

Non-Domestic Rating Account

2021/22 Annual Audit Report



 AUDIT SCOTLAND

Prepared for the Scottish Government and the Auditor General for Scotland
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Key messages

2021/22 Non-Domestic Rating Account

- 1 The independent auditor's report for the 2021/22 Non-Domestic Rating Account is unqualified.
- 2 The receipts and payments presented in the 2021/22 Non-Domestic Rating Account were incurred in accordance with the relevant applicable enactments and guidance issued by Scottish Ministers.

Financial sustainability, governance and transparency

- 3 The 2021/22 account shows Scottish Ministers received £2,065 million of non-domestic rates in the year and paid back £2,205 million to local authorities. This resulted in an in-year deficit of £140 million which increased the overall deficit on the account to £200 million in 2021/22.
- 4 A cumulative deficit balance of £75 million was estimated which is £125 million less than the actual outturn position. The 2021/22 Scottish Budget set out plans to bring the account back into balance by the end of 2024/25.
- 5 There is scope for the Scottish Government to improve the transparency of financial information and reporting on Non-Domestic rates. For example, the account does not provide any information as to how the deficit will be recovered.

Introduction

1. This report summarises the findings from our 2021/22 audit of the Non-Domestic Rating Account (NDR Account).
2. The scope of our audit was set out in our 2021/22 Annual Audit Plan presented to the March meeting of the Scottish Government Audit and Assurance Committee. This report comprises the findings from:
 - an audit of the 2021/22 Non-Domestic Rating Account
 - our consideration of arrangements in relation to financial sustainability, governance and transparency.
3. The Covid-19 pandemic continued to have a considerable impact on the Scottish public sector during 2021/22. This had significant implications for the NDR account. During 2021/22, 100 per cent non-domestic rates relief was provided to cover all Retail, Hospitality, Leisure and Aviation businesses in Scotland for the full financial year. This resulted in a decrease of NDR funding to local authorities of £541 million. General Revenue Grant funding was increased by the same amount to protect local authorities from the shortfall in NDR receipts.

Responsibilities and reporting

4. The Scottish Government has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing the NDR account in accordance with the accounts direction from Scottish Ministers.
5. The Scottish Government is also responsible for compliance with legislation, putting arrangements in place for governance, propriety and regularity that enable it to successfully deliver its objectives.
6. 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.
7. As public sector auditors we give independent opinions on the NDR account and we conclude on the arrangements for securing financial sustainability and the appropriateness of the governance statement disclosures. Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.
8. The [Code of Audit Practice 2016](#) (the Code) includes provisions relating to the audit of small bodies. Where the application of the full wider audit scope is judged by auditors not to be appropriate to an audited body then the annual audit work can focus on the appropriateness of the disclosures in the governance statement and the financial sustainability of the body and its services. As highlighted in our

2021/22 Annual Audit Plan, we applied the small body provisions of the Code to the 2021/22 audit of the NDR account.

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

10. Our annual audit report contains an agreed action plan at [Appendix 1](#) setting out specific recommendations, responsible officers, and dates for implementation.

Auditor independence

11. Auditors appointed by the 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.

12. We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We have not undertaken any non-audit related services and therefore the 2021/22 audit fee of £11,880 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.

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

Audit appointment from 2022/23

14. 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. The current appointment round was due to end in 2020/21 but this was extended for a year due to the disruption caused by the Covid-19 pandemic.

15. The procurement process for the new round of audit appointments was completed in May 2022. The Non-Domestic Rating Account audit will remain with Audit Scotland.

16. 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.

17. We would like to thank all staff involved in assisting our audit of the Non-Domestic Rating Account, particularly those in finance for their co-operation and assistance over the last six years.

Part 1. Audit of 2021/22 Non-Domestic Rating Account

Main judgements

The independent auditor's report for the 2021/22 Non-Domestic Rating Account is unqualified.

The receipts and payments presented in the 2021/22 Non-Domestic Rating Account were incurred in accordance with the relevant applicable enactments and guidance issued by Scottish Ministers.

Our audit opinions are unmodified

18. The NDR account for the year ended 31 March 2022 was presented to the Scottish Government's Audit and Assurance Committee on 21 November 2022. As reported in the independent auditor's report:

- the financial statements properly present in accordance with Schedule 12 of the Local Government Finance Act 1992 as amended by Schedule 13 of the Local Government etc (Scotland) Act 1994 and directions made thereunder by the Scottish Ministers the receipts and payments of the account for the year ended 31 March 2022 and the balances held at that date
- in all material respects the receipts and payments in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers
- information given in the Foreword for the financial year for which the financial statements are prepared is consistent with the financial statements and our understanding of the NDR account. Additionally, we are satisfied that there are no matters which we are required by the Auditor General to report by exception.

Working papers were of a good standard

19. The unaudited NDR account was received in line with our agreed audit timetable on 31 May 2022. We did not encounter any difficulties in obtaining the evidence required.

20. The working papers provided to support the accounts were of a good standard and the audit team received support from finance staff which helped ensure the audit process ran smoothly.

Overall materiality is £20.9 million

21. Our initial assessment of materiality was carried out during the planning phase of the audit. This was reviewed on receipt of the unaudited accounts and it was concluded that they remained appropriate. Materiality is summarised in [Exhibit 1](#).

Exhibit 1 Materiality values

Materiality level	Amount
Overall materiality: This is the figure we calculate to assess the overall impact of audit adjustments on the financial statements. It has been set at 1% of the distributable amount for the year ended 31 March 2022 based on the 2021/22 Scottish Budget.	£20.9 million
Performance materiality: This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality this would indicate that further audit procedures should be considered. Using our professional judgement, we have assessed performance materiality at 75% of planning materiality.	£15.7 million
Reporting threshold: We are required to report to those charged with governance on all unadjusted misstatements more than the 'reporting threshold' amount. This has been calculated at 5% of planning materiality but capped at a maximum level of £0.25 million.	£250,000

Source: Audit Scotland

We have no significant findings to report on the 2021/22 Non-Domestic Rating Account

22. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the body's accounting practices. Our audit identified a number of presentational and disclosure issues which were discussed with management. These were adjusted and reflected in the audited NDR account. We have raised issues around the transparency of information provided within the NDR Account which are discussed at paragraphs 36-38 in this report.

23. [Exhibit 2](#) sets out the significant risk 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 this risk and the conclusions from the work completed.

Exhibit 2

Significant risk from the audit of the financial statements

Audit risk	Assurance procedure	Results and conclusions
<p>1. Risk due to fraud caused by the management override of controls</p> <p>As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that otherwise appear to be operating effectively.</p>	<p>Performed detailed testing of journal entries</p> <p>Tested any significant transactions outside the normal course of business</p> <p>Reviewed accounting estimates where appropriate</p>	<p>Our testing did not identify any issues and we found no evidence of management override of controls.</p>

Source: Audit Scotland

Other areas of audit focus

24. We identified in our 2021/22 Annual Audit Plan one area where we considered there to be a risk of material misstatement to the financial statements. The area of specific audit focus related to the processing of mid-year adjustments and their compliance with legislation. In 2020/21 the NDR account included £40.4 million of receipts and £19.9 million of payments which were not in accordance with the regulations and last year we qualified our audit opinion on regularity in relation to this matter.

25. We noted that one mid-year adjustment was made during 2021/22. We reviewed the relevant regulations and formed the view that it was compliant with the prescribed conditions.

26. There were no identified misstatements in the draft NDR account presented for audit.

Part 2. Financial sustainability, governance and transparency

Main judgements

The 2021/22 account shows Scottish Ministers received £2,065 million of non-domestic rates in the year and paid back £2,205 million to local authorities. This resulted in an in-year deficit of £140 million which increased the overall deficit on the account to £200 million in 2021/22.

A cumulative deficit balance of £75 million was estimated which is £125 million less than the actual outturn position. The current expectation is that the account will be brought back into balance by the end of 2024/25.

There is scope for the Scottish Government to improve the transparency of financial information and reporting on NDR. For example, the account does not provide any information as to how the deficit will be recovered.

Financial performance in 2021/22

27. The NDR account operates on a receipts and payments basis and is managed by the Scottish Government. All NDR receipts collected by local authorities in Scotland are placed in a national “pool” and distributed to the local authorities as part of the Scottish Government’s funding arrangements.

28. The amount distributed as non-domestic rates funding to local authorities (the Distributable Amount) was set in the Local Government Finance (Scotland) Order 2021 at £2,090 million for 2021/22 after taking into account the expected NDR receipts to be received by local authorities in 2021/22. This was a £541 million reduction from the amount provisionally set in the 2021/22 Scottish Budget published in January 2021 due to the extension of 100% rates relief for Retail, Hospitality, Leisure and Aviation businesses announced in February 2021.

29. The Scottish Government guarantees the combined amount of revenue grant funding and non-domestic rates distributions provided to councils each year. Where variances in non-domestic rates occur, the Scottish Government adjusts the council’s General Revenue Grant to ensure funding levels to local government align to the levels agreed in the local government finance settlement for that year.

30. Total non-domestic rates contributed by councils in 2021/22 was £2,065 million of which £10 million related to prior years. The total amount distributed to

councils for 2021/22 was £2,205 million which includes £115 million relating to prior years.

31. The net position for 2021/22 represents an excess of distributions over contributions resulting in a negative balance of £140 million (2020/21: deficit of £85 million). The cumulative deficit balance on the account of £200 million will be carried forward into 2022/23.

32. In the Scottish Budget for 2021/22, published in January 2021, the Scottish Government made a policy decision to set the distributable amount at a level which led to a forecast £75 million deficit balance in the account at 31 March 2022, with plans set out in the same budget document to bring the account back into balance by the end of 2024/25.

33. Significant amendments to the 2021/22 budget were made in the Autumn Budget revision, (published in September 2021), reducing the distributable amount by £541 million. This reflected the reduction in NDR income as a result of the provision of 100% rates relief provided to Retail, Hospitality, Leisure and Aviation businesses introduced by Ministers in response to the Covid-19 emergency. As NDR income and expenditure were both reduced, these changes did not impact on the planned cumulative negative balance.

34. The 2021/22 budget had anticipated a £19 million in-year deficit on the 2021/22 NDR account. Actual 2021/22 NDR receipts contributed by councils were £85 million less than expected and net payments due to prior year adjustments were £36 million more than expected. This led to the expected in-year deficit of £19 million rising to £140 million.

Financial sustainability and transparency

35. The Scottish Budget for 2022/23 shows that the Scottish Government plans to allocate £64 million less (including prior year adjustments) than it receives, which would decrease the overall balance on the account from a deficit of £200 million to a deficit of £136 million. The Scottish Government plans to bring the account back into balance by the end of the 2024/25 financial year.

36. We have previously recommended that there is scope for the Scottish Government to improve the transparency of financial information and reporting on NDR. We first raised this in 2016/17. The Scottish Government should provide the Parliament and the wider public with a fuller understanding of how the NDR account operates. We noted the following:

- the narrative could be enhanced by including more information in the Foreword to the annual accounts about reasons for the annual deficit (£200 million) and future plans to reduce the overall deficit on the account and return to break-even
- further information could be provided around NDR forecasts and funding within its medium-term financial strategy
- scenario planning and sensitivity analysis to provide decision makers with greater information of how any fluctuations in NDR contributions or distributions may impact on decisions about how local government is funded could be undertaken and published.

37. By providing greater transparency the Scottish Government could demonstrate more clearly their plans for the NDR account, the funding choices it presents, and how these align to the Government's wider decision-making on financial sustainability.

38. We have not identified any notable improvement over the years in the transparency of information in the NDR Account. It remains the responsibility of the Scottish Government to take action to address this action point. Increasing users' understanding of the NDR account and how it links with the Scottish budget should be addressed.

Recommendation 1

The Scottish Government should improve the transparency and therefore users' understanding of the narrative within the Non-Domestic Rates Account. [See Appendix 1.](#)

Financial systems of internal control are operating effectively

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

40. The NDR account is subject to the same controls that apply to the Scottish Government therefore for this audit we place reliance on our findings from our Management (interim) Report presented to the Scottish Government Assurance and Audit Committee in June 2022. No significant internal control weaknesses were identified during the audit which could affect the ability to record, process, summarise and report financial and other relevant data to result in a material misstatement in the NDR account.

Governance arrangements are effective

41. The governance arrangements for the NDR account operate within the context of the Scottish Government's overall system of corporate governance. Our judgements on the adequacy of the governance arrangements form part of our reporting on the 2021/22 Scottish Government's Consolidated Accounts.

42. The Scottish Government Audit and Assurance Committee is responsible for oversight of the NDR account on an exceptions basis. Any issues relating to reporting or the administration of the NDR account are escalated to the Committee.

43. The arrangements, within which the NDR account operates, are assessed by the Scottish Government who confirmed that these arrangements comply with generally accepted best practices and relevant guidelines. Assurance is also provided by the work of internal and external audit and can be supported by SGAAC if required.

44. A separate governance statement is not prepared for the NDR account as it is not an entity but an extract of the Scottish Consolidated Fund. Although the Scottish Consolidated Fund sits outside the Scottish Government's internal governance arrangements, the Fund, like the NDR account, is subject to the same controls and assurance procedures that apply to the Scottish Government.

Appendix 1. Action plan 2021/22

2021/22 recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p>1. Transparency of reporting</p> <p>We have previously recommended that there is scope for the Scottish Government to improve the transparency of financial information and reporting on NDR. The Scottish Government should provide the Parliament and the wider public with a fuller understanding of how the NDR account operates.</p> <p>Risk: There is a risk that the reader's understanding is impaired by the lack of transparency.</p>	<p>The Scottish Government should improve the transparency and therefore users' understanding of the narrative within the Non-Domestic Rates Account.</p> <p>Paragraph 38</p>	<p>The Scottish Government will consider how best to improve the transparency of the NDR system including how any future surpluses or deficits will be distributed or recovered.</p> <p>Bill Stitt, Team Leader – Revenue and Capital, Local Government Finance</p> <p>15 November 2022</p>

Non-Domestic Rating Account

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

www.audit-scotland.gov.uk/accessibility



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