

INITIAL RESPONSE FROM THE SCOTTISH GOVERNMENT, DATED 12 APRIL 2017

Thank you for your letter of 28 March requesting a response from the Scottish Government to the Auditor General for Scotland's report "*Managing new financial powers: An update*".

Establishing arrangements for the transfer of new financial powers is a transformative piece of work and I am confident that the Scottish Government has robust plans in place to ensure smooth delivery of service. I welcome the report's findings that the Scottish Government is currently well-organised to deliver substantial changes to public finances and the recognition that implementing the new social security system is "an exceptionally wide ranging and complex task."

The report noted that good programme management processes are in place to oversee the new functions. This conclusion has also been supported by a recent independent 'Gateway Review' of the Fiscal Framework Implementation Programme. This strategic assessment review was conducted in February and provided an overall delivery confidence assessment of Green, i.e. that successful delivery of the programme appears highly likely and there are no major outstanding issues that appear to threaten delivery significantly. The Review found that the workstreams due to deliver in 2016-17 and those for operational implementation from April 2017 are all on track or have been delivered. Areas with longer-term milestones were considered to be making appropriate progress. The Review Team also found that all intended outcomes were managed and in control.

I also welcome the report's recognition that the "Scottish Government is providing more financial information and is committed to enhanced financial transparency". The Committee will be interested to note the publication in December 2016 of the Scottish Government's "Open Government Partnership - Scottish National Action Plan"¹ which contains a specific commitment on Financial Transparency, to:

"clearly explain how public finances works and provide an accessible presentation of public financial flows into and out of the Scottish Government, including to local authorities, commercial and third sector organisations; and develop, with partners, ways to provide financial, procurement and commercial information that is coherent, consistent and in a format that is useful and easy to understand for communities, the 3rd sector and citizens - this will include consideration of how national budget information could complement participatory budgeting at local and national levels."

I have addressed the key findings and the recommendations of the report in the Annex below and I hope Committee members find this response useful as part of their consideration of the report.

Yours sincerely

GORDON WALES

Acting Director-General Finance

¹ <http://www.gov.scot/Resource/0051/00511323.pdf>

SCOTTISH GOVERNMENT RESPONSE TO AUDITOR GENERAL FOR SCOTLAND'S REPORT "MANAGING NEW FINANCIAL POWERS: AN UPDATE"

Report key messages

1. The Scottish Parliament's financial powers are changing substantially, with new responsibilities for taxes, social security and borrowing through the 2012 and 2016 Scotland Acts. The amount of money raised in Scotland will go up from about £4 billion before the Scotland Acts were introduced, to £22 billion by 2020. The scale of the change needed to implement and manage the new financial powers is significant. The Scottish Government is identifying the staff and skills it needs to set-up and manage the financial powers, although recruiting enough people with the required skills may prove difficult. The Scottish Government spent £18.5 million up to the end of 2015/16 on programmes to implement the new financial powers. Set-up costs will increase significantly during the next four years. It is important that the Scottish Government builds a clearer picture of potential future costs and plans how it will fund implementation of the new powers over the next four years.

2. The Scottish Government has updated its structures for overseeing the new powers and has good programme management processes in place. Arrangements are being put in place to ensure data is shared among relevant bodies to support effective decision-making, financial planning and scrutiny. The transition of the Scottish Fiscal Commission to a statutory body is being managed effectively.

3. Revenue Scotland is collecting two devolved taxes and is making good progress in preparing for further devolved taxes. The National Audit Office found that HM Revenue and Customs (HMRC) did not identify 420,000 Scottish taxpayers before the Scottish rate of income tax was introduced. The Scottish Government worked with HMRC to resolve this and work is ongoing to prepare for further income tax powers.

4. The Scottish Government's social security programme is in the early stages. The next stage, in establishing an agency and implementing the new social security system, is an exceptionally wide-ranging and complex task. Once its approach to delivering the social security system is more established, sharing it publicly will support scrutiny of the Scottish Government's proposals and provide the public with more information about the changes. Underpinning this approach with detailed, coordinated project plans will enable oversight of the programme's progress towards delivering the new social security powers by the end of the current parliamentary session in 2021.

5. The new financial powers require a more strategic approach to Scottish public financial management and reporting, including an overarching medium-term financial strategy underpinned by clear policies and principles. The Scottish Government is developing its approach to financial management. This has included longer-term analysis and assessment to support decision-making. It needs to finalise policies and principles for borrowing and reserves, and further develop its longer-term financial scenario planning. Making these publicly available will enhance financial transparency.

6. The Scottish budget is becoming increasingly complex, with more reliance on forecasting than ever before and more adjustments likely throughout the budget cycle. The Scottish Parliament's Budget Process Review Group is reviewing current arrangements and assessing what is needed to support scrutiny in the future. The Scottish Government is taking steps to enhance financial reporting to provide a more comprehensive picture of Scotland's public finances but more work is required. This will enable the Parliament and wider public to understand and scrutinise the Scottish Government's decisions.

I welcome the report's findings that the Scottish Government is currently well organised to deliver substantial changes to public finances and the recognition that good programme management processes are in place to oversee the new functions. The arrangements required to support the implementation and operation of the first year of the new powers under the Scotland Act 2016 were in place on time, and evidenced in the Draft Budget.

The report also recognises that the programme governing the devolution of social security powers is at an early stage and the comment within the report regarding the benefits of sharing information when there is more certainty is noted.

Recommendations

The Scottish Government should:

- monitor regularly how much is being spent on implementing the financial powers in the Scotland Acts against what has been planned. The costs of each individual programme, and the total cost, should be reported regularly through existing governance structures (paragraph 16)

Scottish Government budgeting and associated monitoring procedures are and will continue to be used to develop and monitor the costs of delivering and implementing the new powers. Appropriate governance structures are already in place to oversee this spending and these will continue.

- develop more detailed estimates of how much it will cost to implement the financial powers in the Scotland Acts, and refine them as policy decisions are made about how the powers will be delivered (paragraph 17)

The Scottish Government is working to fully develop potential future costs as it prepares to deliver further powers including social security by the end of the current Parliamentary session. Costings are developed as a routine element of policy making and these will be naturally be refined over time as the policy to be implemented becomes clearer. This is similar to the way in which HMRC have been able to refine the estimate of the lifetime costs for the implementation of the Scottish rate of income tax on an annual basis as a greater understanding of both the changes required and their actual costs has developed.

- integrate new approaches to workforce planning, developed through its SG2020 change programme, into its processes at all levels of the organisation (paragraph 24)

Workforce planning is integrated into the core of Scottish Government's SG2020 programme. Substantial improvement activity has already taken place and the SG will continue to develop the workforce planning process during 2017-18. This modelling is used to monitor and inform decision making about capacity and capability at all levels of the organisation. To meet the requirements of new powers, the Scottish Government has a significant programme of work underway to identify and recruit suitable staff.

- share its approach to implementing the social security powers publicly and underpin this approach with detailed plans for the social security system programme and its projects (paragraph 68 to 70)

As the report recognises, the social security programme is at an early stage. Ministers and officials recognise the public interest in the delivery of the new social security powers. The Cabinet Secretary and Minister have been providing regular updates on the implementation of the new powers to Parliament since June 2015 and will continue to do so, most recently in the Ministerial Statement of 22 February and the Minister's Committee appearance on 2 March.

- develop a medium-term financial strategy setting out (paragraph 83):
 - forecast economic performance and its effect on Scotland's public finances;
 - broad financial plans for the next three to five years;
 - clear principles for using and managing the new financial powers;
 - scenario plans

The complexity of Scotland's public finances has increased with the devolution of the new powers and we acknowledge the increasing importance of medium-term financial planning. In this context, it is important to note the work of the tri-partite Budget Review Process Group and its fundamental review of the Budget process following the devolution of powers. The Review Group's interim report, published in March, summarised a range of key areas, including the importance of medium-term financial planning. The Cabinet Secretary for Finance and the Constitution and the Finance Committee Convener will receive a final set of recommendations from the Review Group before the Parliamentary summer recess. The Scottish Government will then consider those recommendations.

- finalise principles for using its borrowing powers and the Scotland Reserve as a matter of urgency and make these publicly available (paragraphs 92 and 94)

The 2017-18 Budget clearly sets out Scottish Ministers' plans for capital borrowing. Ministers have previously been clear that the use of revenue borrowing would not, because of its nature, be planned in advance of the need arising. New resource borrowing powers are limited to managing forecast errors in tax revenues rather than being a tool to increase resource spending.

- demonstrate publicly the progress it is making toward introducing a comprehensive account of Scotland's public finances (paragraph 112)

The recognition of the steps the Scottish Government is taking to enhance financial reporting is also welcomed. The report references the additional reporting outputs produced in December 2016 in furtherance of commitments made previously and also notes the work currently in progress. I am happy to provide an update on that work:

- preparations for the 2016-17 accounts are well underway and this included building on the improvements welcomed in the 2015-16 accounts;*
- using the 2015-16 annual accounts information, a model of enhanced reporting for the Scottish Administration as a whole, including balance sheet information, has been shared with the Scottish Government Audit and Assurance Committee (SGAAC) and with Audit Scotland; this will inform the outputs to be produced alongside the 2016-17 annual accounts.*

I can also confirm that good progress has been made on the commitment to agree a more formal plan setting out the scope, format and content of a 'tailored for Scotland' consolidated public account. Proposals were shared with SGAAC and with Audit Scotland in March, and we expect further engagement with Audit Scotland on this shortly.

Members may recall that the letter from the Permanent Secretary to the Committee of 2 November 2016 regarding these consolidated accounts included a significant caveat about the position of Local Authorities and their compliance with International Financial Reporting Standards. This caveat was in relation to the accounting treatment of highways network assets and the quality issue of a risk of qualified audit opinion if harmonised accounting was not achieved. The relevant standard-setter (CIPFA/LASAAC)² has now decided that the accounting policy will not be brought into line. We have considered our approach in the light of this and decided that, although the quality risk continues, this should not prevent our development work and in due course we will consider how 2016-17 information could be presented perhaps as a "shadow" year.

- explain and better link different parts of the budget, and provide more detailed explanations for differences between the budget and outturn (paragraph 115)*

The Scottish Government's annual consolidated accounts provide explanations of variances greater than £3 million. Review of the information which is helpful to support scrutiny will be an element of the consideration of Budget Review Group recommendations in due course.

² <http://www.cipfa.org/policy-and-guidance/technical-panels-and-boards/cipfa-lasaac-local-authority-code-board>