadership and assurance for the Shared Outcomes Framework. SFC has submitted project status reports to the SOAG for the Regional Tertiary Pathfinder projects. Papers and minutes from SOAG meetings are published on the Scottish Government website.

95. SFC and SDS senior management teams held a joint workshop in May 2022 to discuss wider engagement and opportunities to further strengthen joint working. At an operational level there is evidence of regular engagement through delivery groups and forums to help support the work of the collaborative projects covered by the Shared Outcomes Framework.

96. Development of the Regional Pathfinder work projects is ongoing and SFC will work closely with SDS to help deliver the programme of work.

97. SFC has submitted regular progress reports to the Board on the Pathfinder projects to demonstrate developments and work requirements. An update paper was presented at the June 2022 Audit and Compliance Committee to update members on SFC's response to the report and progress it had made against the recommendations.

98. SFC has taken action to help address the key points in the national report but further work is required. SFC should continue developing joint working arrangements to address the report's recommendations and ensure successful delivery of the skills outcomes set by the NSET.

National performance audit reports

99. Audit Scotland carries out a national performance audit programme on behalf of the Account Commission and the Auditor General for Scotland. In 2021/22 several reports were published which may be of interest to SFC. These are outlined in [Appendix 2](#).

100. Audit Scotland also published [Scotland's Colleges 2022](#) in July 2022.

Appendix 1. Action plan 2021/22

2021/22 recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p>1. IFRS 9 accounting</p> <p>The annual report and accounts provided for audit did not reflect the adoption of International Financial Reporting Standard 9, Financial Instruments. IFRS 9 specifies how an entity should classify and measure financial assets and financial liabilities.</p> <p>SFC assessed the impact and concluded that the IFRS 9 adjustments and disclosures for its financial transaction balances is not material in the context of its accounts. On this basis, it did not apply IFRS 9 in preparing its accounts.</p> <p>Risk – SFC will receive further financial transactions funding in 2022/23. This may result in its accounting treatment no longer being appropriate.</p>	<p>Management should review its accounting policy for financial transactions annually and assess whether to apply IFRS 9 in future.</p> <p>Paragraph 27</p>	<p>Agreed</p> <p>Responsible officer: Deputy Director, Finance & Operations</p> <p>Agreed date: 31 March 2023</p>
<p>2. ESF accounting</p> <p>SFC's accounts are prepared on an accruals basis but it continues to account for ESF income on a cash basis. This is because in SFC's view the timing and receipt of this income is uncertain.</p>	<p>Management should carry out an annual assessment of the accounting treatment of ESF funding to ensure it is in accordance with the FReM.</p> <p>Paragraph 27</p>	<p>Agreed</p> <p>Responsible officer: Deputy Director, Finance & Operations</p> <p>Agreed date: 31 March 2023</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>In 2021/22 SFC received £11.7 million of ESF funding. No further amounts have since been received, as the claims process is still ongoing.</p> <p>Risk – There is a risk that the income figure in the annual accounts is understated.</p>		
<p>3. Financial Sustainability</p> <p>It is important that SFC supports colleges and universities to develop realistic medium term financial plans and forecasts, and uses them to build a picture of the financial health of both sectors. This will help to inform its own financial plans, within the parameters of the Scottish Government’s medium-term spending plans.</p> <p>SFC is making better use of the financial information it receives from colleges and universities to report publicly on the financial sustainability of both sectors.</p> <p>These reports help to support transparency and understanding of the financial position in these key sectors, and we would encourage SFC to continue to develop its reporting in this area.</p> <p>Risk – There is a risk that SFC does not have enough information to form a longer-term view of its finances, and that of the sectors, and its options for future funding.</p>	<p>SFC should continue working with colleges and universities to produce longer-term financial plans.</p> <p>Paragraphs 59 to 64</p>	<p>Agreed</p> <p>Responsible officer: Deputy Director, Institutional Sustainability & Governance</p> <p>Agreed date: 31 March 2023</p>
<p>4. Performance report</p> <p>SFC’s performance report complies with FReM requirements, but reporting on performance could be</p>	<p>SFC should work to further improve the content and presentation of its performance report.</p> <p>Paragraphs 72 to 73</p>	<p>Agreed</p> <p>Responsible officer: Deputy Director, Finance & Operations</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>clearer. The performance analysis section could be improved by:</p> <ul style="list-style-type: none"> • making it more concise and accessible • including more clearly defined performance measures and targets linked to strategic objectives • telling a clearer story about how SFC managed its budget. <p>Risk – There is a risk that SFC fails to communicate effectively to stakeholders.</p>		<p>Agreed date: 31 March 2023</p>
<p>5. Governance of cyber security</p> <p>In 2020/21 we identified the risk that a cyber attack could disrupt SFC’s key financial systems and lead to a loss of data with financial and reputational consequences.</p> <p>SFC has identified areas where it needs additional resource to further develop its use of technology. It is planning to build capacity through recruitment within the IT team.</p> <p>Last year we highlighted SFC’s plan to introduce an IT risk register. Cyber security currently forms part of SFC’s main risk register, but a separate IT risk register is not yet in place.</p> <p>Risk – There is a risk that a cyber-attack would disrupt SFC’s key financial systems.</p>	<p>SFC should continue work to review and improve its governance of cyber security.</p> <p>Paragraphs 75 to 77</p>	<p>Agreed</p> <p>Responsible officer: Chief Information Officer</p> <p>Agreed date: 31 March 2023</p>
<p>6. Performance measures</p> <p>SFC is developing a new strategic plan covering an extended period from 2022 to</p>	<p>SFC should ensure it sets clear performance targets and measures in its new</p>	<p>Agreed</p> <p>Responsible officer: Director of Finance</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>2027 to align with the Scottish Government's spending review.</p> <p>The strategic plan will set out how SFC will support the NSET objectives and reflect the recommendations in SFC's review of coherent provision and sustainability in tertiary education and research. SFC should ensure that the strategic plan and annual operating plan include key performance indicators and targets to measure performance.</p> <p>Risk – There is a risk that SFC is unable to measure and demonstrate performance against its strategic objectives.</p>	<p>strategic plan and annual operating plan.</p> <p>Paragraphs 88 to 89</p>	<p>Agreed date: 31 October 2022</p>

Follow-up of prior year recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p>7. Submission of annual report and accounts for audit</p> <p>We received the 2020/21 unaudited annual report and accounts and working papers package in line with our agreed audit timetable. SFC achieved this alongside administering additional funding to help support further and higher education respond to the impact of Covid-19. The annual report and accounts were generally of an acceptable standard but some sections were incomplete and a key working paper relating to financial transactions was only made available to us after the audit commenced.</p> <p>Risk – The audit is delayed and SFC is unable to approve its annual report and accounts in accordance with its agreed timetable.</p>	<p>SFC should introduce additional steps to ensure the accounts presented for audit and the related working papers are complete.</p>	<p>Complete</p> <p>The 2021/22 unaudited annual report and accounts were received in line with our agreed audit timetable and were of an acceptable standard.</p>
<p>8. General ledger user access</p> <p>Our testing confirmed that management review general ledger access rights once a year.</p> <p>Risk – There is a risk that inappropriate access to the general ledger is not identified on a timely basis.</p>	<p>SFC should ensure senior officers review access to the general ledger on a more regular basis throughout the year.</p>	<p>Complete</p> <p>Our testing confirmed that general ledger access rights are now reviewed twice annually.</p>
<p>9. Cyber Essentials accreditation</p> <p>SFC received an external assessment in 2020/21 as part of the Cyber Essentials Plus accreditation process. The assessment identified some internal and external vulnerabilities.</p> <p>Risk – A cyber attack could disrupt SFC's key financial systems and lead to loss of data with financial and reputational consequences.</p>	<p>SFC should address the issues identified in the Cyber Essential Plus assessment and continue to work towards achieving this accreditation.</p>	<p>Complete</p> <p>SFC has achieved Cyber Essentials Plus accreditation.</p>
<p>10. Performance reporting</p> <p>An annual performance report is provided to the Board summarising the performance of colleges, universities and the sectors using</p>	<p>SFC should ensure it reports to the Board on sector performance to enable effective scrutiny</p>	<p>Complete</p> <p>An annual performance report was issued</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>performance measures set out in the strategic framework document. This was due to be presented at the August 2020 Board meeting but was postponed due to Covid-19. It has not yet been presented to the Board.</p> <p>Risk – SFC does not effectively scrutinise college and university performance.</p>	<p>of college and university performance.</p>	<p>to the Board in December 2021 summarising performance of colleges, universities and the sectors.</p>

Appendix 2. 2021/22 national performance publications

May

[Local government in Scotland Overview 2021](#)

June

[Covid 19: Personal protective equipment](#)

July

[Community justice: Sustainable alternatives to custody](#)

September

[Covid 19: Vaccination programme](#)

January

[Planning for skills](#)

[Social care briefing](#)

February

[NHS in Scotland 2021](#)

March

[Local government in Scotland: Financial Overview 20/21](#)

[Drug and alcohol: An update](#)

[Scotland's economy: Supporting businesses through the Covid 19 pandemic](#)

Scottish Funding Council

2021/22 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:

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