



OFFICIAL REPORT
AITHISG OIFIGEIL

Public Audit and Post-legislative Scrutiny Committee

Thursday 1 November 2018

Session 5



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PUBLIC AUDIT AND POST-LEGISLATIVE SCRUTINY COMMITTEE
24th Meeting 2018, Session 5

CONVENER

*Jenny Marra (North East Scotland) (Lab)

DEPUTY CONVENER

*Liam Kerr (North East Scotland) (Con)

COMMITTEE MEMBERS

*Colin Beattie (Midlothian North and Musselburgh) (SNP)

*Bill Bowman (North East Scotland) (Con)

*Willie Coffey (Kilmarnock and Irvine Valley) (SNP)

*Iain Gray (East Lothian) (Lab)

*Alex Neil (Airdrie and Shotts) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Stephen Boyle (Audit Scotland)

Joanne Brown (Grant Thornton UK LLP)

Caroline Gardner (Auditor General for Scotland)

Leigh Johnston (Audit Scotland)

Pat Kenny (Deloitte LLP)

Michael Oliphant (Audit Scotland)

CLERK TO THE COMMITTEE

Lucy Scharbert

LOCATION

The Adam Smith Room (CR5)

Scottish Parliament

Public Audit and Post-legislative Scrutiny Committee

Thursday 1 November 2018

[The Convener opened the meeting at 09:00]

Decision on Taking Business in Private

The Convener (Jenny Marra): Good morning, and welcome to the 24th meeting in 2018 of the Public Audit and Post-legislative Scrutiny Committee. I ask everyone in the public gallery to switch their electronic devices to silent.

Item 1 is a decision on taking business in private. Do members agree to take items 4, 5, 6 and 7 in private this morning?

Members indicated agreement.

Section 22 Reports

“The 2017/18 audit of NHS Ayrshire and Arran”

“The 2017/18 audit of NHS Highland”

09:00

The Convener: I welcome our witnesses today: Caroline Gardner, the Auditor General for Scotland; Leigh Johnston, senior manager, performance and best value, Audit Scotland; Joanne Brown, director at Grant Thornton UK LLP; and Pat Kenny, director at Deloitte LLP. I invite the Auditor General to make a short opening statement.

Caroline Gardner (Auditor General for Scotland): The first report this morning concerns financial pressures in NHS Ayrshire and Arran. The external auditor gave an unqualified opinion on the 2017-18 accounts for the board, but it is facing significant financial and performance challenges. In 2017-18, the board needed £23 million of brokerage from the Scottish Government to achieve financial balance. At the beginning of the year, the board’s potential deficit was £13.2 million, but that increased to £23 million during the year. The board faces an extremely challenging position in 2018-19 and beyond. It is projecting a deficit of £22.4 million in 2018-19, the current financial year, with an additional £13 million in 2019-20 before projecting a balanced budget in 2020-21.

An external review of the board’s approach to efficiency and transformation concluded that its current plans are not substantial enough to achieve long-term financial sustainability. NHS Ayrshire and Arran will find it difficult to address the financial and performance challenges that it faces and to implement the recommendations of the external review. That represents a significant leadership challenge.

The second report highlights financial pressures in NHS Highland. Again, the auditor gave an unqualified opinion on the 2017-18 accounts but reported on the scale of the challenges that the board faces in achieving financial balance. In 2017-18, the board delivered £35 million of savings, but it still required brokerage of £15 million. It faces an extremely challenging position in 2018-19 and beyond. It has identified that it needs to make £52 million savings in the current financial year. So far, savings of £30 million have been identified, leaving a funding gap of £22 million.

NHS Highland plans to produce a longer-term recovery plan, underpinned by a more detailed

operational plan setting out new models of care in the Highlands. It has engaged the help of external consultants. Stable leadership will be needed to implement those plans, and I anticipate that the board's financial position will deteriorate before the underlying issues are addressed and performance improves. The chief executive leaves the board at the end of December and the director of finance is acting on an interim basis. That obviously creates risks around the future leadership of the board.

I am joined by Pat Kenny from Deloitte, who is the appointed auditor for NHS Ayrshire and Arran; Joanne Brown from Grant Thornton, who is the appointed auditor for NHS Highland; and Leigh Johnston from Audit Scotland. Together, we will do our best to answer the committee's questions.

The Convener: Thank you, Auditor General. I will ask Willie Coffey to open questioning.

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): I have a few questions about the Ayrshire and Arran report and situation. As you said, Auditor General—and it has been well covered—the brokerage amounts in the past couple of years have been pretty substantial. Your report preceded the cabinet secretary's announcement that they would be written off, not just for Ayrshire and Arran but for all the health boards that have received brokerage in the past five years, which is welcome.

I want to explore some of the potential reasons behind that overspend. I do not doubt for a minute that that level of expenditure was required to deliver healthcare to the citizens of Ayrshire and Arran, but I would like to understand the main reasons behind that substantial overspend.

Caroline Gardner: I will make a couple of points and then ask Pat Kenny to come in. First, Mr Coffey referred to the cabinet secretary's announcement about writing off brokerage, which is obviously welcome for the boards that are affected. It is worth noting that the financial projections of both the boards that I am reporting on this morning do not include any provision for repayment, so it does not change the position that I have brought to the committee's attention today.

Secondly, Mr Coffey is right that every board is trying to balance the need to manage its financial targets, its activity targets for things such as waiting times and the quality of patient care. That is why the challenges are so difficult to resolve. Pat Kenny will talk through the financial reasons for the overspend last year.

Pat Kenny (Deloitte LLP): The board went into the financial year with an estimated deficit of around £13 million. That was due to underlying financial pressures—overspending in acute services, reliance on locum and agency bank personnel and that sort of thing. That underlying

financial pressure of £13 million increased to £23 million during the year. The main reason for that was additional demand. The board was assuming that certain beds would be closed during the year, but that was not possible due to demand. The nursing costs associated with keeping those beds open resulted in another £6.2 million overspend. The balance of the overspend came from a failure to deliver assumed efficiency savings during the year, and that takes us to the £23 million brokerage figure.

Willie Coffey: We know that Ayrshire and Arran's health indicators are not as good as the rest of Scotland's. Is there something unique about the overspend in Ayrshire and Arran that we are not seeing in the rest of Scotland, such as the demand?

Caroline Gardner: From our work across the national health service in Scotland, I would say that all boards are facing significant financial pressures for very understandable reasons to do with demographic change—there is an ageing population, which brings with it increasing demand. However, each board tends to have a different combination of factors that cause its specific local challenges.

As Pat Kenny said, Ayrshire and Arran NHS Board had made its budget dependent on assumptions about the ability to close some beds, but in practice those beds were needed to meet the demand for unscheduled care. The other savings proved difficult to achieve in practice. Every board will have its own set of circumstances.

There will be three section 22 reports this year on NHS boards in which these challenges have resulted in the need for brokerage. However, the report that I published last week on the NHS as a whole showed that all boards are struggling with balancing the three sides of the triangle—finances, waiting times and the quality of care.

Willie Coffey: How much of the transformation agenda that we expect Ayrshire and Arran and other health boards to deliver can the boards control and deliver themselves? Three local councils make up the health board authority in Ayrshire and Arran—North Ayrshire, East Ayrshire and South Ayrshire—and, if we look at factors such as daily discharge, we will see a variable pattern across the authorities. How much can the boards effect change themselves and how much are they relying on their partners in the local authorities to make an effort to get performance up?

Caroline Gardner: There is no doubt that, in every health board area, tackling that agenda depends on the whole health and social care system working well. The integration joint boards

are increasingly important in doing that. Does Pat Kenny want to say anything about the specifics in Ayrshire and Arran?

Pat Kenny: A combination of both factors is needed to deliver the savings that are required. I am the auditor for the IJB and the councils in Ayrshire, and they are making good progress on moving some care from acute services to the community. There are some excellent examples in the health and social care space of improvements in things such as care at home, and end-of-life care is another good example of progress. However, there is still a long way to go in moving the services from the acute to the community side. There is a feeling—certainly from the health board perspective—that the community sector is not yet resilient enough to absorb the level of demand that will allow efficiencies to be made in the acute side.

Willie Coffey: Is it fair to say that no health board has complete control over the transformation agenda and that health boards rely on local authorities playing their part, too?

Caroline Gardner: The health and social care system depends on health boards and local authorities working well together. In a few weeks' time, we will publish a report on progress with the integration authorities, but the bigger challenge is the whole prevention agenda and the way in which we help people to remain healthy as they grow older, rather than needing support for long periods of their lives.

Willie Coffey: You have mentioned that the staff agency and locum costs were quite substantial but were coming down. There has been a consistent problem in attracting NHS staff to work in Ayrshire and Arran. The price of that is the higher fees that are paid in agency and locum costs. I think that Alex Neil raised that issue in the committee previously. Are you aware of any national work that is going on to reduce that dependency and the high cost of that factor, which hits this health board and others?

Caroline Gardner: That has been a big focus for the Scottish Government at the national level. The report that I published last week showed that agency costs, although there were still high, had reduced slightly in 2017-18.

Leigh Johnston will say something about the work that is going on at the national level.

Leigh Johnston (Audit Scotland): Work is going on to try to attract people. I think that we will hear from NHS Highland that that is a big issue for it, too. The Scottish Government is undertaking a number of programmes of work to try to attract staff. Project lift, for example, is relatively new. It encourages people to take on more senior roles. Both reports allude to the fact that leadership is a challenge as well as the staff who deal with things.

However, a lot of boards focus on reducing their staffing costs, as they are one of the things that they can try to reduce over a period of time.

Willie Coffey: I presume that they can do that only if they successfully recruit locally. The problems that there are in recruiting locally to deliver the service are an issue.

Caroline Gardner: They are. We know that, at the national level, the workforce is under pressure. We are seeing increasing difficulties in recruiting, some very long-term vacancies, rising turnover and risking sickness absence. That is another indicator of strain on the workforce. We are starting to see some improvements in national workforce planning to deal with that.

At the other end of the problem, there are short-term issues such as making better use of locum staff rather than agency staff, who tend to be more expensive and less familiar with local health services.

That is certainly an area that is a significant problem, and there is no quick fix. That will take time to resolve.

The Convener: I want to pick up on a point that Mr Coffey made about workforce planning and training. One of my concerns about workforce planning in the NHS relates to the training of nurses. The concern relates to how many nurses are being trained, how many Scotland-domiciled nurses are being trained for the places that are available to them, and the places that are available to nursing students from overseas who are perhaps more likely to return to their home countries to nurse there. Did your audits look at whether the Scottish Government is training enough Scotland-domiciled nurses? Are there enough nurse training places for Scotland-domiciled students, who are more likely to work in our NHS hospitals?

Caroline Gardner: We have a programme of work that is looking at workforce planning because of its importance to the NHS and the health and social care system more widely. We do not have the details of that in front of us today, but we can certainly refer back to that after the meeting.

In broad terms, we have found that there is a need for improvement in the workforce planning that is required, particularly in looking at the demand side of the equation. Our first report on that found that the number of staff who were being trained tended to be the number needed to replace staff who were likely to retire and leave the service in other ways. However, we know that demand is increasing and that changing models of care mean that we need different types of staff in different places. We have reported on that, but that is not in the reports that we are discussing.

The Convener: I have a specific question for Leigh Johnston. You talked about project lift, which is to encourage people. Surely the best form of encouragement by the Government is to make training places available for people who want to nurse in our NHS. In your analysis of the programmes to encourage more people to work in our NHS, did you do an analysis of the available places?

09:15

Leigh Johnston: No, we did not. I think that the Royal College of Nursing is looking at that issue. In our recent “NHS in Scotland” report we recommend that more work needs to be done on workforce planning. The Scottish Government has recently published three workforce plans, but at a local level there needs to be more work on planning and on how the NHS will recruit people and, as you say, train people for the future. However, that is a long-term undertaking.

The Convener: How much is being spent on project lift?

Leigh Johnston: I do not have those details.

The Convener: It seems to me that you can spend as much money as you want encouraging people, but if you do not make the training places available, it is a bit of a waste of money.

Colin Beattie (Midlothian North and Musselburgh) (SNP): Paragraph 26 says:

“Following discussion with the Scottish Government in June 2017, NHS Ayrshire and Arran agreed to work with an external partner—”

PWC—

“to review the board’s approach to efficiency and transformation.”

Further discussions in early 2018 resulted in the appointment of an improvement director. However, in paragraph 23 you say:

“there is currently a lack of attention being given to detailed medium to long term financial planning by the board.”

That does not sound too good.

Caroline Gardner: What underlies those two paragraphs is, first, the board’s recognition, with support from the Scottish Government, that it needed to get to grips with the challenges that it faced, and secondly, the urgent nature of the short-term problems faced by the board was getting in the way of its ability to think about the longer-term picture and what was needed to deal with that. The latter is a theme that is common to my reporting on the NHS.

Pat Kenny will be able to talk you through the specifics that he is seeing in Ayrshire and Arran.

Pat Kenny: What we were looking for there was a linkage between the medium and long-term financial planning and the transformational planning. Obviously, for the transformation to be successful, or to deliver the targets that it needed to, the two would have to be compatible. Given the short-term pressures that the board was under, during the audit we found that there was a deficit in the board’s medium and long-term financial planning. Those plans were simply not available to the auditors at the time of the audit.

Colin Beattie: From the bare bones of the report, it does not sound as if the board has had a grip of the situation.

Caroline Gardner: The board recognises the scale of the situation and is very focused on the immediate actions that it needs to take to halt the decline that we are seeing in its performance and financial position. However, there is no doubt that it will be very challenging for the board to make the changes that are required at the same time as continuing to deliver services.

Colin Beattie: But this did not happen overnight.

Caroline Gardner: No. I have been reporting since 2012 about the danger that the focus on short-term targets is obscuring the underlying pressures that face all health boards, including NHS Ayrshire and Arran.

Colin Beattie: The board has got an improvement director in place. What is the improvement director’s remit?

Pat Kenny: It is basically to turn around the financial performance of the board and implement the transformational change that is required to enable the board to operate within its financial envelope. I believe that the director has significant experience of similar work in other parts of the health sector.

Colin Beattie: I am looking at some of the reasons that have been given for the overspend—this touches on something that Willie Coffey was talking about. Paragraph 19 says:

“A key factor is the older age profile and high levels of deprivation in the Ayrshire and Arran population.”

That will not go away, so how will the board effect the changes that are referred to in paragraph 17?

Caroline Gardner: I think that the underlying solution to the challenges at NHS Ayrshire and Arran, and right across the NHS, is about changing the way in which services are provided. That is absolutely in line with the Government’s 2020 vision for providing much more health and social care in people’s homes, or close to their homes, and avoiding unnecessary admissions,

making it easier for people to be discharged quickly if they do need to be admitted to hospital.

The problem is that we are not seeing progress happening quickly enough on that, partly because of the continuing focus on short-term financial targets and on the local development plan targets, which tend to be for aspects of the acute services, such as waiting times for elective treatment or accident and emergency waiting times. I have been recommending for some time that boards need to find space to pull back to look at how the overall system works, to understand what services are being provided in the community and the impact that they are having, and to rebalance the system to meet the needs of the ageing population—and, as you said, that is a factor that is not going to go away.

Colin Beattie: It seems to me from looking at the report that the problem has been there for some years but, according to what you say in paragraph 23, the board has not been addressing it. The Government seems to have stepped in and put a bit of pressure on and has put someone in place to help the board along. That is not wrong, but it seems that this has been allowed to go on for quite some time, and the board has not been addressing the problems. Is there not a better mechanism for picking this up and for ensuring that boards get the support that they should have?

Caroline Gardner: I do not think that the board is alone in the challenges that it faces. Two boards are being reported on today that face similar problems. The committee is well aware of the challenges that NHS Tayside has faced in achieving financial balance, and my report last week on the NHS as a whole shows that the whole system is facing similar pressures with both financial performance and performance on such things as waiting times declining. The underlying reason for that is the ageing population that we have in Scotland and the changing types of care that we all need as we get older.

The signs of that pressure have been visible during the time that I have been in the job. I welcome the fact that the Government is now trying to make space for that longer-term view. We have seen some announcements from the cabinet secretary over the past few weeks that demonstrate the commitment to making a bit of breathing space to tackle the underlying challenges, but you are right to say that they are not new issues. I have been reporting on them for some time now.

Alex Neil (Airdrie and Shotts) (SNP): You mentioned that there are pressures right across the system in every board, although we are focusing this morning on Ayrshire and Arran and on Highland. If you add up the number of partnership boards and the number of NHS

boards, plus the three regional structures that have been created, that is a total of 56 different organisations, each with its own board, its own chief executive—many of whom are on film-star salaries—its own structural finance director and all that kind of stuff. Given the financial pressures, has the time not come to look at the massive overhead that is involved in having 56 different organisations—not including the 32 councils—delivering health and social care in Scotland?

Caroline Gardner: I do not want to veer into the territory that is covered by my report on the NHS, which was published last week and which I know the committee will consider soon. However, that report talks about the growing complexity of the governance of the health and social care system in Scotland and the risk that that poses to people's ability, first, to get the right leaders in place to do what is needed across Scotland and, secondly, to be clear about who is accountable for what and therefore what progress we are making.

Alex Neil: We can discuss those issues when we consider your latest report. It is quite interesting that Highland is the only part of Scotland where there is only one board delivering the single agency model for health and social care, although there are 31 partnerships in total. Although Highland clearly has financial pressures, is there any evidence so far that the single agency model is better or worse at delivering health and social care according to plan?

Caroline Gardner: That is a very good question and one that we are considering as we finalise our report on health and social care integration, which is due for publication in the next few weeks.

At this stage, I can say that it is clear from the report on NHS Highland that the lead agency model is not a panacea and that there are still financial pressures in the health board and the council. The different accountabilities that those bodies have and the financial pressures that they face more widely constrain how matters are dealt with. We are watching the situation closely to see how it develops.

Joanne Brown (Grant Thornton UK LLP): That is fair. The NHS Highland report outlines that the board faces challenges in adult social care, including in relation to the financial sustainability of that service, and in its working relationship with the council through the lead agency model. Although the board can demonstrate good outcomes from the model, there are underlying challenges in it, including in relation to how governance operates for the board.

Alex Neil: I return to an issue that the Auditor General specifically mentioned in relation to Ayrshire but which also affects NHS Highland and, indeed other boards. One cause of the problems is

an underestimation of the demand for services, particularly acute services. That is one of the reasons why the 100 beds were not closed down. In this day and age, we know the size of the population in every area, the complexities that are likely to be faced—they are changing, but we have a good idea of what they are—the age structure of the population and historical demand. We can predict accurately the number of people who are likely to be seen at an A&E department day by day. Is the starting point not to get a far better handle on and a more professional, systematic approach to demand forecasting?

Caroline Gardner: We are seeing progress on that issue—I will ask Leigh Johnston to talk about what we understand about the Government work that is under way—but there is another dimension to it. The committee has heard a lot about optimism bias, particularly in relation to information technology projects. The focus on financial and waiting time targets means that there is a degree of optimism bias in boards' financial planning, too—they tend to make assumptions that they will achieve savings that are, in practice, very difficult to achieve. Both sides of the equation need to be tackled.

I ask Leigh Johnston to say a bit about demand planning.

Leigh Johnston: Work is being undertaken to plan better. We must also think about the issue in the context of integration and how more care is being moved into the community. The hope is that, in future, there will be less unscheduled care.

Winter pressure is the other issue to which the Government would point. That occurs yearly, but the winter this year was particularly bad, which had an impact on NHS Ayrshire and Arran.

Alex Neil: Are we sure that we are talking about overspending? Were the boards allocated budgets that were too low in the first place? For example, reference has been made to the economic and social profile of Ayrshire. It is one of the poorest parts of Scotland, and we know that, to a large extent, demand for health and social care is driven by levels of poverty and deprivation. Is there overspending, or are we really talking about underfunding?

The chief executive of NHS Ayrshire and Arran doubles up as the chief executive of the west of Scotland regional planning group. The chief executive of NHS Lothian, which is another health board that is in trouble, also doubles up in a similar role. Does that not send out the wrong message? Given the situation in Ayrshire, should the chief executive not be working full time on NHS Ayrshire and Arran?

Caroline Gardner: I will start, but Pat Kenny may want to add to my response.

On whether the budget as a whole is sufficient, health boards are funded—Alex Neil will know this better than anybody else in the room—on the basis of a national formula, which aims to take account of a number of factors, including the make-up of the population, its age profile, levels of deprivation and so on. The Government has been making more rapid progress towards ensuring that everybody achieves their funding under the national resource allocation committee formula.

As I say in the report on the NHS that was published last week, across a period of time, the Government has succeeded in keeping health service funding slightly ahead of inflation. However, funding on a per capita basis tends to lag behind inflation, and we know that healthcare costs increase more quickly than inflation as a whole and that the population is ageing. Therefore, there is no doubt that the health service budget as a whole is under pressure. In my view, it is probably not possible simply to buy our way out of the challenges that we face. The answer is in reshaping how care is provided in order to meet the needs of an ageing population.

09:30

The leadership examples that Alex Neil touched on are another feature of the complexity of the structures that we now see in the health service and the number of bodies that are involved. That is compounded by the difficulties that the health service is having in attracting the number and quality of chief executives needed to do the work. My report on NHS Highland highlights that the chief executive there will leave by the end of the year, and we know that a number of other very experienced and senior chief executives have indicated their intention to leave or retire, so the pressure on leadership will only get worse. For me, that is one reason for looking at the way in which the NHS is governed and structured to ensure that we make the best use of the leadership that is there.

Does Pat Kenny want to add to that?

Pat Kenny: I would add only that, in Ayrshire and Arran, as in most other boards in Scotland, there has been limited progress in moving the set-aside budget for acute services into the community sector. That is where the biggest bang for the buck would be in terms of improvement overall. More progress in moving the set-aside budget could have an impact on the ground.

Alex Neil: It might be useful if you explained what the set-aside budget is.

Pat Kenny: Basically, it is the provision that was set aside for acute services when the health and social care partnerships were formed, with the

objective of moving it to the community sector over a period.

Iain Gray (East Lothian) (Lab): Auditor General, I want to follow on from the answer that you just gave Alex Neil on the difficulty of finding leadership with the capacity to address some of the problems. As you pointed out, in Ayrshire and Arran, the chief executive and the finance director are leaving, and we have seen similar issues in Tayside, for example. In your answer to Mr Neil, you said that we cannot buy our way out of the problems and that we have to change how we deliver health and social care. However, you have also said on a number of occasions that the difficulty facing those two boards, and other boards, is in balancing the level of activity and performance needed to deal with demand with the need to balance the books and the finances. Is it not the case that there just simply is not enough money in the health service to do the things that we want it to do?

Caroline Gardner: I point out for the record that it is the chief executive of NHS Highland, not NHS Ayrshire and Arran, who is due to retire, but your point holds.

Iain Gray: Sorry—my mistake.

Caroline Gardner: I need to be careful here, because it is clearly a question of significant Government policy. However, I can say that 42 per cent of the Scottish Government's overall budget is already spent on the NHS, and that has risen as a proportion over recent years. The challenge of meeting the immediate demand for health services means that there has probably been no alternative to that. However, if we keep on doing it, it will squeeze out the ability to spend on other public services, including equally important ones such as education and other things that will set up Scotland as a country that can thrive in the future, whatever the constitutional arrangements might be.

There is good evidence that continuing to meet demand as it ships up at the hospital door is not the best way of providing care for older people. There is good evidence that we will treat the people of Scotland much better if we provide much more care in the community and in people's homes or close to home, if we keep them well for as long as possible and if we support them at home for as long as possible. If people are admitted to hospital only when that is best for them and go home as quickly as possible, access for younger people who have more acute needs that can be treated and cured will not be slowed down by the number of older people who have no alternative but to be admitted to hospital. For me, it is not just a matter of whether we should shovel more money into the health service. Of course, the health service is a vital part of society but, if we do

not change the way that we provide services, the demands will swamp other equally important public services. On top of that, the current approach is not the best way of looking after people.

Iain Gray: In some of your previous comments about transforming the delivery of services, you talked about the need to create space in which to make that change. My question is more about leadership than finances. In Highland, two of the senior managers have left, while in Tayside, the whole senior management team has moved. Problems have also arisen in boards; as the Highland report points out, there has been a significant turnover of non-executive directors on that board. Are we asking those in leadership positions in our health service to do something that is simply impossible? Is that why they are leaving and why we cannot find replacements?

Caroline Gardner: The very narrow focus that there has been in the past on short-term targets such as achieving in-year financial balance and local development plan standards has tended to mean that people have focused on the short term in certain ways and, as a result, they have had to run faster and faster to try to keep up. Clearly, that is becoming impossible, so there is a link in that respect.

I welcome the cabinet secretary's announcement of a medium-term financial framework for the NHS, which will help people think about where the local development plan standards fit into that context and will buy them some breathing space to make the sorts of changes that will genuinely address the underlying challenges. The committee might want to explore with the Government how it intends to use that space to build leadership capacity and how it will ensure that that capacity is going into the right things and that the governance is clear and strong enough to deliver what is needed in practice.

Iain Gray: Again, on the issue of leadership, Mr Neil talked about the number of chief executives required under the current system—indeed, I think that he also used the phrase “film-star salaries”. However, in the Highland report, you point out that the number of clinicians who earn more than £200,000 has doubled and that two clinicians now earn £400,000 each per annum. Is there a problem with the salary structure not just on the governance side but on the clinical side of the NHS?

Caroline Gardner: It is important to point out that although chief executives are highly paid members of staff, they do, as you said, a very demanding job. Personally, I do not recognise the phrase “film-star salaries”.

As for clinical salaries, clinicians are obviously vital to running the health service, and what we see in Highland is very much an effect of the difficulties in recruiting and retaining people to provide services in remote and rural areas. I ask Joanne Brown and Leigh Johnston to give you a bit more detail about what is happening in Highland.

Joanne Brown: With regard to the two individuals highlighted in paragraph 21 of the Highland report, the issue links to wider challenges that NHS Highland faces with regard to agency and locum costs. This is about providing suitable, safe and effective clinical care in the Caithness general hospital and Belford hospital areas—in other words, the areas outwith Inverness—and a challenge for NHS Highland has been to look at service provision across those remote and rural areas, recognising that acute services are based at Raigmore. The question is how locum and agency staff can be used to provide the care that is required at those outlying hospital sites.

Iain Gray: I am sorry—I am not sure that I understand. Are you saying that those two clinicians are earning more £400,000 a year because they are temporary staff on inflated remuneration rather than permanent staff employed by the board?

Joanne Brown: In those two instances, the people involved are agency locum staff, and the salaries reflect the nature of the clinical specialisms and skills that are required as well as where they are based. In some of NHS Highland's outlying hospital sites, there is a requirement for 24-hour care and access to a clinical specialist on that basis. The issue relates to the need to provide that service.

Iain Gray: I am still not sure that I quite understand why somebody is paid £400,000 just because they work in Caithness.

Joanne Brown: It is about the specialisms that they provide under their contract, the nature of the clinical services and the nature of the pay arrangements that are in place. It is an on-going and increasing cost for NHS Highland.

Iain Gray: Okay—so are the nurses who work in Caithness, who also work in a rural area, paid twice as much as the nurses at Raigmore hospital?

Joanne Brown: I do not have that information to hand. It depends on whether they are agency or locum, the nature of the clinical specialism and where that nurse is based as part of their employment contract.

Liam Kerr (North East Scotland) (Con): Auditor General, you talked about measures that

have been taken in the past few weeks, including the decision to write off all outstanding brokerage by the end of the 2018-19 financial year. That sounds very welcome, but what is the practical impact of that if, as you said in your opening statement, no provision had been made to pay back that brokerage?

Caroline Gardner: For the two boards that the committee is looking at today, the financial projections that I have reported to you do not include any plans to repay the brokerage that they have received so far, so their financial position, as they are forecasting it at this stage, remains as challenging up to 2020-21 as it did before the Government announcement on brokerage.

A small number of boards have financial plans that include provision to repay brokerage over a period. Of those, I think that NHS 24 is the most significant. For those boards, having the outstanding brokerage written off will provide them with welcome breathing space to look at their financial forecasting more generally and at how they can use the resources available to them. However, it will make no difference to the financial forecasts for the two boards that are being looked at today.

Liam Kerr: I will come back to that last point in a second. Although all the brokerage has been written off, it looks as though NHS Ayrshire and Arran will rack it all up again. Your report indicates that the board anticipates that it will require a further £22.4 million of brokerage in 2018-19, but that hinges on high-risk savings being achieved. Therefore, there is the potential for a further write-off. Is it your understanding that, irrespective of how much brokerage is on the books by the end of 2018-19, it will all be written off?

Caroline Gardner: I think that it is fair to say that we are not yet sure. Leigh Johnston may want to say a little bit more about the range of announcements that we have heard recently.

Leigh Johnston: The financial framework was published recently, which will require boards to plan over and break even after a three-year period. They also have a 1 per cent flexibility in their budgets. Other than that, we do not have much detail. We are in the process of working through the framework and understanding what it will mean for the boards. I am sure that the boards will be looking at their forward planning and trying to understand what it will mean for them, but we really do not have details about what it means in practice.

Liam Kerr: On the issue of forward planning, paragraph 21 of the Ayrshire and Arran report says that the projected figures are based on the board achieving £26.1 million-worth of savings, of which £9.7 million has either not yet been

identified or is identified as “high risk” so may well not happen. I accept that the Government announcement looks very welcome on paper, but is there a risk that the board will not strive in quite the same way to achieve those £26.1 million-worth of savings because it knows that the brokerage will be written off anyway?

Leigh Johnston: The brokerage will be written off in 2019, but the announcements do not address the underlying issue. As I said, we are trying to understand what the three-year break-even requirement and the 1 per cent flexibility mean in practice. Until we have a better understanding of that, we will not know what that means in relation to what the board has said to date about what it is trying to achieve.

Liam Kerr: I have a question about something that the Auditor General said. Some boards have plans to repay their brokerage, which is a point that was raised when the committee looked at financial planning in education and the college sector. I hesitate to use the word fairness, but is there a concern that boards that have made significant sacrifices and have made significant plans to repay their brokerage will look at this situation and say, “We have cut our cloth very carefully and now we are being penalised for that.”

09:45

Caroline Gardner: I am sure that those boards will feel slightly hard done by, in the way that you have described. My concern is twofold. First, steps are being taken towards the longer-term financial planning that I have recommended since I have been in this job, which I welcome. However, it is important that long-term planning is done in a way that does not undermine incentives for good financial management and that the space it creates is used to address the underlying challenges that Leigh Johnston described. The demand pressures will only keep increasing and healthcare costs will keep increasing faster than the Scottish Government’s resources are likely to increase. The measures are useful only if they build a bit of breathing space for people to tackle the underlying changes that are required. As I said in my report last week, we need to work with local people and involve them in planning better health services that are more sustainable for an ageing population.

Liam Kerr: I have a final question on NHS Ayrshire and Arran. Your report says:

“In 2017/18 ... 60 per cent ... of savings were achieved on a recurring basis”.

How does that compare with recurring savings that have been achieved by other boards throughout Scotland? Is 60 per cent a sustainable figure?

Ideally, what percentage would you be looking for the board to achieve?

Caroline Gardner: I am racking my brains—I am not sure whether Leigh Johnston can help me. The report that we published last week contained that information for all health boards throughout Scotland. I think that the 60 per cent figure is probably higher than the average. Pat Kenny is nodding, so I will ask him to say something in a moment.

The challenge is that, the higher the level of non-recurring savings, the more the board will be back to square 1 at the beginning of the next financial year, in needing to look at ways of reducing cuts—potentially, by cutting services—in order to balance its budget. We know that that is getting harder for all boards to do each year, and having a high level of non-recurring savings is simply not a sustainable way of delivering health services in the long term. Do you want to comment on NHS Ayrshire and Arran, Pat?

Pat Kenny: Yes. I confirm that, based on the boards that I audit, the 60 per cent figure is probably above average. Generally, the overreliance on non-recurring savings is a problem throughout the sector. I certainly find that with the boards that I audit.

Bill Bowman (North East Scotland) (Con): Paragraph 3 of the Auditor General’s report on NHS Ayrshire and Arran has a little bit of explanation about brokerage:

“This is a form of loan funding known as brokerage. It is arranged based on assurance from the board that it can repay the brokerage over an agreed period.”

Today we have heard that the board cannot repay the brokerage. What is the value of an assurance from it?

Caroline Gardner: Before the cabinet secretary’s recent announcement, there was an agreement between the Scottish Government and the health board based on that assurance; that was the arrangement that was in place. For a number of years, I have reported that health boards in general are not doing enough long-term financial planning. That places such assurances in question, as you have highlighted.

Bill Bowman: When you take representations from the board, how does that affect the rest of your audit?

Caroline Gardner: Jo Brown and Pat Kenny—and every health board auditor—will be looking at the going-concern question in the specific circumstances of their boards. They are considering the assurance around the narrow question of brokerage and the wider quality of financial management and planning, and the assurances that the Government is providing

about its commitment to continue to fund health services in that regard. Clearly, however, that judgment is more difficult to make in boards where brokerage is involved than it is in other boards.

Bill Bowman: It is more than just the going-concern question—it involves assurances being given that are blatantly not correct. What is your view about the Scottish Government's part in this? It is providing money without testing that assurance.

Caroline Gardner: It is testing the assurance and, in both the boards that are being reported on today, you can see the measures that they are putting in place to make the assurances more robust by providing support for the changes that are needed.

In general terms, I have been reporting for a number of years that the focus has been too much on achieving in-year financial balance and not enough on making sure that the longer-term plans are robust and tested. The two boards that you are looking at today are a symptom of that.

Bill Bowman: We come back to the governance issues that we have raised before.

The Convener: Auditor General, I want to explore workforce planning a wee bit more. It comes up in both reports and we touched on it earlier.

Are we training enough doctors and nurses who are likely to stay and work in our NHS hospitals in Scotland? I recently heard of a young doctor who qualified in Scotland—with the Scottish taxpayer paying for her to train right through university and in our NHS hospitals—and went off to take a job in New Zealand. Is she likely to come back? That is anyone's guess. I have heard—although I cannot substantiate this figure—that up to 40 per cent of doctors, who we pay to train here in Scotland, leave for Australia and New Zealand. Is that a good use of public money?

Caroline Gardner: You are absolutely right to identify the problem. About a year ago, we published a report for the committee that looked at workforce planning in the acute sector of the health service. It identified a number of problems with planning for the workforce that we need and the training that is under way, particularly given the length of time that it takes to train professionals to the quality and the standard that we need, as well as the other demands that are making it harder to retain them. I do not have the detail of that in front of me, but I am happy to write to the committee to follow up on your questions.

That significant issue is one of the things that is increasing the pressures on services, which we experience as patients, and on the staff who work in the health service. It adds to the capacity

challenges that we refer to in all our reports on the NHS.

The Convener: Did you say that you are preparing a report on that specific issue?

Caroline Gardner: No. We published a report on workforce planning in the acute sector about 12 months ago.

The Convener: Okay, we can refer to that.

My second question is on prescribing. You identified prescribing as an issue in the two section 22 reports that are in front of us this morning, as well as in previous NHS Tayside reports. In NHS Ayrshire and Arran, you identified general practitioner prescribing costs as an issue, and in NHS Highland, you said that brokerage is required for prescribing costs of £2.8 million. Will you tell us a wee bit more about why there is pressure on prescribing costs?

Caroline Gardner: Again, that issue affects the NHS around Scotland; it is not just those two boards. There are at least two factors. First, we have an ageing population. As people get older, they tend to have a range of conditions that can all be treated with medication, so we end up with people taking a number of different medications that are prescribed to them on a recurring basis, which increases costs.

Secondly, new drugs are becoming available to treat conditions that were not treatable before or that treat conditions more effectively. Those drugs are often more expensive than the previous approaches to treatment. The combination of the volume and the cost of the medications means that the increases in prescribing costs and drug costs are much higher than the increases in the funding that is available for the health service as a whole. That does not affect just Scotland; it is prevalent around the developed world.

There are factors in some boards that mean that their prescribing rates tend to be higher than those of other boards. As you say, convener, that is the case in NHS Tayside, but it is an overarching problem for the NHS as a whole. Pat Kenny or Joanne Brown may want to add something on that.

Joanne Brown: Similarly to NHS Tayside, prescribing rates in NHS Highland are slightly higher than they are in the rest of the NHS in Scotland. The board is looking at that issue as part of its financial sustainability plans and at how those costs can be contained. It is working very closely with GPs and clinicians to understand the nature of the prescribing, which it will consider and factor into its financial plans.

The Convener: What you said at the end really intrigues me, Ms Brown. We are getting to a situation in which we are asking GPs to think twice

before prescribing basic drugs. Auditor General, does that not undermine the Government's policy of free prescriptions?

Caroline Gardner: It is very difficult to comment on specific circumstances. We are auditors, not clinicians. In the past, we have done work on prescribing costs, which shows that there are significant variations across Scotland in the patterns of prescribing for some common drugs, and it is not always clear that that is accounted for by the make-up of the population in terms of age and sex, or by deprivation levels. The Government and health boards have done a lot of work to address that. For example, we know that the rate of prescription of generic drugs has increased significantly, which generally means that patients get the drugs that they need at a lower cost to the health service. However, because of the scale of the cost of drugs to the NHS and the rate at which it is increasing, that is not an area in which the Government or health boards should be complacent.

Liam Kerr: In paragraph 22 of your report on NHS Ayrshire and Arran, you talk about areas in which the board will have to make savings, which include the need to close unfunded beds and the need to reduce workforce costs. The question that is begged is, if the board does those things, what will the impact be on the quality of care? What will the attendant impact be on the board's ability to meet national targets and standards?

Caroline Gardner: I want to make it clear that the areas that are referred to in paragraph 22 are not areas in which I think the board should be targeting savings; those are areas in which savings are planned. I will ask Pat Kenny to talk about the process that has been gone through in identifying those savings.

Pat Kenny: The savings that are identified in paragraph 22 are the savings that NHS Ayrshire and Arran is working towards. The closing of unfunded beds is reliant on the resilience of the health and social care or community sector, so there is a risk factor attached to it. In seeking to drive down workforce costs, the board is homing in on the agency and locum elements of the costs. Paragraph 22 identifies the actions that the board is taking in an effort to reduce costs in certain areas.

Liam Kerr: What impact will that have? When the board does the analysis, it will say, "That will strip cost out of the system," but I presume that it must also factor in the practical impact on patient care. Has that been done?

Pat Kenny: I go back to the £6.2 million that I referred to in the report. The community sector was not ready to absorb the demand and the board was not able to close the beds that it had

anticipated closing because of that excess demand. I think that the board looks at the impact carefully, and it will close the beds only when it feels that it is safe to do so.

I have had several conversations with the board's chief executive. As I said earlier, he does not feel that the community sector is ready or resilient enough to absorb that demand. That is why he thinks that the board cannot safely close those beds.

Liam Kerr: I understand the point that you make, but I want to press you a bit further. You said that the chief executive cannot close the beds at this time, because the social care sector is not ready to pick up what it needs to. However, the report suggests that the board seems to have identified that those beds must be closed in order to make the savings. It sounds as though the board is going to do that in the full knowledge that the social care sector is not ready to pick up the slack. Am I hearing you correctly?

Pat Kenny: No. I think that the board is making that assumption on the basis that, in targeted areas, it can close the beds safely. What the board was expecting to happen is not happening on the ground and the demand is still there, so it cannot safely close the beds. That consideration is made, and the board will close the beds only when it feels that it is absolutely safe to do so, which is the right approach to take.

The Convener: Do members have any further questions for our witnesses on the reports?

Alex Neil: Mr Kenny, you mentioned the set-aside moneys, which are an issue in not just NHS Ayrshire and Arran but many other boards. When we were emptying the Victorian so-called asylums many years ago, the health boards were provided with bridge funding, because there was a transition period during which boards must run down existing services in parallel with providing new services in the community. That bridge funding was regarded as a major part of the infrastructure in making the transformation in mental health care from those Victorian institutions to care in the community. The fact is that the set-aside money is not being set aside. Is that not indicative of the need for some kind of bridge funding as we transfer people from treatment in the acute sector to treatment in the community?

10:00

Caroline Gardner: That is a very good question. It is one of the questions that the Government should be considering as it develops its medium-term financial framework for the health service, particularly given the financial and service pressures that we are seeing on health boards

right across Scotland, not just on these two boards.

Colin Beattie: I have a couple of questions on NHS Highland. Paragraph 25 of your report says:

“the board commissioned an external independent review of governance arrangements”.

It seems that the hiring of consultants and so on is almost a reflex when boards get into difficulties. NHS Tayside did it, NHS Ayrshire and Arran did it and NHS Highland did it. How much is that costing?

Caroline Gardner: The review of governance had no financial cost attached to it. It was an initiative that was started off by the health board chief executives, working with the Government to commission what was almost a peer-review of governance. The review was led by the chair of NHS Greater Glasgow and Clyde. Both NHS Highland and NHS Ayrshire and Arran have, at the same time, received some consultancy support for their transformation plans, which is referenced in the two reports. However, that does not apply to the governance review that you highlighted in your question.

Colin Beattie: Is there a pattern of consultant costs arising from these situations where, almost by reflex, boards reach out and bring in an external consultant?

Caroline Gardner: I would say that it is not by reflex. Our sense is that the Scottish Government has been increasingly aware of the pressures that health boards are under and, as they have demonstrated that they are unable to deliver their plans, the Government has worked with them to bring in support for transformation. As long as that is done well, I welcome it. Often, people think that the hard work is done when a plan has been produced, but of course its success depends on the quality of the plan and the quality of the implementation. I am not against the use of consultants per se, but that needs to be managed well and to demonstrate good value for money.

Colin Beattie: Exhibit 2 on page 7 of your NHS Highland report details the reasons why brokerage was needed. They seem to be exactly the same reasons that this committee looked at when we went up to Inverness and met the board. Raigmore hospital is mentioned; it was a problem then and it seems to be a problem now. The board does not seem to have got a grip of that.

In terms of the point that the board

“has struggled to recruit sufficiently skilled staff”,

there seemed to be evidence last time around that the board was managing the vacancies to try to create cost savings. Is there evidence of that happening again?

Caroline Gardner: Your first point is right. I produced a report back in 2013-14 on NHS Highland and some of the cost pressures then were very similar to those that we are seeing now.

NHS Highland is interesting in that it appeared to be making progress in dealing with those cost pressures—it was able to deliver financial balance for a couple of years—and then the position worsened again. That reinforces the point that these are underlying pressures rather than simply poor financial management.

As Joanne Brown said, the particular workforce challenges in NHS Highland are definitely exacerbated by the fact that it is remote and rural and the normal ways of providing services that we are used to in more urban areas simply do not work well in NHS Highland.

The progress that it has been able to make in finding sustainable ways of providing those services that reduce the need to rely on locum staff, whether from agencies or banks, is getting more difficult, given its workforce challenges: the number of vacancies is going up and, in order to continue to deliver services, it is having to rely on agency staff in some areas.

Colin Beattie: Lastly, just to put my mind at rest, may I presume that there are no governance issues in relation to the board? Last time, there were governance problems in how the board operated. Is it now transparent and above board?

Caroline Gardner: I say in my report that the financial reporting to the board is much better. The problems were being signalled to the board and the discussions about the need for brokerage were held properly and in good time, which is in contrast to the previous report that I made.

That is not to say that there are not some governance challenges. You referred to the review of governance, which identified some areas for improvement. As my report says, the chief executive will leave at the end of the year and the director of finance is acting on an interim basis, so there are challenges to the governance of the board.

The Convener: As there are no further questions from members on these health reports, I thank the witnesses very much for their evidence. We will suspend for two minutes to allow a changeover of witnesses. Thank you.

10:05

Meeting suspended.

10:07

On resuming—

“The 2017/18 audit of the Scottish Government Consolidated Accounts”

The Convener: Item 3 is on the section 22 report, “The 2017/18 audit of the Scottish Government Consolidated Accounts”. I welcome Caroline Gardner, Auditor General for Scotland, Stephen Boyle, assistant director, and Michael Oliphant, senior audit manager at Audit Scotland.

I ask the Auditor General to make an opening statement.

Caroline Gardner: As the committee knows, the Scottish Parliament has new responsibilities for taxes, borrowing and social security. The changes enhance the Scottish Government’s ability to manage its spending but they also introduce more complexity and risk. That increases the importance of comprehensive, clear and consistent financial reporting to support this committee and the wider Parliament in your vital scrutiny role.

The annual consolidated accounts are a critical component of the Government’s accountability to Parliament and the public. They cover around 90 per cent of the spending approved by Parliament in 2017-18. My independent opinion on the consolidated accounts is unqualified; I am content that they provide a true and fair view of the Government’s finances and that they meet the legal and accounting requirements.

I would like to highlight three areas from my report for the committee. First, on financial management, the Government managed its budget for 2017-18 within the overall limit set by Parliament, and budget management was effective. The Government borrowed its full annual capital limit of £450 million, in line with plans outlined by ministers as part of the 2017-18 budget. At the end of the financial year, the Government had net capital borrowings of £1.036 billion, which is around 35 per cent of the overall £3 billion cap. The Government still needs to finalise the policies and principles within which it will manage its new borrowing powers; that is important to support decision making about the level, type and timing of borrowing, and to avoid excess borrowing and associated interest costs.

The Government has taken policy decisions to provide significant financial support to private companies, which inevitably increases its exposure to risk. My report highlights the need for more transparency on the Government’s approach to supporting private companies. Although business cases were clear for the loans that were provided to two companies during 2017-18, there is no framework to guide support of that kind. That

should cover issues such as financial capacity, risk tolerance and the expected outcomes, and it would provide Parliament with better information and greater assurance.

Secondly, on financial reporting, the Government has improved its financial reporting this year through its first medium-term financial strategy and its “Fiscal Framework Outturn Report”, both of which play important roles in the Parliament’s new budget process. They will develop further over time. However, the use of capital borrowing powers for the first time in 2017-18 reinforces the need for the Government to improve the reporting of its overall financial position, as I have recommended before. Currently, there is no appropriate audited account that sets out all the Government’s assets and liabilities, including borrowing by the Scottish ministers. That would provide important information about the impact of past decisions on future budgets and potential risks to financial sustainability. The Government has committed to producing a consolidated account that covers the whole public sector in Scotland, but that is now overdue.

Thirdly, on performance reporting, the performance report that is included in the consolidated accounts complies with reporting requirements and the accounts direction. However, the accounts still do not report on the performance of individual portfolios or the Scottish Government as a whole, on the outcomes that it seeks to achieve. There is a need for more detailed and transparent performance reporting that links spending with outcomes, in line with the Parliament’s new budget process.

My report on the 2017-18 consolidated accounts is intended to support parliamentary scrutiny of the Government’s finances. It provides assurance and identifies a number of areas for further improvement.

As always, we will do our best to answer the committee’s questions.

The Convener: Thank you very much, Auditor General. I invite Iain Gray to ask the first question.

Iain Gray: I want to ask about the support to private companies through the provision of loan finance, which is the second of the newer elements of the consolidated accounts to which the Auditor General referred. The report says:

“Publicly available information about the extent of the loans is limited.”

You reiterated that in your opening remarks. Commercial confidentiality is one of the reasons why the Scottish Government has argued that it has to limit what information is available. Is it reasonable to withhold information for that reason,

or is the Scottish Government being overcautious in doing so?

Caroline Gardner: I will answer that question on two levels. First, the consolidated accounts do not contain very much information about any of the support to private companies. That is contained in notes to the accounts. However, the Cabinet Secretary for Finance, Economy and Fair Work has provided information in more detail to the Finance and Constitution Committee compared with what is included in the accounts in most circumstances. I think that there is a case for more transparency not just on the loan support and other guarantees that are provided, but on the principles that the Government intends to use in making decisions about that support—on the overall amount available, what factors it takes into account, and what risk it is prepared to bear. There is a case for greater transparency in general.

Secondly, on commercial sensitivity, I accept that there are circumstances in which there may be a good argument for keeping information confidential for a short period of time—for example, while a significant negotiation is under way or while a significant contract is under procurement—but the commercial sensitivity test should be applied sparingly and should be time limited. The Government should cover that as part of its framework. Given the inevitable risks that are associated with such support and the fact that the Government's appetite for providing it appears to be increasing over time, it is important that Parliament has that framework to let it understand better what is happening in practice.

Iain Gray: On transparency on the principles and the framework, is it correct to say that you are specifically recommending to the Scottish Government that it produce a framework that outlines the criteria that it will apply and the potential scale of support for private companies?

Caroline Gardner: Exactly.

Iain Gray: That is a specific recommendation.

Caroline Gardner: Yes. I have recommended that the framework should be public and that it should cover things such as the capacity for providing support, the risk appetite and the criteria that will be used in assessing individual cases.

Iain Gray: I presume that you have not had a response to that recommendation yet, because the accounts are new.

Caroline Gardner: I do not think that we have yet had a response in the annual audit report process. I ask Stephen Boyle to pick that up.

10:15

Stephen Boyle (Audit Scotland): We have had no confirmation that that forms part of the Government's planned response to the report. We will continue to follow that through in the course of our audit work over the next few months.

Colin Beattie: I confess my ignorance. What is the remit of the internal audit directorate?

Caroline Gardner: It provides the internal audit service to the Scottish Government and to a number of other public bodies that opt in to receiving their internal audit service in that way.

Colin Beattie: Out of curiosity, what are those other public bodies?

Stephen Boyle: We are talking about a range of public bodies. Some that come to mind are the Scottish Public Pensions Agency, Transport Scotland and Registers of Scotland. The financial results of many of the bodies involved are captured in the consolidated accounts for the Government.

Colin Beattie: NHS boards are not among those bodies.

Stephen Boyle: No—you are right. The internal audit directorate does not provide internal audit services to NHS boards, although its work would cover the Scottish Government health and social care directorate.

Colin Beattie: I am a bit alarmed that paragraph 46 says that

"the Internal Audit Directorate ... does not comply with significant aspects of the standards."

In the next paragraph, the report says that

"significant improvements are required in audit planning, audit documentation, audit reporting and management review."

That is all pretty basic stuff, in which you are saying that there are deficiencies.

Stephen Boyle: Those are important matters, which we have reported to the Government under its governance arrangements, as well as capturing them in the report.

The scope of our work is under auditing standards. That requires us to look at the work of internal audit as something that external auditors would do routinely on an annual basis. We identified deficiencies against some of the public sector internal audit standards, but certainly not all of them. We thought that the deficiencies that we identified were material and that improvement was required.

I am pleased to say that the Scottish Government's internal audit directorate has taken the matter very seriously and has invested in what

it is describing as a “back to basics” approach to ensure that there is on-going work to improvement its arrangements.

It is probably worth mentioning that a host of improvements and changes have been made in the internal audit directorate over a number of years in an effort to transform the service. We have regular dialogue with the directorate, and we are confident that the work that it is doing will improve the standard of provision.

Colin Beattie: Is there a timescale for that?

Stephen Boyle: The internal audit directorate gave an update to the Scottish Government’s audit committee in September, and it is content to track that progress. We will pick that up through a review of the directorate’s work early in 2019.

Colin Beattie: Our of interest, what is the line of reporting for the internal audit directorate?

Stephen Boyle: The director of internal audit reports to the Scottish Government’s director general for the Scottish exchequer. In addition, the directorate reports the outcomes of its work to the audit committees of the organisations to which it provides services. For the Scottish Government, it reports to the Scottish Government’s audit and assurance committee. For the other public bodies to which it provides services, it reports to their audit committees.

Willie Coffey: Could you say a wee bit about the forecasting that has to be used, which you mention in paragraph 28? For my sins, I also serve on the Finance and Constitution Committee, which sees huge variations between the forecasts from the Scottish Fiscal Commission and those from the relevant United Kingdom Government agency—the Office for Budget Responsibility. As I understand it, the Scottish Government is tied to using the forecasts from the Fiscal Commission, but there are big differences between its forecasts and those of the OBR. Does that present us with difficulties in getting more accurate forecasts for the budget in years to come?

Caroline Gardner: One of the starting points for my report to you this time is that the Scottish Government’s finances are becoming more complex and volatile—more risky, to put it crudely—because of the new financial powers. That would be the case anyway, because we are now reliant on taxes that are raised in Scotland, which reflect the performance of the Scottish economy relative to the UK economy. However, the fiscal framework means that volatility is even greater, because of the interaction between the Fiscal Commission’s forecasts about what is happening to the Scottish economy and Scottish taxes and the OBR’s forecasts for the UK economy, which affect the block-grant adjustment. The way in which those two factors move can

either reduce the impact on the Scottish budget or amplify it.

A couple of weeks ago, I produced a briefing on the risk in the Scottish budget, which I sent to the Finance and Constitution Committee for its interest and information. The issue is one of the factors that mean that financial management is more difficult for the Government, which reinforces the importance of the recommendations that I am making in this report for things such as a consolidated public sector account and clarity about the principles that will be used for the new borrowing powers, as well as support for private companies.

Willie Coffey: The fact that there is such great variation between the estimates and forecasting of the two bodies certainly challenges the Finance and Constitution Committee.

VAT assignment is coming soon. We understand that that will be based on surveys and estimates rather than on any actual outturn data, which we understand is difficult to gather and is not recorded as Scottish in that sense. Does the fact that we are constantly dealing with survey data when estimating VAT assignment present any difficulty?

Caroline Gardner: I do not know any more than the Finance and Constitution Committee does about the basis that will finally be agreed for apportioning VAT receipts to Scotland, but I understand that you are correct that it will be based on survey data, which, clearly, brings with it risks that will need to be managed. We will be watching closely to see what the agreement says and the way in which it is implemented in practice by the two Governments.

Willie Coffey: In paragraph 24 of your report, you say that the value of the common agricultural policy to Scotland is about £500 million. I do not want to make any political points about that but when do we need to know that that money will continue to come to Scotland, so that we can work it into the Scottish budget?

Caroline Gardner: Anyone who is making firm predictions about the impact of EU withdrawal is on dodgy ground at the moment. Stephen Boyle can tell you where we are in terms of the current position.

Stephen Boyle: There is probably not much more to add. We conduct an annual audit of Scotland’s share of the UK agricultural policy money. This year’s audit is scheduled to conclude in February. Thereafter, as the Auditor General suggested, there is uncertainty about what will happen after Brexit day and whether there will be any transitional period. Those issues will inevitably play into the duration of that funding as it relates to Europe and the question of whether the funding

comes from the UK Government or the Scottish Government thereafter.

Willie Coffey: I was just asking whether the amount of money has to be announced by a certain point—for example, February every year—so that it can start to work its way through the budget. Is that the case, or are things a bit more flexible?

Caroline Gardner: I think that, in line with the assurances from the UK Government, the budget will be based on an assumption that the current EU funding period will continue. However, none of us knows what will happen if there is a no-deal outcome or if there is a change in the UK policy for the way in which that funding is allocated across the UK. That is another element of uncertainty in the budget that will need to be managed.

The Convener: There are a few more questions, so I ask everyone to keep the questions and answers as tight as possible.

Bill Bowman: I have a couple of questions on the financial statements. On page 88 of the consolidated accounts document, note 8 says that the figure for “Inventories” was £106 million in 2017-18 and also £106 million in 2016-17. Is that a coincidence?

Stephen Boyle: I think that it is exactly that—a coincidence. I will give a little bit of context. If my memory serves me, it predominately relates to the stock of theatre supplies that individual hospitals hold. It is subject to audit each year and it is just—

Bill Bowman: Is it not just the same stuff getting older?

Stephen Boyle: We are confident that it has been appropriately covered.

Bill Bowman: On page 89, you mention that some of the comparative numbers have had to be “restated”, which, as I understand it, happens either to make the statement consistent because the accounting methodology has been changed, or because there is an error that needs to be corrected. Are there any other restatements in the financial statements?

Stephen Boyle: I will do my best to start with that point. Note 9a gives an analysis of the loans or non-current financial assets that the Scottish Government has across a range of categories, from loans to Scottish Water to housing loans to the very specific one that the Government has sought to include in this year’s note. A consequence is that it has needed to restate it to provide more detail and transparency on the loans to farmers that were a consequence of some of the challenges with the IT system. We think that it is welcome and appropriate to provide additional transparency in the financial statements.

I am not sure about other restatements. I will just check.

Michael Oliphant (Audit Scotland): Off the top of my head, I am not aware of any restatements with regard to the core financial statements. We can double-check that for you.

Bill Bowman: What about the one on page 36?

Michael Oliphant: It is not in the core financial statements but, in relation to the First Minister’s benefit in kind of Bute house, a restatement was required to the 2016-17 figure. That was as a result of an error that was identified by the Scottish Government in the calculation of the benefit in kind that is provided by the accommodation at Bute house in Edinburgh. The restatement was required because of an error over a number of years, which the Scottish Government picked up in August last year. It held discussions with Her Majesty’s Revenue and Customs to arrange a back payment of £16,765 to cover it. As part of our discussions with the Scottish Government, we asked that the prior-year figure should be restated to bring it into line with the current-year figure in 2017-18.

Bill Bowman: Was the settlement figure borne by the public purse or by the First Minister?

Caroline Gardner: The Scottish Government took the decision to meet it because it was the result of an error in a civil servant’s calculation.

Bill Bowman: That does not change the fact that it is the personal liability of the First Minister, so her tax has been paid by the Government.

Caroline Gardner: Given the period over which it occurred and the relatively small amount of the money involved, the Government took the decision to directly fund the adjustment of the benefit in kind for the use of Bute house.

Bill Bowman: I think that we need to think further about that.

Liam Kerr: Auditor General, in your opening statement, you told us that the Scottish Government borrowed £450 million this year for capital funds, which is up to its limit. Overall, the net borrowings are £1.036 billion.

You said that there is no borrowing policy in place; I have written down the words “needs to have one”. Can you clarify whether a borrowing policy should be put in place? Do other jurisdictions have one, and how imperative is it that we have one?

Caroline Gardner: The new borrowing powers are a significant element of the financial powers that were devolved under the Scotland Act 2016. There is an overall £3 billion cap for borrowing, there is a £450 million a year annual limit and the Government has net borrowing of £1.036 billion. Those are significant amounts of money. I have

made a couple of recommendations that relate to the new borrowing powers. The first, as you quite rightly said, is that there should be a statement of the policies and principles that the Government will apply in using those borrowing powers to guide its decision making and to support parliamentary scrutiny of the budget and the Government's financial statements.

The overall total of £3 billion is a relatively small amount of money, and it is important that the Government thinks over the long term about how it wants to use that to support its investment in the assets and infrastructure of Scotland as a whole. It is also important that it makes sure that it draws that down at the right time, rather than borrowing before it needs to and incurring the associated interest costs.

Other jurisdictions and Governments have that approach, which is part of good financial management. In many ways, it is close to the prudential approach that applies to local government borrowing, through which councils are required to have a policy and a long-term plan for the way in which they will use their ability to borrow. It is entirely consistent with good financial management.

10:30

Liam Kerr: Have you recommended the approach previously and, if so, when and what has happened as a result?

Caroline Gardner: From memory, it was one of the recommendations in my report on the consolidated accounts last year, as we knew that the borrowing powers were coming. The Government has not yet published a policy and principles, which is something that the committee may want to follow up with the Government.

It is worth noting that that borrowing does not appear on an audited account anywhere. It comes in and out through the consolidated fund, which is a cash account and which does not have a statement of financial position—a balance sheet, as it is more commonly known. The borrowing is not recognised on the balance sheet within the consolidated accounts. For transparency, it would be good for the Government to fulfil its commitment to having consolidated public sector accounts including a balance sheet with all its assets and liabilities.

Liam Kerr: That is useful. Do you have any sense of when the borrowing policy will be in place?

Stephen Boyle: The Government is considering how and when that will be developed. We expect that much of that work will fall to the new directorate for the Scottish exchequer as part of its

core responsibilities. As I said earlier, we will continue to engage closely with the Government on that over the next few months.

Alex Neil: I have two questions. First, before the new borrowing powers were introduced, there was a limit in that no more than 5 per cent of the Government's revenue could be used to fund repayments for borrowing, private finance initiative deals and all the rest of it. Is that still the case and, if so, is there now a case for reviewing that 5 per cent limit? For example, if it was allowed to go up to 6 per cent, that would in principle allow a 20 per cent increase in capital spend. Is that still happening?

Caroline Gardner: The 5 per cent limit is still in place. The Government has set that limit for itself, so it is not like the £450 million annual cap, which is within the fiscal framework. The issue is closely linked to the questions that Mr Kerr asked about a framework for borrowing. It is part of the Government's overall capacity for investment.

I ask Michael Oliphant to update you on where we are with that.

Michael Oliphant: The limit is still in place. The medium-term financial strategy, or "Scotland's Fiscal Outlook: The Scottish Government's Five Year Financial Strategy", as it was called, which was published during the summer, outlines the projections and where the Government is at and plans to be against the 5 per cent limit. If memory serves me right, it is close to 4 per cent at the moment. As the Scottish Government borrows more through capital borrowing such as the £450 million that it borrowed in 2017-18, the figure will increase towards 5 per cent. Obviously, the repayments that are made on previous borrowing will have the opposite effect. As members will be aware from the 2018-19 budget, the Scottish Government plans to borrow a further £450 million, which again will increase the pressure. There are some changes to the status of regulatory asset base funding for rail projects, and we still have to find out from the Government how those will affect the 5 per cent affordability cap.

Alex Neil: Obviously, as the Government increases its revenue—last year, it increased income tax, so we would expect revenue to go up—the limit will be 5 per cent of a higher figure. If we increase revenue sufficiently, that will perhaps give the ability to fund more than 5 per cent. Would it be prudent to look at that 5 per cent figure as part of the review and in designing a new policy for the new circumstances?

Michael Oliphant: As the Scottish Government is outlining a policy on borrowing, I think that it will look at the 5 per cent affordability cap. It is a self-imposed cap, so it is within the Government's gift to raise or lower it. As you say, as the total budget

increases or perhaps decreases, that obviously affects the underlying amount behind the 5 per cent.

Alex Neil: I want to go back and follow up on Mr Coffey's questioning.

The Convener: Briefly, please.

Alex Neil: Yes. We have seen the issues in getting our share of the EU agricultural money, but there is a wider question about when we will stop paying our annual EU contribution at the current levels, whether that is next year or at the start of 2020-21. Obviously, that contribution will be substantially lower. The Scottish Parliament information centre has indicated that the existing gross figure for Scotland's share of EU contributions from the UK annually is around £1.6 billion. If we got that money and funded every single EU programme that exists in Scotland right across the board, we would have £800 million a year left to spend on other things.

The Convener: Briefly, please. You should ask a question.

Alex Neil: Is any work being done to look at the impact of Scotland getting its share of the EU UK funding two or three years ahead?

Caroline Gardner: You would have to ask the Government that question. I imagine that it will be undertaking work on that. We have not done any work on that at this stage.

Alex Neil: Thank you.

The Convener: Exhibit 1 on page 6 of your report shows "Total expenditure (resource and capital)". Will you clarify where the local government spending is? Is it under each portfolio headline?

Caroline Gardner: No. The main local government settlement is under the "Communities, Social Security and Equalities" line in the table.

The Convener: Is the money that is given to local authorities and is then spent on education under "Communities, Social Security and Equalities" or under "Education and Skills"?

Caroline Gardner: Most of it is within the settlement and is therefore under "Communities" in the line that I have just referred the committee to.

The Convener: Okay. The "Education and Skills" budget line shows the largest underspend of any Government department. However, we understand from the First Minister that that is her number 1 priority, so that seems to me to be a little strange. Do you have any explanation for such a large underspend?

Caroline Gardner: Yes. Pages 53 to 63 of the accounts include some information about those. I ask Stephen Boyle to talk members through the specifics of that line.

Stephen Boyle: I refer to page 55 of the consolidated accounts. The accounts follow a similar format whereby all the individual Scottish Government departments analyse their revenue and expenditure over the year. The set format is that any variance against budget that is over £3 million comes is accompanied by an explanation. Specifically, there are a couple of explanations that relate to the education department, one of which relates to the calculation of student loans, which is captured under that budget heading.

Another variance is the lower than anticipated funding that was required by the Scottish Further and Higher Education Funding Council during the year. We will probably need to come back to the committee in writing on the detail of that and what lies underneath it, or the committee could explore that directly with the Scottish Government.

The Convener: I think that I would like both to happen. Will you come back with more information in writing, Mr Boyle?

Stephen Boyle: Of course.

The Convener: Members have no further questions about the consolidated accounts for the Auditor General and her team.

I put on record my thanks to Iain Gray MSP for his service on the committee. This is his last meeting with us, and I am very sorry to see him go. I thank him for all his scrutiny.

10:38

Meeting continued in private until 11:13.

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