



The Scottish Parliament
Pàrlamaid na h-Alba

PUBLIC AUDIT COMMITTEE

AGENDA

7th Meeting, 2015 (Session 4)

Wednesday 1 April 2015

The Committee will meet at 9.30 am in the Adam Smith Room (CR5).

1. **Decision on taking business in private:** The Committee will decide whether to take item 5 and 6 in private.

2. **Accounts Commission - Borrowing and treasury management in councils:** The Committee will receive a briefing on the Accounts Commission report entitled "Borrowing and treasury management in councils" from—

Graham Sharp, and Pauline Weetman, Accounts Commission;

Fraser McKinlay, Director and Controller of Audit, and Gemma Diamond, Senior Manager, Audit Scotland.

3. **Section 23 report - Update on developing financial reporting:** The Committee will take evidence on the Auditor General for Scotland report entitled "Update on developing financial reporting" from—

Caroline Gardner, Auditor General for Scotland;

Mark Taylor, Assistant Director, and Gordon Smail, Senior Manager, Audit Scotland.

4. **Accountability, audit and the further devolution of powers:** The Committee will take evidence on the accountability and audit arrangements arising from the further devolution of powers proposed in the UK Command paper entitled "Scotland in the United Kingdom: An enduring settlement" from—

Caroline Gardner, Auditor General for Scotland;

Russell Frith, Assistant Auditor General, Fraser McKinlay, Director and Controller of Audit, and Mark Taylor, Assistant Director, Audit Scotland.

5. **Section 23 report - Update on developing financial reporting:** The Committee will consider its approach to the Auditor General for Scotland report entitled "Update on developing financial reporting" and take evidence from—

Caroline Gardner, Auditor General for Scotland;

Mark Taylor, Assistant Director, and Gordon Smail, Senior Manager, Audit Scotland.

6. **Accountability, audit and the further devolution of powers:** The Committee will consider the evidence received at agenda item 4 on the accountability and audit arrangements arising from the further devolution of powers proposed in the UK Command paper entitled "Scotland in the United Kingdom: An enduring settlement".

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The papers for this meeting are as follows—

Agenda Item 2

Accounts Commission briefing paper

PA/S4/15/7/1

[Accounts Commission report](#)

PA/S4/15/7/2

Agenda Item 3

Auditor General for Scotland briefing paper

PA/S4/15/7/3

[Auditor General for Scotland report](#)

PA/S4/15/7/4

Agenda Item 4

Draft Memorandum of Understanding on the audit of SRIT

PA/S4/15/7/5

PRIVATE PAPER

PA/S4/15/7/6 (P)

Agenda Item 5

PRIVATE PAPER

PA/S4/15/7/7 (P)

SCOTTISH PARLIAMENT PUBLIC AUDIT COMMITTEE

WEDNESDAY 1 APRIL 2015

REPORT BY THE ACCOUNTS COMMISSION

BORROWING AND TREASURY MANAGEMENT IN COUNCILS

The report by the Accounts Commission on borrowing and treasury management in councils was published on Thursday 19 March. The report focuses on whether councils openly and clearly demonstrate the affordability and sustainability of borrowing decisions over the short term, and the long term. It considers the skills and expertise that councillors need to perform their key scrutiny role and how effective this scrutiny is.

Key messages from the report are:

- Borrowing is a key source of finance for councils to invest in vital public services. Overall borrowing has remained at around £12 billion for the last three years, with total assets of £39 billion. Councils have developed borrowing strategies to suit their own local priorities and needs, in response to the flexibility introduced by the Prudential Code in 2004. Seventeen councils have increased their borrowing levels, in real terms, over the last ten years.
- Councils are following the general principles of the relevant codes of practice in demonstrating short-term affordability, but they are not always highlighting the strategic importance of borrowing and treasury management or clearly analysing and reporting the long-term affordability and sustainability of their borrowing. Councils need to develop detailed analysis to support borrowing decisions and to demonstrate they represent best value for the council.
- Treasury management is a professionally run function in councils with appropriately qualified officers. Ongoing training and the availability of appropriate professional qualifications and skills are important. Councils have started to integrate their treasury management and capital investment functions which is a positive step.
- Councils need to improve scrutiny of borrowing and treasury management. This is a complex and technical subject and officers need to provide wider training and support to councillors, and also provide clearer, more accessible reports. The current governance structures in some councils could be improved to support more effective scrutiny.

SCOTTISH PARLIAMENT PUBLIC AUDIT COMMITTEE

WEDNESDAY 1 APRIL 2015

REPORT BY THE AUDITOR GENERAL FOR SCOTLAND

UPDATE ON DEVELOPING FINANCIAL REPORTING

The report by the Auditor General, *Update on developing financial reporting*, was published on 17 March 2015. It reviews the changing context for public financial reporting and provides an update on the actions the Scottish Government is taking to further develop financial reporting since the Auditor General reported on this area in 2013.¹

The report highlights that:

- **The environment for public finances in Scotland is changing.** The Scotland Act 2012, and the changes that would flow from the Smith Commission Agreement, mean the Scottish Government will have more control over, and responsibility for, its finances. Its budget will become more dependent on Scotland's economic performance.
- **Transparent financial reporting is more important than ever.** The case for comprehensive, transparent, reliable and timely reporting of public finances has never been stronger. A financial reporting framework that provides transparency over the public finances will be an essential component of an updated fiscal framework for Scotland. It supports effective Parliamentary scrutiny and informs decisions about how public money is used to deliver services.
- **Consolidated Scottish public sector accounts would provide a better understanding of the financial position.** In the absence of easily accessible, aggregate information in one place on what the Scottish public sector owns and owes overall, it is difficult for the Scottish Parliament, taxpayers and others to get a full picture and understanding about where money is spent and the longer-term implications for public finances. This type of information is also essential to those making decisions about public finances. Consolidated accounts for the whole of the Scottish public sector would help provide an overall picture of the financial position.
- **The Scottish Government is further developing its approach to financial reporting.** The Scottish Government has continued to improve and develop its reporting framework since Audit Scotland reported on this area in 2013. It now needs to set out details of how it proposes to further improve and enhance its financial reporting in the changing financial context.

¹ *Developing financial reporting in Scotland*, Audit Scotland, July 2013.

MEMORANDUM OF UNDERSTANDING

**For cooperation between the Comptroller and Auditor
General and the Auditor General for Scotland, on the audit
of the Scottish rate of income tax**

DRAFT

Introduction

1. The Scotland Act 1998 (“the 1998 Act”), as amended by the Scotland Act 2012 (“the 2012 Act”), gives the Scottish Parliament the power to set a Scottish rate of income tax (SRIT) for Scottish taxpayers (as defined in a new section 80D of the 1998 Act). SRIT will commence from a date to be set by the UK Government, expected to be April 2016. It will be administered by HM Revenue and Customs (HMRC) as part of the UK-wide income tax system and applied to non-savings income. The Scottish Parliament will be able to set a rate of SRIT from zero to any number of pence or half-pence in the pound. This rate will be added to each of the main UK rate bands after ten pence in the pound has been deducted from each rate.
2. An amount equal to ten pence of each rate will be deducted from the Scottish Block grant whether the Scottish Parliament sets a rate or not and replaced by the amount received through SRIT will be included in the overall Scottish Block grant for each year based on estimated figures, with a reconciliation to actual amounts raised taking place twelve months after the end of the year
3. The Command Paper which accompanied the draft 2012 Act, entitled *Strengthening Scotland’s Future*¹, outlined the arrangements that the UK Government proposed to put in place to ensure accountability in relation to HMRC implementing and operating the SRIT:
 - The UK Government will invite the Comptroller and Auditor General (C&AG), as head of the National Audit Office (NAO), to prepare a report to the Scottish Parliament on HMRC’s administration of the SRIT.
 - The Scottish Parliament will receive a report from HMRC on the administration of the Scottish income tax receipts;
 - Scottish Parliamentary Committees will be able to request HMRC’s Accounting Officers to give evidence.
 - An HMRC Additional Accounting Officer will be made specifically accountable for the collection of the SRIT.
 - The UK Government will also inform Scottish Ministers in writing of HMRC Commissioner appointments.
4. The UK Finance Act 2014 places a duty on the C&AG, as the statutory external auditor of HMRC, to prepare a report on the administration of the SRIT for each financial year, to be laid before the Scottish Parliament not later than 31 January of the financial year following that to which the report relates.
5. HMRC is governed by the Commissioners for Revenue and Customs Act 2005 which prohibits disclosure of HMRC’s information except under specific circumstances. Audit Scotland is not HMRC’s auditor, nor does it have any statutory right of access to HMRC information.

¹ Command Paper CM 7973 November 2010

<https://www.gov.uk/government/publications/strengthening-scotland-s-future-hm-command-paper>

6. The C&AG and the Auditor General for Scotland have confirmed to the Public Audit Committee of the Scottish Parliament that they are happy to work together to ensure that the Parliament receives appropriate reports on the operation of the SRIT.
7. This Memorandum of Understanding describes our respective powers and responsibilities and sets out a framework for collaborative working. This framework is designed to optimise the skills and experience involved in audits, reviews or investigations, avoid duplication of effort and ensure that the Scottish Parliament receives the assurance it requires about the implementation and operation of the SRIT.

Statutory role of the Comptroller and Auditor General and the NAO

8. The National Audit Office (NAO) scrutinises public spending on behalf of the UK Parliament and its audit of central government has two main aims. By reporting the results of audits to the UK Parliament, it holds government departments and bodies to account for the way they use public money, thereby safeguarding the interests of taxpayers. In addition, its work aims to help public service managers improve performance and service delivery.
9. The audit and inspection rights are vested in the head of the National Audit Office, the Comptroller and Auditor General (C&AG). The NAO undertakes these tasks on his behalf.
10. The C&AG is an Officer of the House of Commons. Both he and the NAO are totally independent of government and are not subject to the control or direction of the UK Government or Parliament.
11. There are a number of Acts of Parliament that give the C&AG the right to audit, or examine the receipt of revenue of, HMRC:
 - The Exchequer and Audit Departments Act 1921 provides that the C&AG audits the revenues collected by HMRC, as accounted for in HMRC's Trust Statement (as directed by HM Treasury) and to examine these "*to ascertain that adequate regulations and procedure have been framed to secure an effective check on the assessment, collection, and proper allocation of revenue*" and to satisfy himself that any such regulations and proceedings are being duly carried out, and as to the correctness of sums brought to account in respect of revenue. This examination takes the form of a separate report (the Standard Report) by the C&AG on HMRC's Annual Accounts;
 - The Government Resource and Accounts Act 2000 provides that the C&AG audits the departmental accounts produced by UK central government departments, including those produced by HMRC; and
 - The National Audit Act 1983 allows the C&AG to undertake examinations into the economy, efficiency and effectiveness of how certain bodies, including HMRC, have used their resources in discharging their functions.

12. Subject to certain constraints, the C&AG has complete discretion in the carrying out of the functions of that office including what is reported to Parliament.
13. The Scotland Act 2012 makes no changes to the way the C&AG and the NAO undertakes their existing roles in respect of HMRC.
14. From 2014-15, under section 80HA of the Scotland Act 1998 (inserted by section 297 of the Finance Act 2014), the C&AG is required to report to the Scottish Parliament on:
 - the adequacy of any of HMRC's regulations and procedures relating to the Scottish rate provisions;
 - whether these rules and procedures are being complied with;
 - the correctness of the sums brought to account by HMRC which relate to SRIT; and
 - the accuracy and fairness of the administrative expenses reimbursed to HMRC.
15. The C&AG may also include in the report an assessment of the economy, efficiency and effectiveness with which HMRC has used its resources in carrying out relevant functions.
16. It is currently envisaged that HMRC will report the revenue collected under the SRIT in notes to the Trust Statement. Costs associated with its collection will be shown in HMRC's Resource Account. HMRC will use these notes to compile a specific report to the Scottish Parliament.
17. The C&AG is required to report to the Scottish Parliament on these activities, and assurances over these figures, from 2014-15. The report must be laid before the Scottish Parliament by 31 January of the financial year following the one to which the report relates. The C&AG might also exercise his rights under the National Audit Act 1983 to report to the UK Parliament on these activities.

Statutory roles of the Auditor General for Scotland and Audit Scotland

18. Under the Scotland Act 1998, the Auditor General for Scotland (AGS) and those who exercise functions on her behalf are not subject to the control or direction of any member of the Scottish Government or the Scottish Parliament. She is responsible for ensuring propriety and value for money in the spending of public funds. She investigates whether public bodies are achieving the best possible value for money and adhering to the highest standards of financial management.
19. Scottish Ministers, the Lord Advocate and every other person to whom sums are paid out of the Consolidated Fund in a financial year must prepare accounts of their expenditure and receipts for that year to be audited by the AGS. The AGS is responsible for securing the audit of the Scottish Government and most other public bodies in Scotland except local authorities. Annual financial audit reports are produced for all of the public bodies that the AGS is responsible for auditing.

20. Section 23 of the Public Finance and Accountability (Scotland) Act 2000 (the 2000 Act) gives the AGS specific powers to examine the economy, efficiency and effectiveness with which resources are being used by specified public bodies.
21. The AGS is required to lay reports in Parliament which are then scrutinised by the Public Audit Committee (and which may also be considered by other relevant Committees).
22. Audit Scotland is a statutory body set up in April 2000 under the 2000 Act. It provides services to the AGS and the Accounts Commission. Audit Scotland provides independent assurance to the people of Scotland that public money is spent properly and provides value for money. It supports improvement in public services by holding to account those responsible for spending public funds.
23. The 2012 Act makes no changes to the role of the AGS or Audit Scotland.
24. The estimated receipts from the SRIT and any subsequent adjustments to reflect actual receipts will flow into the Scottish Consolidated Fund as an adjustment to the overall Scottish Block Grant. This is the first point at which the SRIT flows become subject to audit by the AGS.
25. As part of its audit of the Scottish Government, Audit Scotland will consider and, where appropriate, report on
 - The Scottish Government's governance arrangements for the development of SRIT;
 - Scottish Government arrangements to prepare information about the proposed Scottish rate;
 - Expenditure paid to HMRC for administrative costs incurred under Section 80H, through the audit of the Scottish Government; and
 - The assurance obtained from NAO on overall arrangements.
26. The Public Audit Committee of the Scottish Parliament has recommended that Audit Scotland should provide additional assurance on the NAO's audit of HMRC and to work with the NAO on the future priorities and focus of its work. This MOU sets out how these recommendations will be fulfilled.

A framework for collaborative working

27. The C&AG and the AGS are committed to ensuring that we deliver our audits, reviews and investigations efficiently and effectively. We have agreed the following arrangements for collaborative working. Specifically we are committed to:
 - Maintaining effective communication and liaison;
 - Sharing relevant information and respecting confidentiality of shared information; and
 - Sharing knowledge, skills, expertise and experience.

28. We will evolve approaches to sharing knowledge and expertise to build mutual confidence in the quality of our audit work. The NAO and Audit Scotland will meet regularly to ensure effective communication and information sharing between the two organisations.
29. As part of the framework to deliver assurance on the implementation and operation of SRIT, each year the NAO will discuss with Audit Scotland:
- their audit planning to ensure that attention is focused on the key risk areas of the audit, that potential problems are identified and resolved timeously and that the audit timetable will meet stakeholder requirements. This will include any plans for value for money work.
 - the NAO's approach to risk assessment undertaken at the start of the audit process. The process will enable the NAO to identify the key risk areas and control systems and develop an audit approach designed to address these risks in the most efficient manner.
 - their application of the concept of materiality to the audit of SRIT. Materiality is concerned with the extent to which auditors can tolerate error and is relevant for determining which account areas are significant from an audit perspective and the nature, timing and extent of audit procedures required. Materiality has both quantitative and qualitative factors; however, the final assessment of what is material is a matter of professional judgement.
 - the NAO's testing strategy to deliver appropriate assurance that the control systems are operating as intended.
 - the NAO's testing strategy for the financial and other information included in the HMRC report.
 - the findings arising from the audit.
 - the draft report on the audit.
30. The first NAO audit report to be prepared under the 2014 Act will cover the financial year ending 31 March 2015 and will have to be published by January 2016 at the latest. The AGS will report on the same period and that report will:
- summarise the extent and nature of work performed by Audit Scotland in relation to NAO's audit on the SRIT.
 - provide views and comments on the reasonableness of NAO's audit approach, findings and conclusions.
 - highlight any specific aspects of NAO's findings or conclusions that are considered pertinent from a Scottish perspective.

Resolving disagreements

- 31. The C&AG and AGS are committed to working together in an environment of professional respect and promoting a culture of openness. This approach should minimise the risk of disagreements. Any disagreements will normally be resolved at a working level between the individuals involved. If this is not possible, it will be referred upwards through normal management reporting channels until resolution is achieved. Ultimately a disagreement may be referred to the C&AG and the AGS who will be responsible for ensuring a mutually satisfactory resolution.

Reviewing the Memorandum of Understanding

- 32. We will formally review this Memorandum at least every three years, or when there are relevant changes to legislation, to ensure both organisations are working within our agreed framework, and consider whether the arrangements needs to be revised to meet changing circumstances.

Signed

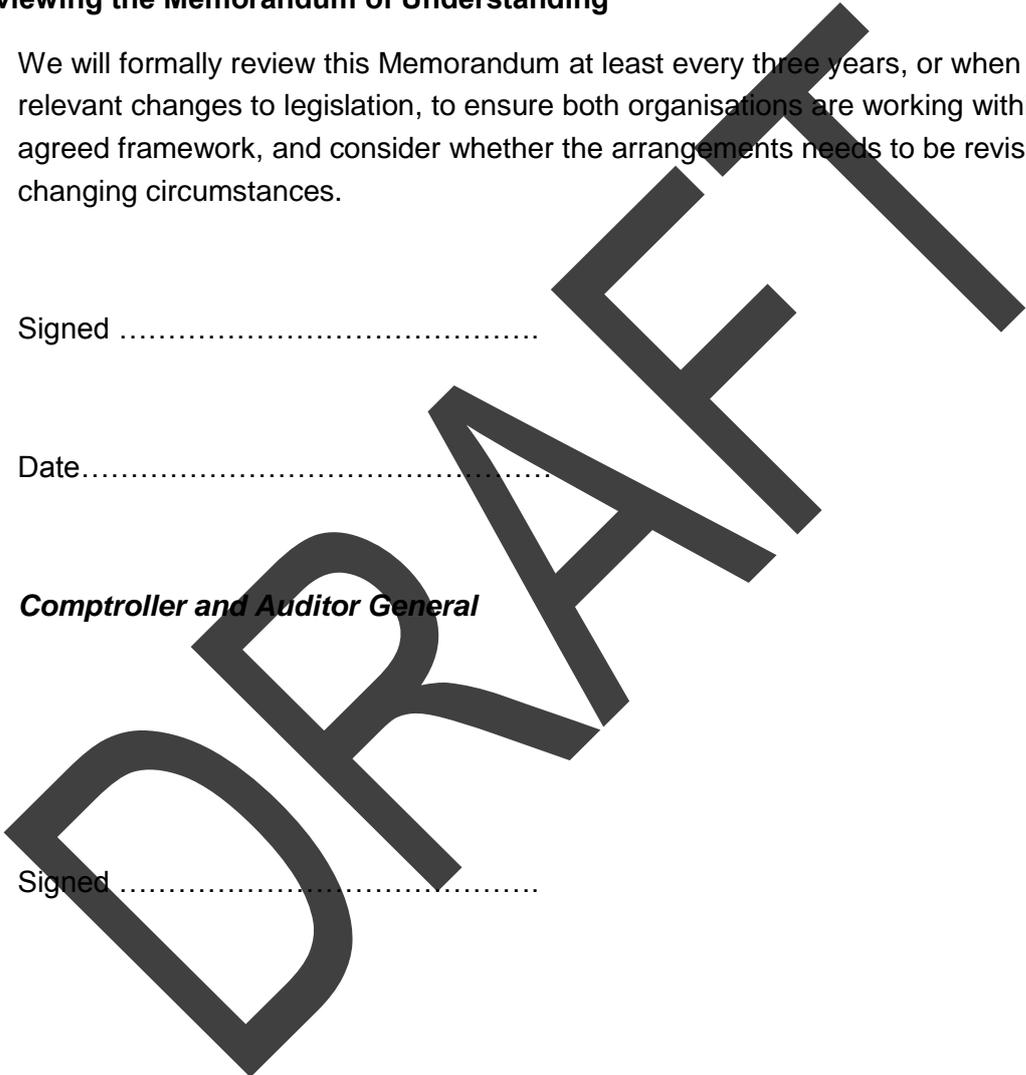
Date.....

Comptroller and Auditor General

Signed

Date.....

Auditor General for Scotland



Appendix 1: EXTRACT FROM THE UK FINANCE ACT 2014

290 Report on administration of the Scottish rate of income tax

(1) In Chapter 2 of Part 4A of the Scotland Act 1998, after section 80H insert—

“80HA Report by the Comptroller and Auditor General

(1) The Comptroller and Auditor General must for each financial year prepare a report on the matters set out in subsection (2).

(2) Those matters are—

(a) the adequacy of any of HMRC’s rules and procedures put in place, in consequence of the Scottish rate provisions, for the purpose of ensuring the proper assessment and collection of

income tax charged at rates determined under those provisions,

(b) whether the rules and procedures described in paragraph (a) are being complied with,

(c) the correctness of the sums brought to account by HMRC which relate to income tax which is attributable to a Scottish rate resolution, and

(d) the accuracy and fairness of the amounts which are reimbursed to HMRC under section 80H (having been identified by it as administrative expenses incurred as a result of the charging of income tax as mentioned in paragraph (a)).

(3) The “Scottish rate provisions” are—

(a) any provision made by or under this Chapter, and

(b) any provision made by or under the Income Tax Acts relating to the Scottish basic rate, the Scottish higher rate or the Scottish additional rate.

(4) A report under this section may also include an assessment of the economy, efficiency and effectiveness with which HMRC has used its resources in carrying out relevant functions.

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(5) “Relevant functions” are functions of HMRC in the performance of which HMRC incurs administrative expenses which are reimbursed to HMRC under section 80H (having been identified by it as administrative expenses incurred as a result of the charging of income tax as mentioned in subsection (2)(a)).

(6) HMRC must give the Comptroller and Auditor General such information as the Comptroller and Auditor General may reasonably require for the purposes of preparing a report under this section.

(7) A report prepared under this section must be laid before the Scottish Parliament not later than 31 January of the financial year following that to which the report relates.

(8) In this section “HMRC” means Her Majesty’s Revenue and Customs.”

(2) The amendment made by this section has effect in relation to the financial year ending on 31 March 2015 and subsequent financial years.