

# The 2015/16 audit of the Scottish Government Consolidated Accounts

AUDITOR GENERAL 

Prepared for the Public Audit Committee by the Auditor General for Scotland  
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## Introduction

**1.** The Scottish Parliament's financial powers are changing substantially, with new responsibilities for taxes and spending.<sup>1</sup> The new powers are coming into force at a time of continuing pressures on public finances and constraints on resources. This comes alongside other significant challenges for the Scottish Government, including work to assess the implications for Scotland of the vote to leave the EU. Transparency in budgets and financial reporting which supports scrutiny of Scottish Government budgets and performance has never been more important.

**2.** The Scottish budget sets out the Scottish Government's spending priorities and plans. Equally important is information about how the Government has managed the budget, how the money was spent and what was achieved. In that regard, the Scottish Government's Consolidated Accounts are a key component of its accountability to the Scottish Parliament and the public.

**3.** The Consolidated Accounts reflect the areas for which the Scottish Government is directly responsible and accountable, including the core portfolios and supporting administration, the executive agencies and NHS bodies. The Consolidated Accounts:

- cover around 90 per cent of the spending approved by the Scottish Parliament
- report the amounts the Scottish Government spent against each main budget heading, and the reasons for any significant differences
- report the assets, liabilities and other financial commitments carried forward to future years
- contain a performance report, in which the Government gives a high-level account of its performance during the year.

**4.** My independent audit opinion on the 2015/16 Consolidated Accounts is unqualified. This means that I am content they show a true and fair picture, follow accounting standards and that the income and expenditure for the year is lawful. My audit opinion is set out at pages 51–53 of the accounts.

**5.** This report highlights key information in the Consolidated Accounts.<sup>2</sup> It explains what they show about the Scottish Government's management of its budget. The report also provides other information about the budget, and about governance and performance. I also set out significant audit findings and identify matters relating to financial and performance management and reporting where further action is required.

**6.** At the conclusion of the previous session of the Scottish Parliament, the Public Audit Committee noted that it had found its evidence sessions on the 2014/15 Consolidated Accounts useful and suggested this practice continues.<sup>3</sup> I provide this report on the 2015/16 Consolidated Accounts to support this process and to support scrutiny and accountability in the Scottish Parliament's work more generally.

## Financial management and reporting

### Budget performance

**7.** The Scottish Government's budget reflected new tax and borrowing powers set out in the Scotland Act 2012 for the first time in 2015/16. This meant that the total amount it could spend was affected by amounts raised through devolved taxes and its capital borrowing decisions, as well as the Scottish Block Grant and other continuing funding sources including Non-Domestic Rates (NDR) income and European programmes of financial assistance.

**8.** The Block Grant remained the largest part of the budget. It is calculated using the Barnett formula, adjusted to reflect the devolution of Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT). The UK Parliament votes the necessary provision to the Secretary of State for Scotland, who makes grants to the Scottish Government into the Scottish Consolidated Fund (SCF). Receipts from devolved taxes are also paid into the Fund as is any capital borrowing by the Scottish Government.

### Scottish budget

**9.** The Scottish Parliament approves the budget to be used by the Scottish Administration and the other bodies whose funding is payable directly out of the SCF. The final budget approved by the Scottish Parliament for 2015/16 permitted total expenditure of £37,408 million for the financial year.

**10.** The majority of the budget (90 per cent or £33,700 million) relates to spending programmes and administration costs covered by the Scottish Government Consolidated Accounts. Amounts are also allocated to other parts of the Scottish Administration (£3,543 million) and direct-funded bodies (£165 million).

**11.** The Consolidated Accounts are an important part of a suite of financial reports laid in Parliament that sets out how the Scottish budget has been used. They reflect the areas that the Scottish Government is directly responsible and accountable for: the core portfolios and related administration; the executive agencies; the Crown Office and Procurator Fiscal Service; the Mental Welfare Commission; and NHS bodies. Separate accounts are also published by these individual bodies, other parts of the Scottish Administration, other bodies sponsored by the Government and by direct-funded bodies. These reflect the accountability each has to the Scottish Parliament.

**12.** The Scottish Government also publishes the audited accounts of the Scottish Consolidated Fund. These report the cash paid in and out of the Fund. The Scottish ministers also report a statement of total audited outturn for the preceding financial year against the final budget for the Scottish Administration as a whole. This is an important part of the Government's accountability.

**13.** The budget and the Consolidated Accounts are presented in a consistent manner which means comparisons between budgeted and actual spending are clear. The accounts (page 54) show that total net expenditure during the year was £33,308 million, £392 million less than budget [Exhibit 1 \(page 6\)](#). The resource budget was underspent by £357 million (1.1 per cent) and capital by £35 million (1.8 per cent).

## Exhibit 1

### Portfolio total expenditure (resource and capital) against budget 2015/16

Portfolio	Actual £m	Budget £m	Over/(under) spend £m
Finance, Constitution and Economy	528	604	(76)
Health, Wellbeing and Sport	12,599	12,483	116
Education and Lifelong Learning	2,773	2,969	(196)
Fair Work, Skills and Training	268	270	(2)
Justice	2,374	2,399	(25)
Social Justice, Communities and Pensioners' Rights	11,454	11,617	(163)
Rural Affairs, Food and Environment	522	511	11
Culture, Europe and External Affairs	203	220	(17)
Infrastructure, Investment and Cities	2,290	2,321	(31)
Administration	183	192	(9)
Crown Office and Procurator Fiscal Service	114	114	-
<b>Total Scottish Government Consolidated</b>	<b>33,308</b>	<b>33,700</b>	<b>(392)</b>
Other Scottish Administration	3,517	3,543	(26)
<b>Total Scottish Administration</b>	<b>36,825</b>	<b>37,243</b>	<b>(418)</b>
Direct-funded bodies	155	165	(10)
<b>Total Scottish Budget</b>	<b>36,980</b>	<b>37,408</b>	<b>(428)</b>

Source: *Audited Consolidated Accounts 2015/16* (page 54) and accounts of other bodies, some of which are unaudited at the time of writing. More information on outturn against budget for bodies not included in the Consolidated Accounts is contained in Appendix 1

**14.** The Consolidated Accounts also contain individual portfolio outturn statements (pages 55 to 65) which give more detail of resource and capital spending against budget in each area. More detail about spending by bodies not covered by the Consolidated Accounts is provided in [Appendix 1](#).

**15.** The Scottish Government manages its budget within the overall limit set by the Parliament. Scottish ministers make decisions about spending priorities based on changing circumstances during the year. Many of these are reflected in budget revisions made in the autumn and spring, which are scrutinised by the Finance Committee. Others affect final outturns. The reasons for significant differences between the final budget and actual spending are summarised in the Consolidated Accounts (pages 67–74). Further information is given in the accounts of other bodies.

**16.** The main differences between budgeted and actual spending were:

- An overspend on Health, Wellbeing and Sport was caused by the change in budgeting treatment of non-profit distributing investment projects in Edinburgh and Dumfries ([paragraphs 26–32](#)).
- An overspend on Rural Affairs, Food and Environment was due to the provision of a loan scheme to compensate for the late payments to farmers ([paragraphs 62–71](#)).
- The underspend in Education and Lifelong Learning was primarily caused by a technical accounting adjustment relating to student loans.
- The underspend in Social Justice, Communities and Pensioners' Rights was mainly due to reduced revenue and capital spending on demand-led housing projects ([paragraphs 26–32](#)).

**17.** Budget management during the year was effective in managing aggregate spending. Total Scottish Administration spending was within the limit set, and aggregate expenditure was within the overall budget total.

### HM Treasury budget

**18.** Total Managed Expenditure (TME) is the total budget agreed with HM Treasury, and is used by the UK Government to manage its spending on the Scottish Block. This is different from the budget approved by the Scottish Parliament, largely for technical reasons reflecting differences between accounting rules and UK budget rules. The Scottish Government has to manage spending within both budgets. The differences between them are reported in the Consolidated Accounts and summarised in [Exhibit 2](#).

## Exhibit 2

### Comparison of Scottish and HM Treasury budgets for 2015/16 (£million)

	£m	
Scottish budget approved	37,408	
Less: HMT funding for DEL not in Spring Budget Revision (SBR)	(156)	Includes £109 million of 14/15 carry forward utilised for NPD budget impact. <a href="#">(paragraph 28, page 10)</a>
Add: HMT funding for AME not included in SBR	117	AME non-cash budget for Non-Departmental Public Bodies (NDPBs)
Add: Judicial salaries	30	Met directly from the Scottish Consolidated Fund
Less: Net technical adjustments	(90)	Includes £206 million NDPB non-cash budgets, less £195 million adjustments for infrastructure projects, repayment of Scottish Water loans and other smaller items
Add: devolved taxes paid into cash reserve	74	Excess of amounts raised compared with forecast <a href="#">(paragraph 24)</a>
<b>HM Treasury budget</b>	<b>37,383</b>	

**19.** TME is categorised as either Annually Managed Expenditure (AME) or Departmental Expenditure Limit (DEL). AME is not subject to firm multi-year limits and does not affect the Scottish Government's spending power. DEL is subject to greater control, with a particular focus on fiscal DEL as a measure of real spending power. Fiscal DEL excludes capital charges that reflect the consumption of physical assets and other technical accounting non-cash items. Spending in the Consolidated Accounts is taken together with information from other accounts to establish the overall Scottish position.

**20.** The aggregate TME budget is based on anticipated AME spending, the adjusted block grant, anticipated revenues from newly devolved taxes and NDR and planned capital borrowing. [Exhibit 3 \(page 9\)](#) provides a summary of the key elements of the final TME budget and the actual amounts applied in 2015/16.<sup>4</sup> This sets the HM Treasury limit on spending and determines the maximum level of the Scottish budget in turn, when adjusted.

**21.** Financial decisions taken by the Scottish Government within the extent of its available powers affect both TME and Scottish budget limits. For example, devolved tax revenues will be affected by tax policies for LBTT, SLfT and NDR. Decisions on the use of borrowing and reserve powers, and the amounts carried forward between years will also affect the aggregate amount of resources available during a particular year.

**22.** In June 2016, the Cabinet Secretary for Finance and the Constitution announced the provisional outturn, reporting that the fiscal DEL budget was underspent by £115 million (£75 million resource, £40 million capital). The Financial Transactions budget was underspent by £40 million. The Scottish Government is able to carry forward the full amount of these underspends into 2016/17. Differences between budget and outturn of £130 million in non-cash DEL and £81 million for the AME budget cannot be carried forward, but do not represent a loss of spending power.

### Devolved taxes

**23.** Tax revenues are inherently unpredictable, and actual receipts are likely to differ from those initially forecast each year. The Scottish Government prepared forecasts for 2015/16 LBTT and SLfT revenues for inclusion in the draft budget and the Scottish Fiscal Commission reviewed these, concluding that they were reasonable within the constraints of the data available. Following the announcement of revised residential LBTT rates in January 2015, the initial budget for 2015/16 was based on forecasted revenues of £381 million from LBTT and £117 million from SLfT, a total of £498 million.

**24.** The actual amounts raised during the year were £425 million and £147 million respectively, £74 million above the amount originally anticipated in January 2015. The Cabinet Secretary announced in June 2016 the Scottish Government's decision to place these additional receipts into a cash reserve in line with the new powers provided for in the 2012 Act. This means that they are available to offset any gap in anticipated revenues from devolved taxes in 2016/17. If all or any of the reserve is not required for this purpose, the remaining amount may be carried forward into 2017/18 as part of the new Scotland Reserve created by the Scotland Act 2016. In response to the Finance Committee's enquiry on LBTT, in August 2016 the Scottish Government provided an analysis of LBTT outturn. The submission also reflects a commitment to provide further analysis against forecast alongside the draft budget.<sup>5</sup>

**Exhibit 3**

## Total provisional outturn against HM Treasury budget 2015/16

Component (with cross-references to paragraphs of this report)	Provisional Outturn £m	HM Treasury Budget £m	Over/ (under) £m
<b>HM Treasury Departmental Expenditure Limit (DEL)</b>			
Gross Resource DEL	26,147	26,222	(75)
Block Grant Adjustment for devolved taxes	(494)	(494)	-
<b>Net Resource DEL (paragraph 22)</b>	<b>25,653</b>	<b>25,728</b>	<b>(75)</b>
Capital DEL – general (paragraph 22)	2,725	2,765	(40)
Capital DEL – Financial Transactions (paragraph 22)	358	398	(40)
<b>Cash DEL – carried forward through Budget Exchange</b>	<b>28,736</b>	<b>28,891</b>	<b>(155)</b>
Non-cash DEL (paragraph 22) not carried forward (see note below)	779	909	(130)
<b>Net block grant</b>	<b>29,515</b>	<b>29,800</b>	<b>(285)</b>
<b>Devolved Tax Revenues (paragraphs 23–25) carried forward in Cash Reserve</b>			
	572	498	74
<b>Capital Borrowing Facility (paragraphs 26–32) carried forward within capital borrowing limits</b>			
	283	306	(23)
<b>HM Treasury Annually Managed Expenditure (AME)</b>			
Non-Domestic Rates Expenditure	2,789	2,789	-
Other Annually Managed Expenditure (paragraph 22)	3,899	3,980	(81)
<b>Total AME – not carried forward (see note below)</b>	<b>6,688</b>	<b>6,769</b>	<b>(81)</b>

Notes: The HM Treasury outturn figures are provisional. Final outturn figures for 2015/16 will be reported to HM Treasury later this year following submission of the audited accounts of all public bodies.

The differences between budget and outturn in non-cash DEL and in AME do not represent a loss in spending power.

Source: Audit Scotland, based on Scottish Office and Office of Advocate General Annual Report & Accounts 2015/16 and provisional outturn statement by Cabinet Secretary for Finance and the Constitution

**25.** More detail of devolved tax revenues is reported in the Devolved Taxes Account published by Revenue Scotland. In September 2016, the Scottish Fiscal Commission reported a comparison between Scottish Government forecasts and actual revenues.<sup>6</sup> It highlighted that:

- residential LBTT revenues were in the lower part of the range forecast by the Scottish Government, after accounting for forestalling behaviour.<sup>7</sup> This meant actual revenues were £27 million less than forecast
- non-residential LBTT revenues were £71 million greater than forecast because the commercial property market was more buoyant than anticipated
- SLfT revenues were £30 million greater than forecast largely due to a discrepancy between revenues and landfill volume data evident for the UK as a whole and anticipated in the original forecast, not applying in Scotland.

### **NPD charges and capital borrowing**

**26.** The treatment of Private Finance Initiative, Public Private Partnership and Non-Profit Distributing (NPD) investment projects in the Consolidated Accounts is based on accounting standards. The Scottish Government has applied the correct accounting treatment and such projects are generally treated as 'on-balance sheet' capital investment in the accounts.

**27.** I reported in October 2015 that the Office for National Statistics (ONS) was considering how the Aberdeen Western Peripheral Route, which is a Scottish NPD investment project, should be classified in the National Accounts.<sup>8</sup> In accordance with HM Treasury Consolidated Budgeting Guidance, budget treatment of these projects is determined by their position in the National Accounts. The ONS decided to classify the Aberdeen Western Peripheral Route as a public sector project. In view of the similarities in the structures of the funding models, the Scottish Government adopted a similar budget treatment for three further projects (Edinburgh Sick Kids Hospital, Dumfries & Galloway Royal Infirmary and the National Blood Centre). The effect of this was to require HM Treasury capital budget cover at the point of initial investment, rather than revenue budget cover for the annual payments over the lifetime of the contract.

**28.** This resulted in charges against fiscal DEL budgets of £109 million for 2014/15 and £283 million for 2015/16, which required to be managed within budget limits. This meant that initial spending plans had to be modified to accommodate £392 million (£328 million capital and £64 million resource) of NPD expenditure within overall budget limits.<sup>9</sup> This effectively reduced the Scottish Government's spending power in 2015/16.

**29.** The Scottish Government was successful in managing its planned spending in 2015/16 to remain within overall budget limits. It did this by reviewing its existing commitments and re-prioritising spending across its budgets, including the funding provided to a number of public bodies. The most significant consequences are reflected in the commentary on significant variances included in the Consolidated Accounts (pages 67–74). Some further information is also included in the accounts of the public bodies affected.

**30.** Decisions about how to manage within the 2015/16 budget were taken by Scottish ministers. This was achieved through the combination of a number of measures. The most significant of these included:

- release of contingency from the Queensferry crossing programme – as the programme has proceeded, budget provisions for anticipated inflation and other contingencies have not been required for these purposes
- re-profiling of loans to Scottish Water – the Scottish Government funds Scottish Water's five-year investment programme. Loans made during 2015/16 for this purpose were reduced from those originally anticipated, being delayed until nearer the point when Scottish Water needs this cash funding
- cancellation of the women's prison at Inverclyde – the Scottish ministers have previously announced changes to plans for the prison estate. The consequential reduction in planned spending in 2015/16 was able to be deployed in managing the overall budget
- postponement of uncommitted grants and lower than forecast expenditure on demand-led capital funding schemes – this had an impact over a number of portfolios, the most significant of which was in the Housing and Regeneration budget (within the Social Justice, Communities and Pensioners' Rights portfolio).

**31.** The initial budget for 2015/16 anticipated that new capital borrowing powers introduced by the Scotland Act 2012 would be used, and £306 million of the capital budget was established on this basis. HM Treasury agreed exceptional arrangements for 2015/16 so that the £283 million budget impact of the NPD classification was set against capital borrowing limits. In managing the overall position against budget the Scottish ministers decided in the interests of prudent financial management that the £23 million balance was not required to finance capital spending.

**32.** Work on the existing four NPD projects is continuing, and the remaining capital budget charges associated with them will need to be managed within budgets in future years alongside capital expenditure postponed from 2015/16. The Scottish Government is considering options for financing its investment programme in the context of increased capital borrowing powers that will be available from 1 April 2017 as a result of the Scotland Act 2016.

### Financial position

**33.** The Consolidated Statement of Financial Position, known previously as the balance sheet, (page 75) is one of the primary financial statements in the Consolidated Accounts. It summarises what is owned and owed by the Scottish Government. This shows taxpayers' equity – an accounting measurement of the amount of taxpayers' money applied that has continuing public benefit. It shows how much of this has arisen from the application of revenues (including the Scottish Block Grant and devolved taxes) and that which has resulted through changes over time in the value of physical assets.

**34.** In public finances, the position at a point in time is helpful but the most valuable insight comes from an analysis of trends in assets and liabilities over time. This provides important information about the impact of past decisions on future budgets and in turn highlights potential risks to financial sustainability. The key items in the Statement of Financial Position over the last four financial years are summarised in [Exhibit 4 \(page 12\)](#).

## Exhibit 4

### Summary of Statement of Financial Position for 4 years to 31 March 2016

	As at 31/3/16 £m	As at 31/3/15 £m	As at 31/3/14 £m	As at 31/3/13 £m
Physical assets	27,596	26,698	26,153	25,887
Financial assets	7,484	6,775	6,228	5,775
Receivables	1,379	1,098	973	921
<b>Total assets</b>	<b>36,459</b>	<b>34,571</b>	<b>33,354</b>	<b>32,583</b>
Payables	(4,882)	(4,416)	(4,572)	(4,527)
Financial liabilities	(679)	(693)	(698)	(705)
Provisions	(717)	(778)	(636)	(720)
<b>Total liabilities</b>	<b>(6,278)</b>	<b>(5,887)</b>	<b>(5,906)</b>	<b>(5,952)</b>
<b>Net assets</b>	<b>30,181</b>	<b>28,684</b>	<b>27,448</b>	<b>26,631</b>
General Fund	20,623	18,843	17,397	16,468
Revaluation Reserve	9,558	9,841	10,051	10,163
<b>Taxpayer Equity</b>	<b>30,181</b>	<b>28,684</b>	<b>27,448</b>	<b>26,631</b>

Source: Audit Scotland from Consolidated Accounts 2012/13 to 2015/16

**35.** The information provided in the Consolidated Accounts complies with accounting requirements. It is important that the Scottish Government can also show how it is managing its overall financial position. The Consolidated Accounts for 2015/16 include commentary on the items included in the balance sheet, making a significant improvement in this area this year.

**36.** The accounts also provide information about some categories of asset, debt or financing activity not shown on the balance sheet under accounting rules (known as 'off-balance sheet' items), largely because of the high level of uncertainty involved. This includes potential liabilities, contingent assets and liabilities and government guarantees.

**37.** A contingent asset is a possible asset and a contingent liability is a possible obligation, whose existence will be confirmed only by uncertain future events not wholly within the Scottish Government's control. The Scottish Government has reported various contingent assets and liabilities in the Consolidated Accounts.<sup>10</sup> Only some of the liabilities can be quantified, with amounts totalling an estimated £378 million. Some of these amounts may need to be funded from future budgets, but this is by no means certain.

**38.** The Scottish Government should continue to build on improvements this year to provide clear information in the accounts and other financial reporting about the opportunities and risks that arise from balance sheet and 'off-balance sheet'

items, and what these mean for budgets over time. For example, as part of its Programme for Government commitments, the Scottish Government has recently announced the 'Scottish Growth Scheme' to provide financial support for business investment and it will be important to report clearly on the implications of this in future years. Such an approach here, and more generally, would enable scrutiny of the impact of longer-term commitments on budgets to be strengthened.

### Developing budget and financial reporting

**39.** The Scottish Government's Consolidated Accounts meet the legal requirements and comply with accounting requirements. They show the financial position and budgetary performance from the perspective of the Scottish Government's role in managing the budget it directly controls, including the distribution of resources to other public bodies such as local government. This covers the majority of public spending in the Scottish budget.

**40.** The Scottish Parliament is seeing its financial powers increase substantially, with new responsibilities for taxes, social security and management of finances flowing from the 2012 and 2016 Scotland Acts. These changes have significant implications for Scotland's public finances and how they are managed and reported.

**41.** The construction and management of the Scottish budget is becoming increasingly complex. In 2015/16 this incorporated devolved taxes, block grant adjustment, borrowing and payments into a cash reserve for the first time. As discussed previously ([paragraphs 23–32](#)) spending pressures had to be managed alongside uncertainties about the amount of devolved tax that would ultimately be collected. As the full range of powers in the 2016 Act comes on-stream the calculation of the available budget will change to reflect:

- movements in the Scottish block grant arising from the application of the Barnett formula, baseline adjustments and indexation for each element of the block grant and any policy spillover effects as set out in the fiscal framework agreed between the UK and Scottish governments
- revenue and spending forecasts, and the reconciliation of these to actual amounts once they are known. The Scottish Government has established the Scottish Fiscal Commission to play a key role in the review and from 2018/19 the preparation of forecasts
- the impact of any capital and resource borrowing, and movements and balances in the Scotland Reserve.

**42.** Information about how the new powers are used is also provided across a range of accounts, prepared by the organisations responsible for each aspect. The Consolidated Accounts are only one component of the overall picture; an overview of the way in which funds will flow through the Scottish public finances is shown in [Appendix 2](#) of this report.

**43.** It is therefore becoming increasingly important that the way the new powers have operated in practice is clearly and objectively reported by the Scottish Government. This needs to cover all material elements of the Scottish budget and the picture overall. The Scottish Government has commenced a programme of work to review and broaden its financial reporting in the context of the new financial powers. This is considering the preparation and content of financial reports at all stages of the budget process – from preparation of the draft budget through to the suite of annual accounts that are audited and published.

**44.** As part of this work, the Scottish Government has reviewed the content of the 2015/16 Consolidated Accounts, to identify opportunities for improvement to explain how the Scottish budget as a whole is funded and to make links with other accounts for the Scottish Consolidated Fund and the Devolved Taxes Account prepared by Revenue Scotland. It has also sought to streamline and simplify elements to the accounts to make them more accessible. These are welcome developments.

**45.** There will be much still to do as further powers are introduced and to respond to the Parliament's needs. This programme of work is continuing. In its legacy paper, the Parliament's Public Audit Committee said that clear, transparent and comprehensive public sector financial and performance reporting is vital.<sup>11</sup> Key elements for the Scottish Government to consider include:

- the draft budget and materials to support in-year budget revisions, so that these show how the key components of the budget (including those set out in [paragraphs 41](#)) have been established and how planned expenditure is expected to be funded overall. The Parliament's Finance Committee has announced a review of the budget process, involving parliamentary and government officials alongside a panel of external experts including the Auditor General
- continued development of the suite of annual accounts that contain detailed outturn information on the different components of the budget, so that the information provided is set in the context of the budget as a whole, and the overall position is clear
- accompanying performance reporting, so that it is clearer what spending is aiming to achieve and how this contributes to the Government's overall purpose and specific outputs and outcomes ([paragraphs 50–54](#)).
- its response to my previous reports that highlight the importance of consolidated accounts for the whole of the Scottish public sector.<sup>12</sup> These would help provide the Scottish Parliament, taxpayers and others with a fuller picture and understanding about public spending and the longer-term implications for public finances. Areas for further consideration include information about the total levels of pension liabilities and borrowing across the Scottish public sector.

**46.** The Scottish Government has committed (to the Scottish Parliament's Finance Committee) to reporting on key fiscal issues in the draft budget publication, commenting on outturn in the most recent past year, and also on the forecast position for the year ahead.<sup>13</sup> The Scottish Government has indicated that this would cover tax receipt forecasting and outturn, block grant adjustments, and other relevant information. This is consistent with more general commitments by the Scottish Government to enhance financial transparency.

## Performance

### Performance reporting

**47.** The Consolidated Accounts are required to comply with the accounting principles and disclosure requirements of the Government Financial Reporting Manual (FReM).<sup>14</sup> A direction by the Scottish ministers to that effect is set out in the Consolidated Accounts (page 138). In Scotland, the form and content of

the annual report and accounts is a matter for the Scottish Parliament, which in practice involves an agreement between the Scottish ministers and the Public Audit Committee on a format based on the principles contained in the FReM.

**48.** The 2015/16 Consolidated Accounts comply with the principles of the FReM as they contain a performance report and an accountability report. The performance report (pages 4–20) summarises financial performance for the year, with particular emphasis on performance against budget. It also contains some specific performance information which is required by current guidance on supplier payment performance compared with policy targets and signposts where more information is available on sustainability and environmental performance. For information on the Scottish Government's progress towards its overall aims and objectives, users of the accounts are directed to the National Performance Framework.

**49.** Consequently, while the performance report provides analysis of some key aspects of financial performance, the Consolidated Accounts focus on the Government's finances. They do not report on the performance of the Scottish Government as a whole. I highlighted last year that there remains scope for the Scottish Government to develop its annual reporting to provide a more extensive analysis of its overall performance and development during the year, drawing on relevant performance data including key financial information from the accounts. That remains the case. A more rounded account of the Scottish Government's overall performance would enhance reporting to the Scottish Parliament and the public, and help strengthen accountability and scrutiny.

### Linking spending and performance

**50.** As indicated, the Consolidated Accounts refer readers to the Scottish Government's National Performance Framework (NPF). The NPF sets out the purpose, objectives and national outcomes which describe in more detail what the Scottish Government aims to achieve. The report provides a link to the Scotland Performs website where progress against the measures set out in the NPF is regularly updated.

**51.** The Scottish Government continues to refine the NPF and in March 2016 published an updated NPF indicator set. The Community Empowerment (Scotland) Act 2015 ensures that the current outcomes approach to government will continue in the longer term. It places a duty on the Scottish ministers to consult on, develop and publish a set of national outcomes for Scotland. The Scottish ministers must also regularly and publicly report on progress towards these outcomes and review them at least every five years. When setting national outcomes, the Act requires Scottish ministers to have regard to the reduction of inequalities of outcomes which result from socio-economic disadvantage.

**52.** A key challenge in managing performance is aligning financial and performance information in a meaningful way, so that the impact of spending decisions on performance and outcomes can be better understood. To assist scrutiny of the draft budget, the Scottish Government provides a Scotland Performs update and, in response to calls for clearer links between spending and national outcomes, the 2015/16 budget provided examples for each of the 16 national outcomes. These outlined information on the how the budget was spent, what was achieved and how this contributes towards the relevant national outcomes. I welcome this and would encourage further development of the approach.

**53.** Outcomes are often, by their nature, longer term, and so there remain opportunities for more systematic use of output measures that describe in more specific terms progress towards desired outcomes. These are more able to be aligned to specific budgets and help support scrutiny of budget proposals for the year ahead.

### Planning for outcomes

**54.** A common theme in my 2015/16 performance audit reports is the potential for greater alignment of resources and actions, including those of public organisations, to the NPF. For example, the reports found that the NPF measures overall progress towards economic targets and outcomes but it does not measure the specific contribution of policies and initiatives to delivering these outcomes. We also found that policy implementation plans often lack indicators or measures to monitor progress. A key element of the Scottish Government's programme is public service reform often involving long-term transformation of services, in vital areas including new models for health and social care and including moves to more preventative care. In embarking on reforms, more work is needed at the outset to define milestones and indicators of planned progress, to support the assessment of progress, performance reporting and accountability.

### Governance

**55.** A Governance Statement (pages 23–34) prepared by the Permanent Secretary is a key feature of the Consolidated Accounts. It forms part of a wider accountability report and summarises how the core Scottish Government organisation is controlled and directed. The statement reports that it complies with relevant guidance on corporate governance. It also highlights some of the main risks and opportunities for the organisation and any significant internal control issues in 2015/16. I am content that the Governance Statement has been prepared in accordance with guidance on this issued by the Scottish ministers.

**56.** The overarching governance arrangements in place during 2015/16 were generally effective and provided an appropriate framework for organisational decision-making. I highlight specific matters that are reflected in the Governance Statement in the section on 'Other significant audit matters' overleaf.

**57.** During 2015/16, the Permanent Secretary initiated a review to explore opportunities to streamline corporate governance arrangements while ensuring the principles of effectiveness and transparency are maintained. It is good practice for organisations to carry out periodic reviews of governance to ensure they are fit for purpose and serve the quickly changing context and continuing demands on resources.

**58.** The new arrangements aim to clarify and better align different aspects of the system making it more cohesive, and to provide a clearer focus on the overall performance of the organisation. The proposals have the potential to achieve this; how they operate in practice will determine their success and, as is the case in all organisations, that will depend on the under-pinning organisational culture and behaviours. Key elements include the involvement of non-executive directors. Further work is continuing to ensure that their challenge role is maintained and transparently exercised in the new arrangements.

**59.** Notwithstanding the specific organisational arrangements that are implemented, culture and behaviour have a critical role. This will include the value those involved place on governance and accountability processes, including the

importance of alternative views, perspectives and challenge and critical evaluation of performance. I will keep the effectiveness of arrangements in practice under review as part of our continuing audit work.

**60.** In implementing a revised approach it is also important to recognise the leadership role that the Scottish Government has for other public bodies. In my view, the Scottish Government's approach must remain, and be seen to remain, aligned with what it expects of other public bodies and that in developing its new arrangements it demonstrates the principles of good governance, including transparency.

### Other significant audit matters

**61.** The following significant matters arose from the audit of the 2015/16 Consolidated Accounts.

#### European funding – CAP Futures

**62.** The Scottish Government provides financial support to farmers and other rural businesses as part of the Common Agricultural Policy (CAP). The 2015/16 Consolidated Accounts include expenditure of £37 million on the Futures Programme, an IT-enabled change programme to implement CAP reforms in Scotland. Capital spending in 2015/16 was £27 million. The relevant amounts are reflected appropriately in the Consolidated Accounts.

**63.** The Governance Statement in the Consolidated Accounts (page 33) notes that this programme has proved very challenging, with payments to farmers being made far later than in previous years. I have issued a number of reports on the CAP Futures programme. Most recently, in May 2016 I reported that the programme was managing its spend within the forecast cost of £178 million. This is 74 per cent above the amount included in the original business case. I highlighted that the scope of the programme has significantly reduced and now aims only to deliver a system that is compliant with European Commission (EC) regulations, without all of the planned customer-focused enhancements and anticipated efficiencies. There is a risk that the programme budget will run out before a CAP compliant system is in place. As at 31 July 2016 the programme had spent £140.8 million, therefore a budget of £37.7 million remained. I do not expect the programme to achieve value for money.

**64.** The programme has not met key programme milestones or ministerial targets. As at 14 September, £329 million had been paid out to 17,864 farmers, crofters and rural business (97 per cent of estimated total number of claims), with 703 yet to receive full payment.

**65.** I highlighted in my report the risk of penalties and disallowance if key deadlines were missed or the system was not fully compliant with EC regulations. In June 2016, the EC announced it was extending the payment deadline from 30 June 2016 to 15 October 2016. While this will help mitigate the risk of incurring penalties and disallowances linked to deadlines, it does not help farmers get full payment quicker. There is still a risk of penalties and disallowances if the controls and systems in place for making payments do not meet the requirements of the regulations. Any penalties and disallowances will be subject to an assessment of specific circumstance by EC auditors, and its extent will not become evident until 2017.

**66.** To help farmers receive payments more quickly, the Scottish Government established schemes to loan funds from the Scottish budget while claims are being processed. The loans are made to farmers in advance of the claim being

processed, the loan is then repaid with the EU funds when the claim has been finalised and is paid. This introduced risk to the Scottish Government budget, including risk of duplicate or over-payments, and delays to other spending if the loans are not repaid when expected.

**67.** Three nationally funded loans schemes were initiated. The cash flow loan scheme and Less Favoured Area Support Scheme (LFASS) (page 20 and 21 of the May 2016 report) were introduced in March 2016, with the National Basic Payment loan scheme introduced in April 2016. [Exhibit 5](#) summarises the amounts loaned to date and the level of repayments.

## Exhibit 5

### Loan payments to farmers as at 14 September 2016

Type of scheme	Value
Cash flow loan scheme	£132,000 loaned, repayment amount being finalised
LFASS loan scheme	£54 million loaned, no repayments to date
National Basic Payment loan scheme	£92.9 million loaned, of which £85.1 million has been repaid

Source: Scottish Government

**68.** The Cabinet Secretary for Rural Economy and Connectivity announced the launch of a new loan scheme on 13 September 2016. This will be open to all farmers and crofters who are eligible for the basic, greening or young farmer payments as part of the 2016 payment round. The deadline for applications is 12 October 2016. The Cabinet Secretary aims for the bulk of payments to be made in the first two weeks of November, and estimates loan payments of around £300 million.

**69.** I concluded in my May 2016 report that programme governance had been ineffective. There had been little accountability in the programme for IT delivery leading to ineffective challenge and oversight. Management failed to deal with conflicts of interest effectively; actions were taken but these were inadequate and arrangements were not sufficient to ensure value for money.

**70.** This is a critical time for the programme and it is important that the Scottish Government learns from its experience of the 2015 payment year, and plans for the effective delivery of 2016 payments.

**71.** In a statement to Parliament on 13 September 2016, the Cabinet Secretary for Rural Economy and Connectivity accepted all the recommendations I made in my report. The Cabinet Secretary has also written to me providing an update on progress and summarising the actions that have been put in place in response to my recommendations. It is too early to assess whether these actions will be effective and I will continue to monitor progress.

### European funding – structural funds

**72.** The Scottish Government manages four European structural fund programmes (two programmes funded by the European Social Fund and two funded by the European Regional Development Fund). These programmes

provide financial assistance to, for example, help improve transport links, support business growth and improve skills. The 2015/16 Consolidated Accounts include £92 million of structural fund expenditure and related funding (page 63). Relevant amounts are reflected appropriately in the Consolidated Accounts.

**73.** The Governance Statement in the Consolidated Accounts (pages 33–34) notes that three structural fund programmes for 2007-13 remained in 'suspension' during 2015/16; the fourth programme continued in 'interruption'.<sup>15</sup> The European Commission (EC) procedures aim to avoid payments from the EC where there is a risk that the 'managing authority', in this case the Scottish Government, has not followed the rules on how funds are spent. EC payments are stopped until it considers such risks have been removed:

- Interruptions are relatively common across Europe and are applied where the EC considers that there may be a significant deficiency in the management and control system. Interruptions are usually resolved by the managing authority correcting expenditure declared as programme expenditure.
- Suspensions represent an escalation where the EC considers that there is a serious deficiency in the management and control system or there is a serious irregularity in expenditure declared. This requires the managing authority to provide further assurances about the extent and effectiveness of controls, and correct declared expenditure.

**74.** The EC's action was in response to concerns and error rates reported by the Scottish Government Internal Audit Directorate in its role as the 'audit authority' for structural funds. The auditors highlighted a range of points, including the robustness of information retained by some grant recipients about how structural funds were spent.

**75.** The Scottish Government is working to provide the EC with the assurances it requires about how it and the bodies in receipt of funds are addressing the control weaknesses. The EC has recognised the actions taken to reduce control weaknesses and errors and, in August 2016, the suspensions for European Social Funds were lifted. In September 2016, the Scottish Government was notified by the EC of its decision to lift the remaining suspension for the European Regional Development Fund programme. Similarly, the interruption for the remaining European Regional Development Fund programme is expected to be lifted with confirmation from the EC for both to follow shortly.

**76.** In order to lift the suspensions, the Scottish Government made self-corrections which involved reducing declared expenditure by € 36 million (approximately £30 million). Because the deadline for eligible expenditure under the 2007-13 programmes has passed, self-corrections cannot be 'recycled' to support other eligible projects. As a result, and taking into account the way in which individual projects are funded, the Consolidated Accounts contain a provision of £14 million to reflect a permanent loss of grant to the Scottish Government which it cannot now recover. As the suspensions and interruptions remained in place during 2015/16, amounts due from the EC accumulated. The Consolidated Accounts include £203 million receivable from the EC.

**77.** Full resolution of the 2007-13 programmes is likely to be finalised by March 2017 when the Scottish Government submits a final reconciliation to the EC which matches total grant received with total eligible project expenditure. Further

audits on amounts declared are on-going and may identify further disallowable expenditure. This could have further financial consequences for the Scottish Government. I will continue to monitor closure of these programmes and will report as appropriate.

**78.** During 2015/16, the Scottish Government developed a management control system, which is required to achieve managing authority designation from the EC for the 2014-20 structural fund programmes. It achieved designation in July 2016. To avoid the difficulties experienced during the 2007-13 programmes and the associated financial consequences, the Scottish Government should ensure that its arrangements for managing structural funds, and those of the other bodies receiving funding, comply fully with EC requirements.

**79.** On 23 June 2016, the UK voted to leave the European Union. The decision to leave the EU has no impact on the figures in the 2015/16 accounts. The longer-term implications for EU funded programmes such as CAP and structural funds are not yet known.

## Conclusion

**80.** The Scottish Government publishes a robust and audited financial report in its Consolidated Accounts for 2015/16. It reports spending against budget and sets out what it owns and owes going into 2016/17. The accounts are prepared from the perspective of the Scottish Government's role in managing the budget it directly controls and cover the majority of public spending in the Scottish budget. This is a critical component of the Scottish Government's accountability to the Parliament and the public.

**81.** The Scottish Government has a good record of financial management and reporting, governance arrangements are generally effective and the National Performance Framework is well established with firm commitments for its further development. Together, these form a strong base to meet the challenges of continuing pressures on public finances and the substantial changes to public revenues and expenditure.

**82.** Against this background, we are now in a period of substantial change and greater uncertainty for public finances. New financial powers bring new opportunities and challenges, and the vote to leave the EU changes the context in which the new financial powers are being implemented. The Scottish Parliament has a vital role in scrutinising the implementation of the new powers and draft budgets and needs comprehensive, transparent, reliable and timely financial and performance information to do this effectively.

**83.** The Scottish Government has developed its consolidated accounts and other financial reporting as it begins to implement new powers. My audit work has highlighted a number of areas for further improvement to support budget scrutiny and financial reporting, which it should consider as it continues to develop its arrangements. My report also highlights risks relating to the management and control of European funding which, for the foreseeable future, will continue to be an important income-stream for the Scottish Government.

**84.** Working with Audit Scotland and the Accounts Commission, I will continue to support the independent scrutiny of Scotland's public finances through all of our audit work.

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# Endnotes

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- ◀ 1 The new financial powers are set out in the Scotland Act 2012 and the Scotland Act 2016. The UK and Scottish governments have agreed a fiscal framework for how the powers will work in practice.
- ◀ 2 This report is made under section 22(3) of the Public Finance and Accountability (Scotland) Act 2000.
- ◀ 3 Public Audit Committee, 3rd report (Session 4), Session 4 Legacy paper:  
<http://www.parliament.scot/parliamentarybusiness/CurrentCommittees/97733.aspx#k>
- ◀ 4 All amounts are subject to final confirmation with HM Treasury in early 2017, following conclusion of the audit of all relevant annual accounts.
- ◀ 5 Letter from Cabinet Secretary for Finance and the Constitution to the Finance Committee, August 2016. [http://www.parliament.scot/Finance\\_Committee\\_-\\_LBTT\\_inquiry\\_-\\_Letter\\_from\\_Cabinet\\_Secretary\\_-\\_August\\_2016.pdf](http://www.parliament.scot/Finance_Committee_-_LBTT_inquiry_-_Letter_from_Cabinet_Secretary_-_August_2016.pdf)
- ◀ 6 [http://fiscal.scot/media/media\\_485479\\_en.pdf](http://fiscal.scot/media/media_485479_en.pdf)
- ◀ 7 Purchases of property costing more than £333,000 being brought forward due to a rise in average tax rate for these transactions under LBTT relative to Stamp Duty Land Tax, reducing revenues in 2015/16.
- ◀ 8 [The 2014/15 audit of the Scottish Government Consolidated Accounts \[PDF\]](#), Audit Scotland, September 2015.
- ◀ 9 The impact on resource arose because the £109 million charge for 2014/15 required to be met from the anticipated carry forward for that year: £45 million was met from the capital underspend and £64 million from the resource underspend.
- ◀ 10 Note 17 on pages 123 – 125.
- ◀ 11 Public Audit Committee, 3rd report (Session 4), Session 4 Legacy paper:  
<http://www.parliament.scot/parliamentarybusiness/CurrentCommittees/97733.aspx#k>
- ◀ 12 [Developing financial reporting in Scotland \[PDF\]](#), Audit Scotland, July 2013, and, [Update on developing financial reporting \[PDF\]](#), Audit Scotland, March 2015. Letter from the Cabinet Secretary for Finance and the Constitution to the Finance Committee, 11 August 2016 [http://www.parliament.scot/Cabinet\\_Secretary\\_to\\_Finance\\_Committee\\_-\\_Fiscal\\_Framework.pdf](http://www.parliament.scot/Cabinet_Secretary_to_Finance_Committee_-_Fiscal_Framework.pdf), and [The 2014/15 audit of the Scottish Government Consolidated Accounts \[PDF\]](#), Audit Scotland, October 2015.
- ◀ 13 Finance Committee, Public Papers (2nd meeting, Session 5), 29 June 2016, Cabinet Secretary for Finance and the Constitution evidence submission.
- ◀ 14 [HM Treasury Government Financial Reporting Manual \(FReM\) 2015/16](#)
- ◀ 15 The three suspended programmes 2007-13 are: Lowlands and Uplands Scotland (LUPS) European Social Fund, LUPS European Regional Development Fund (ERDF), and Highland and Islands (H&I) European Social Fund. The interrupted programme is the Highland and Islands European Regional Development Fund.

# Appendix 1

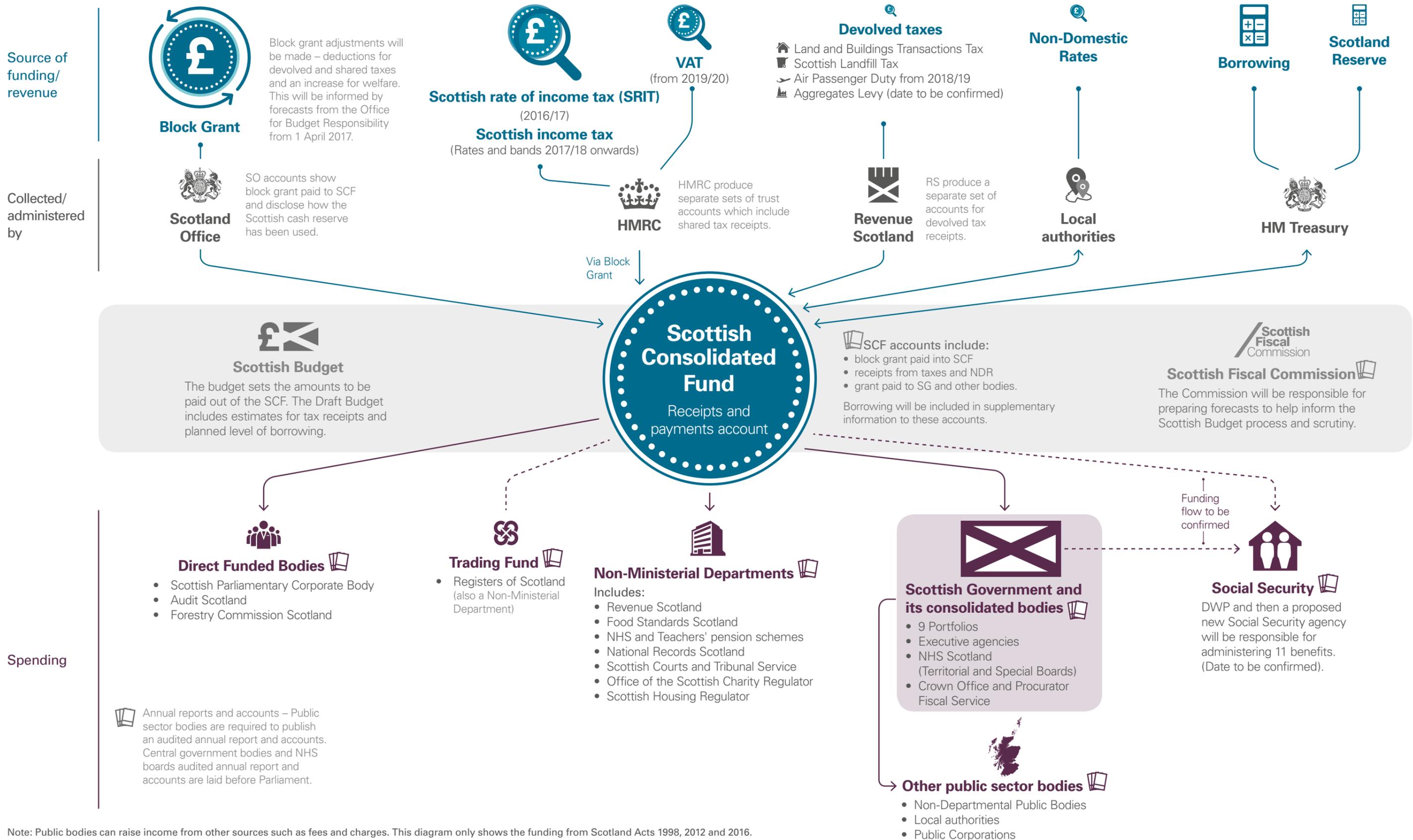
## Scottish budget 2015/16: outturn against budget for bodies not included in the Consolidated Accounts

Entity	Actual £m	Budget £m	Over/(under) spend £m
Scottish Government Consolidated Accounts	33,308	33,700	(392)
National Records of Scotland	21	23	(2)
Teachers' and National Health Service Pension Schemes	3,375	3,398	(23)
Office of the Scottish Charity Regulator	3	3	-
Scottish Courts and Tribunals Service	93	94	(1)
Scottish Housing Regulator	4	4	-
Revenue Scotland	5	5	-
Food Standards Scotland	16	16	-
<b>Total Scottish Administration</b>	<b>36,825</b>	<b>37,243</b>	<b>(418)</b>
Forestry Commission	55	63	(8)
Scottish Parliamentary Corporate Body	91	92	(1)
Audit Scotland	9	10	(1)
<b>Total Scottish Budget</b>	<b>36,980</b>	<b>37,408</b>	<b>(428)</b>

Source: Audit Scotland based on 2015/16 audited accounts (except National Records of Scotland and pension schemes which were unaudited at time of writing)

# Appendix 2

## The Consolidated Accounts – one component of the wider picture



# The 2015/16 audit of the Scottish Government Consolidated Accounts

This report is available in PDF and RTF formats,  
along with a podcast summary at:  
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