



**OFFICIAL REPORT**  
AITHISG OIFIGEIL

# Public Audit and Post-legislative Scrutiny Committee

**Thursday 10 October 2019**

**Session 5**



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Pàrlamaid na h-Alba

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**PUBLIC AUDIT AND POST-LEGISLATIVE SCRUTINY COMMITTEE**  
**23<sup>rd</sup> Meeting 2019, 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)

\*Alex Neil (Airdrie and Shotts) (SNP)

\*Anas Sarwar (Glasgow) (Lab)

\*attended

**THE FOLLOWING ALSO PARTICIPATED:**

Stephen Boyle (Audit Scotland)

Gemma Diamond (Audit Scotland)

Caroline Gardner (Auditor General for Scotland)

Mark Taylor (Audit Scotland)

**CLERK TO THE COMMITTEE**

Lucy Scharbert

**LOCATION**

The David Livingstone Room (CR6)



## Scottish Parliament

### Public Audit and Post-legislative Scrutiny Committee

Thursday 10 October 2019

[The Convener opened the meeting at 09:00]

### Decision on Taking Business in Private

**The Convener (Jenny Marra):** Good morning and welcome to the 23rd meeting in 2019 of the Public Audit and Post-legislative Scrutiny Committee. I ask everyone in the public gallery to switch off their devices or turn them to silent, please.

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

**Members indicated agreement.**

## Section 22 Reports

### “The 2018/19 audit of the Scottish Government Consolidated Accounts”

09:00

**The Convener:** Item 2 is on the section 22 report, “The 2018/19 audit of the Scottish Government Consolidated Accounts”. I welcome our witnesses from Audit Scotland: Caroline Gardner, Auditor General for Scotland; Stephen Boyle, audit director; and Pauline Gillen, audit manager, audit services. I understand that the Auditor General would like to make an opening statement.

**Caroline Gardner (Auditor General for Scotland):** Thank you, convener. The Scottish Government’s annual consolidated accounts are a critical component of its accountability to Parliament and the public. The current challenging and increasingly complex financial environment and the uncertainty from the European Union withdrawal highlight the importance of comprehensive, clear and consistent financial reporting to support this committee and the wider Parliament in their scrutiny roles.

The consolidated accounts cover around 84 per cent of the spending approved by Parliament in 2018-19—the elements that the Government is directly responsible for. The accounts show the amounts that the Government spent against each main budget heading and the reasons for any significant differences. They also show the assets, liabilities and other financial commitments of the Scottish Government carried forward to future years.

My independent opinion on the consolidated accounts is unqualified. That means that I am confident that they provide a true and fair view of the Government’s finances and that they meet legal and accounting requirements.

I would like to highlight three areas from my report. The first area is financial management. The Scottish Government managed its budget for 2018-19 within the overall limits set by Parliament and budget management during the year was effective in managing aggregate spending, borrowing and tax receipts within that limit. The accounts show that total net expenditure during 2018-19 was £36.137 billion—£778 million less than the budget.

My report highlights the status of Government loans and guarantees to private companies such as Ferguson Marine Engineering Ltd, Burntisland Fabrications Ltd and Prestwick airport, where the valuations of financial support have declined significantly. The Scottish Government has not yet

implemented my recommendation from last year to develop a framework to clearly outline its approach to providing that sort of financial support to private companies. Such a framework should provide clear information on financial capacity, risk tolerance and the expected outcomes in order to provide Parliament and the public with better information about the Government's objectives in entering such agreements.

The second area to highlight is financial reporting. Last year, I welcomed the Government's publication of its first medium-term financial strategy. The Government published its second strategy in May this year. The new strategy includes principles and policies on reserves and borrowing powers, which is welcome, but it does not reflect some basic components of the medium-term financial plan that were included in 2018. In addition, the Government has still not fulfilled its commitment to this committee to publish a consolidated account covering the whole devolved public sector in Scotland. That would fill an important gap, providing information about the impact of past decisions on future budgets, the scale of assets and liabilities and potential risks to financial sustainability.

Finally, the performance report included in the consolidated accounts complies with the principles of the Government reporting requirements and the accounts direction. However, as in previous years, it provides only very limited performance information on the Government's own progress towards its overall aims and objectives, with users of the accounts being directed to the national performance framework. There is a need for the Government to prepare a performance report that clearly links to the financial resources outlined in the consolidated accounts.

As ever, we will do our best to answer the committee's questions.

**The Convener:** Thank you very much, Auditor General. We intend to cover all those issues. The committee is particularly concerned about the lack of a framework on the loans and grants to private companies. Alex Neil will open up questioning on that point.

**Alex Neil (Airdrie and Shotts) (SNP):** Good morning, Auditor General. You raise an important point about the need for a framework for deciding which organisations and companies should receive assistance. We need to know what the criteria are, what the process is, and why some, such as St Rollox, receive nothing while others receive a lot of money—justifiably, on the face of it. What are the criteria and what needs to happen to make sure that the process is properly governed?

**Caroline Gardner:** We are confident that the individual decisions are properly governed, with due diligence being carried out at the point at which a decision is made. What is not in place and what I recommended last year is a framework that gives the context in which those choices are made.

We all understand that, from time to time, the Government will look to support companies to safeguard jobs and perhaps to give companies more time to gain financial support on the capital markets, but there are always more of those sorts of calls than there will be funding available for them. They are inherently political choices that any Government will have to make and they bring with them risks, as we have seen in the consolidated accounts this year, with the value of the loans and guarantees being written down quite substantially.

I am calling for the Government to set out a framework that provides Parliament and the wider public with information about its risk appetite, the overall amount of capacity for providing financial support and how it goes about making those trade-offs so that we can see why this company and not that company has been chosen, and so that Parliament can be sure that the Government is not investing in declining industries at the expense of industries that may have a longer-term future.

**Alex Neil:** You mentioned due diligence and jobs and gave the example of Ferguson Marine Engineering. The Government made a statement that when it made an offer to the administrator to take over Ferguson Marine Engineering, it had not done any financial estimates of the cost to the public purse of doing so. Surely that indicates that there was not proper due diligence. For example, no estimates were given of the additional working capital that will need to be met by the taxpayer or whether there was due diligence in relation to the technical ability of the yard to finish those two ships.

Given the 20 per cent rule whereby a publicly owned shipyard must have no more than 20 per cent of its turnover from the state sector in orders, the loss of potential jobs means that the yard cannot compete for international work that it could have done previously. It was estimated that up to a total of 1,000 jobs could have been created, compared with the 300-odd jobs that will be protected under the new nationalised arrangement. Has the right decision been made in terms of due diligence and jobs?

**Caroline Gardner:** My reference to due diligence was about the guarantees and support that are covered by these accounts. That includes the £45 million provided to Ferguson Marine Engineering up to the point of the balance sheet date, rather than decisions about potential

nationalisation that were taken after that point. We are confident that the decisions to provide support to Ferguson Marine Engineering, BiFab, Prestwick airport and Lochaber were all subject to due diligence. As I say in my report, I expect that either I or my successor will want to look at the decision to nationalise Ferguson Marine Engineering once that has been fully worked through.

Stephen Boyle can tell you a little bit more about the process so far.

**Stephen Boyle (Audit Scotland):** Our work in assessing due diligence was focused on the loans and guarantees that the Government has provided to Ferguson Marine Engineering and on whether the Government and other public bodies took appropriate legal and financial advice from suitably qualified experts to assess the risks that they were entering into. In that regard, we are satisfied that the decisions taken to support those industries at the point of offering the loans and guarantees went through proper processes.

The decision point latterly on the future obligations—which the Auditor General will return to in future reporting to the committee—is something that we will continue to track in the audit of the Scottish Government and of some of the other public bodies that are more closely connected to the issue, such as Transport Scotland.

**Alex Neil:** Is there not a need for a more urgent review of the whole Ferguson Marine Engineering process? Is it not true that Caledonian Maritime Assets Ltd, which is separate from CalMac Ferries, ordered ships that CalMac did not ask for but which CMAL decided it would get anyway, with the new technology that has proved extremely difficult and caused all the problems? Why are CMAL and CalMac still separate? Why did CMAL order ships that CalMac did not ask for? Why did the Government go in without estimating the total cost to the taxpayer of its bid? Why are we engaged in a solution that puts at risk the potential job creation that otherwise could happen? These are legitimate questions that require fairly urgent responses.

**Stephen Boyle:** On the scope of these accounts, as you know, Mr Neil, CMAL is not covered by the audit.

**Alex Neil:** I am thinking beyond the accounts to where we go from here, because you have quite rightly raised a number of issues in the report. There are the implications of what you are saying about the need to be clear about what the Government is doing when it takes over a company or buys into a company—or refuses to buy into a company, as was the case with St Rollox, for understandable reasons. You are saying, quite rightly, that there needs to be a

framework. Surely these issues all have to be part of that framework.

**Stephen Boyle:** In the lead-up to the decision point around nationalisation, the Scottish Government has kept us fully briefed and informed, which we welcome. I can see a clear improvement from the level of communication that we have had in previous years. The decision point to nationalise—recognising that your interest lies beyond these accounts—happened after the date that these accounts were approved. We signal our intention to come back to the committee to report further on the circumstances leading to the nationalisation of Ferguson Marine Engineering.

We understand that the Government's commitment is to complete the two remaining ferries that Ferguson Marine Engineering was undertaking on behalf of CMAL. Our intention is to carry out further reporting to the committee during 2020 with more details of the circumstances.

**Alex Neil:** I am linking the issue to the recommendation for a framework. I am told that, technically, it will be very difficult to complete the ships without possibly another £50 million of taxpayers' money because of the spec. I understand that one of the reasons why CalMac did not ask for these ferries is that they were too complicated and complex. It needed the ferries urgently, as we see from the problem with the Arran ferry last week. This is quite an urgent issue in ferries policy.

**Caroline Gardner:** Those are questions that we will look to answer in the further piece of work that we have referred to. However, it is important to be clear that we do not have the powers to stop Government doing something. Government will make its own decisions and we will review those decisions and report to Parliament.

**Alex Neil:** Absolutely, but I think that the issue highlights the need for a framework.

**Caroline Gardner:** I could not agree more.

**The Convener:** I would like to probe the framework issue a little bit further. Stephen Boyle said that the Government took advice on whether to grant these sums of money from "suitably qualified experts". Can you tell us who those experts are?

**Stephen Boyle:** Certainly, convener. The Government uses a range of financial experts and legal advisers. They are typically external, and usually from the big four accountancy firms and other large accountancy firms, which provide experts on the anticipated costing, cash-flow projections and so forth. I can provide in writing the detail of which experts have been involved in which contracts.

**The Convener:** Can you remind us who the big four are, for the record?

**Stephen Boyle:** Of course. They are EY, PwC, Deloitte and KPMG.

**The Convener:** Quite recently in the chamber, I raised a situation involving KPMG as the Government adviser. McGill Electrical, a company based in Dundee but employing 470 people across Scotland, was looking for a loan—not a grant—from the Scottish Government of £2 million to keep the company afloat and retain the 470 jobs. The Government refused that loan. KPMG was the company adviser, but the day after that decision was made, KPMG became the liquidator—the administrator—getting the huge fee that administration brings. Do you think that there is a conflict of interest there?

**Stephen Boyle:** It is potentially difficult for me to comment on the circumstances of that individual case, convener. I would assume that all auditors with professional qualifications are bound by appropriate ethical standards. The circumstances are perhaps not for me to comment on.

**The Convener:** Let me separate my question slightly from the particulars of that case. I was really concerned that we have a situation in Scotland where companies come to the Scottish Government to look for assistance to save jobs—and in the current economic climate, we have seen several companies do that, as we have discussed. The Scottish Government takes advice from independent experts, which you named, one of them being KPMG, but when the Government makes a decision not to give the money, the independent expert benefits financially from that decision by becoming the administrator. Auditor General, do you think there is an issue here?

09:15

**Caroline Gardner:** I understand the concern, convener. It is a question for Government about the conditions that it places on the appointment of the advisers that it uses in such cases. As Stephen Boyle said, it is then a question of the independence and the ethical standards that are in play for accountants who act in that role. There are strong independence and ethical requirements for auditors. I am not an expert on how they apply in advisory and administration or liquidation roles, but I think that it is an appropriate question to ask Government.

**The Convener:** We have a situation in Scotland where we want to see construction. There are problems in the construction industry, but I am told by experts that the big four and other accountancy firms are circling like vultures around those construction companies because they operate on such tight margins. Is it ethical for the Scottish

Government, knowing that that is the case, to trust the independent expertise of those firms?

**Caroline Gardner:** As I said, it is entirely proper to ask Government about the conditions that it places in its contracts when it engages a firm to provide it with advice about support, whether that is a loan, a grant or a guarantee to a company. It would be possible to put in place restrictions that say, “If you provide advice here, you are precluded from acting as the administrator”. I do not know whether Government does that, but I think that it is an appropriate question to ask Government.

**The Convener:** Let me probe a little bit further Mr Neil’s question about jobs. I was incensed by the situation because of the number of jobs involved and the relatively small amount of money requested. I understand that the company has to be looked at and that decisions have to be made. You talked about due diligence, but I was very aware of the contrasting situation down in Inverclyde, where Texas Instruments was given £15 million, I think, by the Government for far fewer jobs—I think that it was 150 jobs. You said there is no framework. Are you aware of any Government guidance that tallies the number of jobs with potential Government investment, or is that irrelevant in these decisions?

**Caroline Gardner:** I do not think that it is irrelevant at all. Guidance alongside “The Government Financial Reporting Manual 2019-20” was recently introduced for civil servants who are working on these cases on how they should go about seeking due diligence, for example. That guidance is in place, as it should be.

However, there is nothing that is publicly available to this Parliament that says, “The Government expects to support private companies in certain circumstances. Here is the amount of financial capacity that we have available; here are the risks that the Government is prepared to take on; and here are the strategic objectives that the Government would look to achieve.” Those strategic objectives might be about job preservation or future job creation, or they might be about sustaining an industry that has long-term potential within the Scottish economy—there could be other things. In my view it is really important that the framework is there so that you, other members of this Parliament and people more widely can understand why a company such as BiFab received support and companies such as the one in your constituency or the one in Mr Neil’s constituency do not. That is not to say that they were the wrong decisions, but you should be able to understand the criteria that Government uses to make them.

**The Convener:** The frustration comes from the lack of transparency. There is a Government decision for which there seems to be no



justification, so I would welcome having your framework developed quickly.

**Liam Kerr (North East Scotland) (Con):** Good morning. I would like to change the topic slightly to your European social fund conclusions. Your report says that there has been a pre-suspension of European social funds because the European Commission's auditors identified, in your words,

"serious deficiencies in the management and control system".

Those apparently mirror similar deficiencies from 2007 to 2013. Can you tell us what those serious deficiencies are, who or which agency has dropped the ball here, and why the situation was not resolved after the last time?

**Caroline Gardner:** I will ask Stephen Boyle to talk you through that.

**Stephen Boyle:** The flow of funds comes from the European Commission to the Scottish Government, on to the Scottish Government's partners and through to typically smaller bodies across Scotland that provide employment training and other opportunities. The conditions that the European Commission requires of grant recipients are quite detailed and complex in some circumstances, but they are set out in the legislation and tested by the European Commission's auditors. When the auditors did their audit, they identified the deficiencies that you refer to.

Who are the bodies? A range of public bodies are affected. One of the most notable, and one that was disclosed by Scottish Government in its own governance statement and accounts—where it, too, acknowledges the weaknesses—is Skills Development Scotland, which is one of the largest recipients of that grant funding. There is then a whole host of smaller public bodies; indeed, there are some local authorities in a larger category. However, a range of public bodies are affected. In correspondence and communications with the European Commission, the Government has set out that it will address the deficiencies by November. There will then be a period of confirmation by the commission's auditors that the weaknesses have been addressed. The Government anticipates that the pre-suspension period will be lifted in early 2020.

**Liam Kerr:** Just to be clear—I want to understand you correctly—the lead partners have serious deficiencies and, as a result of the deficiencies of each individual lead partner or whoever, that filters up the chain and the European social fund is pre-suspended. If that is the same as what was happening in 2007 to 2013, why did the Scottish Government not say at the time, "The lead partners are messing this up for

everyone. Let's put in place a proper system to make sure that it doesn't happen again"?

**Stephen Boyle:** That is certainly a line of inquiry that the committee might wish to explore further with the Scottish Government. Our understanding is that the remedial action that the Government has taken to address the current problem is appropriate. You can see the dialogue and the specific communication as well as the additional training that it is providing to the grant recipients. In its view, those are the steps that it needs to take now to address the pre-suspension matters. As I suggested, those steps will be tested when the commission's auditors return towards the end of this year and into early 2020.

**Liam Kerr:** Finally, your report says that, at the moment, the lead partners are paying out money that they have not received—I think that a contingent liability has been put into the Scottish Government's accounts. If the pre-suspension is lifted, as you suggest it might be, will the Scottish Government fully reimburse the lead partners—will it just put the money out? If the programme is fully suspended, will the lead partners lose the money that they have paid out during the pre-suspension?

**Stephen Boyle:** It is difficult for me to be definitive about what will happen to the flow of funds. You are right that the public bodies have not been receiving funding from the Scottish Government and are funding the programmes themselves for the time being. In the event that the pre-suspension period is lifted and the flow of funds returns from Europe, the expectation is that the funds would trickle down to the bodies that have not been in receipt of them. Government would certainly be able to provide an answer on what its intentions are, on the assumption that the pre-suspension period is lifted.

**The Convener:** We have a couple of questions on Prestwick airport.

**Willie Coffey (Kilmarnock and Irvine Valley) (SNP):** If you ask the ordinary person on the street—and certainly if you ask any of the more than 3,000 employees who are connected to Prestwick in the aerospace industry—to justify the Scottish Government's intentions, I think that the answer would be obvious and clear. For example, there is the impact on jobs; the aerospace industry is at Prestwick; the airport and the runway are strategic assets; and the airport has a year-round ability to handle traffic. What more do you think needs to be said to make things clear to us as an audit committee and to the public scrutinising the Government's finances? What is perhaps missing?

**Caroline Gardner:** Like you, I recognise the strategic importance of Prestwick airport. When

the Government made the decision to purchase it, its rationale was much less about Prestwick's scope as a commercial airport for passenger transport and much more about Prestwick as an aerospace hub that could be used for the wider aviation industry in Scotland. You have described some of that, and I recognise that entirely.

When I reported on that decision to purchase the airport, I noted that how the airport could achieve a financially sustainable future was a question that had not been answered at that point, as well as whether the income that can be generated from that sort of aviation work was sufficient to maintain it in future and, if not, what the longer-term future might be for the airport.

Those questions are still unanswered and are another indication of why, in putting the decision into context, it would have been helpful to have a framework around what the strategic objectives were, what the financial capacity was and what the risk appetite was. Nobody wants to see Prestwick airport close but, equally, nearly £40 million of Scottish Government loan has been provided and it has now been written down to a small fraction of that. It is not clear how, some time on from the original purchase decision by Government, the airport can become independently financially sustainable with its current business model.

**Willie Coffey:** Members have mentioned the framework. Do you envisage an overarching framework that would give us the answer to all those issues, or do you see it being used on more of an individual, case-by-case basis as situations arise? I find it hard to imagine an overall framework that would capture all of that satisfactorily.

**Caroline Gardner:** There is bound to be judgment involved in each individual case. I do not think that there would be a framework where you would plug in a situation and a yes or no answer would come out the end. For me, it is about those three things: the overall financial capacity, or how much Government has available for such support; the Government's risk appetite; and what strategic objectives beyond preserving jobs in the short term the Government is trying to achieve. We all understand the importance of jobs to people and communities, but those jobs need to be sustainable for the longer term. The framework would provide a useful link when it comes to thinking about the way in which the intervention fits into the wider economic strategy.

**Willie Coffey:** Finally, the spaceport potential at Prestwick airport is incredible—it could deliver thousands of jobs down there. You say at paragraph 19 of your report that

"Transport Scotland anticipates that a sale may be achievable by the end of 2019/20."

Could you add any more to that, or is that as much as you are able to say at the moment?

**Caroline Gardner:** I am not sure that we can say much more.

**Stephen Boyle:** Certainly, it is a conversation that we are content to have with our colleagues who audit Transport Scotland and to track that, but, like the committee, we are just monitoring progress and awaiting the outcome.

**Anas Sarwar (Glasgow) (Lab):** Prestwick airport is undoubtedly strategically important, but, apart from six Ryanair flights every day, it is largely a US military airbase. It was purchased for £1, and £39.9 million of loans were put into it by the Scottish Government. Can you confirm how much of that loan has been written off?

**Caroline Gardner:** The value of the loan has been impaired by £33 million. It is important to be clear that does not represent writing it off: it is writing down its value in the accounts. It may rise again in future, but its current valuation is £6.9 million.

**Anas Sarwar:** That is 6.9 million from a £39.9 million loan. What do you think the likelihood of a sale is?

**Caroline Gardner:** As Stephen Boyle said, we know that the Government is still in conversations, but it has been looking at the airport's future since it was purchased back in 2013 and we are now nearly six years on. The important thing is for there to be a strategic view of the future of the airport and what Government's role is in supporting that.

**Anas Sarwar:** Has there been any audit of Prestwick's pricing policy, particularly in relation to pricing for US military flights? There is a suggestion that there is underpricing.

**Caroline Gardner:** There has not been an audit by me or the auditors I appoint because we do not appoint the auditors to the company that owns Prestwick airport. It is a private company. Transport Scotland is in dialogue with it about the Government's financial support and the future business case, but we do not have direct access to the airport's financial accounts.

**Anas Sarwar:** What the public will see is an airport that was bought for £1, had almost £40 million put into it and is now an asset worth around £6 to £7 million that is being used for US military flights. At the same time as the US is imposing tariffs on Scottish products—for example, 25 per cent on Scottish whisky—we are giving them cut-price charges to land at Prestwick, perhaps even for rendition flights. Clearly there is inconsistency there. Should the Scottish Government not be looking to up the prices for US military flights, if not scrapping those flights altogether?

09:30

**Caroline Gardner:** You are asking very political, policy questions and, therefore, they are not questions that I can answer as Auditor General. They are questions that you might want to raise with Government.

**Anas Sarwar:** But is it something that you can raise with Transport Scotland and Prestwick airport? Can you raise how we audit and track the pricing policy? That obviously impacts on the value of the money that comes back into the public purse and the hopes of recouping some of that £40 million.

**Caroline Gardner:** For good reasons, my remit and the remit of the auditors I appoint excludes questions of policy. The Transport Scotland auditor will continue to talk to Transport Scotland about Government support and the Government's objectives for the airport, but the very clearly policy-based and political questions that you are raising are not ones that I can answer. They are for Government and Transport Scotland to answer.

**Liam Kerr:** I would like to clarify something. In response to Anas Sarwar, you said that a private company owns Prestwick airport. For clarity, as a taxpayer, what do I own and what is up for sale?

**Caroline Gardner:** The airport is operated by Prestwick Airport Ltd, as a holding company. The Government owns the airport but has set up a company to operate it, and, since 2013, the Government has provided loan funding to enable that company to keep operating. As Mr Sarwar said, the value of that loan funding is £39.9 million. In the most recent Government accounts, the value of that has been written down by £33 million to £6.9 million to reflect expected losses against the value of the loans.

**Liam Kerr:** Forgive me if I am missing something, but you said that a company has been set up that owns all the assets of Prestwick airport and that it is a private company. What is the shareholding of that? Is that not the taxpayer or—

**Caroline Gardner:** I am not sure that we can give you the detailed answers now. I do not want to mislead the committee. We can certainly follow up after this meeting. Does Stephen Boyle want to add anything at this stage?

**Stephen Boyle:** As the Auditor General says, we will confirm this in writing, Mr Kerr, but our understanding is that the Scottish ministers are the sole shareholder of Prestwick Airport Ltd, but that is not reflected in the accounts that you have before you today. It is not part of the consolidation boundary, as it were, of the Scottish Government's accounts.

**Caroline Gardner:** The same is true for companies such as CalMac, Caledonian Maritime Assets Ltd and Highlands and Islands Airports Ltd. They are all private companies in which the Scottish ministers are the sole shareholder.

**Alex Neil:** For clarification, is that because of European Union rules? Why is that the case? I find it difficult in principle to accept that you should not audit something that is owned by Scottish ministers on behalf of the taxpayer.

**Caroline Gardner:** We have previously responded to a request from the committee to say that there is an anomaly around those companies, and indeed the Scottish Futures Trust, as none of them falls within the Auditor General's responsibilities, even though they are wholly owned by Scottish ministers.

**Alex Neil:** Whose decision is that?

**Caroline Gardner:** It was the decision of Scottish ministers to set them up in that way.

**Alex Neil:** They have decided that they do not fall within your remit.

**Caroline Gardner:** They have decided to set them up as companies limited by guarantee in that way, which fall outside my remit.

**Alex Neil:** Who decided that companies limited by guarantee fall outside your remit?

**Caroline Gardner:** I think that that goes back to the original founding legislation for what the Auditor General does and the interaction with companies legislation.

**The Convener:** I thought that I was being a bit slow, but it seems that the position is what it is by design. Let me give my understanding. We have companies that are owned by Scottish ministers at the taxpayers' expense but which have been set up as private entities so that you cannot audit them.

**Caroline Gardner:** I did not say that they were set up in that way so that I cannot audit them, but the effect is that I cannot audit them.

**The Convener:** The result is that you cannot audit them, but they are owned by Scottish Government ministers—that is, the taxpayer. We pay for them and they are not within your jurisdiction to audit. Is that correct?

**Caroline Gardner:** That is right.

**Bill Bowman (North East Scotland) (Con):** Maybe I can help with this.

**The Convener:** If you have a question for the Auditor General—

**Bill Bowman:** I do, yes. I should mention, since its name has come up this morning, that I used to be a partner in KPMG—I no longer am.

Auditor General, I read your report, which is very helpful. All the questions that we have had so far relate to the loans and investments. I was trying to tie them back to the accounts, and the only area that I could find that was relevant in that regard was page 106, if anybody wants to look at that—the report is 136 pages long. It explains that Scottish ministers are the sole shareholder in CMAL, David MacBrayne Ltd, HIAL and TS Prestwick Holdco. Then it says:

“These organisations are operated and managed independently of the Scottish Government, and, therefore, do not fall within the consolidated portfolio.”

Counterintuitively, given our discussion, it seems that we are all a bit surprised by that. We get a little bit of information about those organisations—three lines—and then the report says:

“These results are in draft as their accounts are yet to be published.”

So in the accounts, we get some draft information—unaudited, presumably—for one year, no comparative information and no reconciliation to draft. Is that best practice by way of disclosure?

**Caroline Gardner:** They are not within the consolidated account boundary. As you know, that means that they are not consolidated to the accounts. I understand the concern that you are raising. What I am required to do, as the auditor of these accounts, is to value the Government’s direct stake in them and exposure to them. That has been done. I think that it would be helpful—the committee’s questions clearly reflect this—for there to be a closer accounting and auditing relationship between those companies and the Government’s accounts.

**Bill Bowman:** Even if you follow the Scottish Government’s logic in giving that limited information, it is odd that, at the bottom of page 106, it adds BiFab, in which it holds a 32.4 per cent stake, and says nothing about the results. That would seem to be a gap.

**Caroline Gardner:** I think that it is a gap. It reflects the fact that loan funding was converted into an equity stake and that that equity stake has been written down in value. What we see is that the committee and Parliament have an interest in greater transparency around this, which is what the report calls for.

**Bill Bowman:** Do you think that any losses are hidden within that type of accounting?

**Caroline Gardner:** It is very hard for us to say. The companies that are listed on page 106 are quite different sorts of companies. CMAL, David

MacBrayne and HIAL are companies that have been up and running for a long time and have specific roles. Prestwick airport was bought by Government for £1 back in 2013 because it was in financial distress. We know from my prior reporting to the committee and the financial results that are in the public domain that the airport has required support from Government to maintain it. There are different categories within the disclosures that are in the report. Transparency is important in understanding future potential liabilities and in being able to understand decisions that Government is making about providing financial support and strategic objectives for things such as Prestwick airport.

**Bill Bowman:** Do any of those organisations rely on the Scottish Government to be going concerns or to be taking guarantees?

**Caroline Gardner:** The loan funding that has gone into Prestwick airport has clearly been critically important to its ability to continue operating so far. We do not know how that expands into the future. We have no information that that is the case for the other companies. I will ask Stephen Boyle to talk you through what he has done as part of the audit work to get us to this stage.

**Bill Bowman:** Finally, is Ferguson Marine Engineering in here somewhere?

**Caroline Gardner:** It is not, because it is not a company in which the Government has an equity stake in that way.

**Bill Bowman:** Where is the loan?

**Caroline Gardner:** Stephen Boyle can tell you where it is in the notes and disclosures that we have.

**Stephen Boyle:** I am relying on my recollection of the note in the accounts in which the loan is captured. We understand that it is the Government’s intention in relation to Ferguson Marine Engineering to create a public body.

**Bill Bowman:** Will it be consolidated?

**Stephen Boyle:** That is broadly our expectation. Again, it is for the Government to confirm its intention around the accounting for Ferguson Marine Engineering as a nationalised public body and where that sits within the quite defined boundary that it has set up for which public bodies are in the Scottish Government consolidated accounts and which public bodies are outside that boundary.

**Bill Bowman:** I think that it shows a need for whole-of-Government accounts.

**Stephen Boyle:** I think that that is right. That is certainly something that is captured in detail in this year’s section 22 report as well as last year’s. The

progress around the public consolidated accounts has not been as fast as we—or indeed the committee, I am sure—would have anticipated around the greater transparency of what Scottish public bodies own and owe. There is a need for that level of disclosure and awareness to be set out in the public consolidated accounts. Although the Government has made some progress during the year in sharing early indications with its own audit committee, and latterly, over the course of the summer, with ourselves, there is a need for the pace to pick up. We have recommended in the report that that needs to come through towards the end of the 2019-20 financial year.

**The Convener:** Do you know what the delay on that has been? The Auditor General is not recommending anything new.

**Caroline Gardner:** The Government made a commitment in 2016 to this committee that it would take that forward. Our sense is that the delay has been a result of priority being placed on other areas of work—there has been a lot of work going into new financial powers, new tax powers and so on. However, as I say in my report, the issue is increasingly urgent, given the financial complexity and uncertainty that Government is facing and the range of interventions and support that it is providing to private companies.

**The Convener:** I will try to tie up this section on loans and grants to private companies. Why has there been the delay on the framework? That is not a new call of yours.

**Caroline Gardner:** I am not sure that the Government has fully accepted the recommendation. As I said in an earlier answer, it has provided more guidance to civil servants who are making decisions in individual cases. That is useful, but it is not the same thing as having a framework for the Government's overall approach to that support, which covers financial capacity, risk appetite and the outcomes that it is looking to achieve.

**The Convener:** You are not sure that the Government agrees with the need for a framework.

**Caroline Gardner:** We certainly have not had a formal acceptance of that need in our conversations with the responsible team.

**The Convener:** Perhaps that is something that the committee can ask the Government.

We would like to scrutinise some other parts of your report. Colin Beattie will go first.

**Colin Beattie (Midlothian North and Musselburgh) (SNP):** Financial planning is a recurring theme that seems to come up in your reports quite frequently. In your report, you talk about the Government publishing a second

medium-term financial strategy. You say that it is “a positive step” that takes things forward, but that some “basic components” are not there. To what extent is the Government constrained in producing a financial plan and financial strategies when it does not really know what its funding will be year by year?

**Caroline Gardner:** I understand that concern, but in a sense it is exactly that uncertainty that makes a longer-term view more important. The medium-term financial strategy is separate from the annual budget process, which clearly still depends to a large extent on the block grant from Westminster and will be affected by the timing of the United Kingdom budget, which we still do not know. The budget process review group, of which I was a part, recommended that its purpose is to give a longer-term view of likely trends in revenues from the various taxation sources that the Government now has powers over, and the direction of travel in indicative spending patterns for large areas like health, education and so on.

We know that the Government has committed to protect health spending. It is possible, therefore, to provide some scenarios for what that might look like. It has made big commitments to early learning and childcare, in line with its policy. Setting out the large budget lines and the way in which they are expected to change over five to 10 years is all the more important, given the uncertainty about both levels of taxation and block grant funding from Westminster.

**Colin Beattie:** I struggle a little bit with that concept when there is such a state of flux in Westminster and we are so reliant on getting our money from it. What might or might not happen with Westminster's budget, what consequentials might or might not come to us and all sorts of things around that seem to change almost month by month. You might say that the Scottish Government should be doing worst-case scenario planning or whatever, but is it not a big enough challenge doing a year-by-year budget in circumstances in which there is no certainty around the UK budget?

**Caroline Gardner:** We are looking for not just the worst-case scenario but a range of possible scenarios: the most likely and the best and worst pictures, if you like. It is possible to forecast what might happen to tax revenues in Scotland and make assumptions about the block grant. Most of the spending on major areas is already either committed or will take some time to change. Given that broad picture of indicative spending patterns and priorities, what does the Government's prioritisation of health spending mean for the areas that are not protected? Those questions are all the more important because of the uncertainty that you are talking about. Any strategy of that sort

is bound to have uncertainty in it, but that is the reason for looking ahead at possible scenarios and how the Government would respond to them if they did materialise.

09:45

**Colin Beattie:** You said in paragraph 35 on page 13 of your report that, overall, the 2019 strategy, which is the second medium-term financial strategy, represents a “missed opportunity” and “a step backwards”. Could you give us a little bit more on that?

**Caroline Gardner:** Of course. The 2018 strategy, which was the first medium-term financial strategy that the Government published, included spending scenarios for the Scottish Government’s priority areas. That was a very welcome big step forward and a good response to the recommendations of the budget process review group, which Government and Parliament both accepted. I think that the Government would say that that information was not included in the 2019 strategy for the reasons that you have articulated: the uncertainty that is around, particularly at Westminster level. My view is that that uncertainty makes including such scenarios all the more important and that it would have been useful to have continued the good practice that was built into the 2018 strategy.

**Colin Beattie:** You have listed a number of areas that the strategy does not cover, such as indicative spending plans and priorities, which I presume you raised during the audit process. What was the Scottish Government’s response?

**Caroline Gardner:** We do not audit the strategies and plans in that way. We step back and look forward and backward at the Government’s financial reporting. We raised the issue in conversation with officials and at the Scottish Government’s audit and assurance committee. The Government’s response, as I have said, was very similar to the point of view that you have put across in your questions, which is that uncertainty makes including those things difficult. As Auditor General, my view is different: I believe that the uncertainty makes doing that more important. That is why I am reporting to this committee in those terms.

**Colin Beattie:** You raised the issue. What was the response?

**Caroline Gardner:** The response was what we are hearing from you: that the uncertainty makes doing those things difficult to the point that it is not useful. My view is that it is absolutely difficult but that it is all the more important to carry on doing that and to build on the good foundations that were laid in 2018. To have set out the direction of travel in 2018 and not update it and build on it in

2019 is a step backwards, as I have said in my report.

**Colin Beattie:** Who is the accountable officer for the audit function in Parliament?

**Caroline Gardner:** In Parliament or in Government?

**Colin Beattie:** In Government.

**Caroline Gardner:** The chief financial officer is Gordon Wales and the permanent secretary is the accountable officer for Government as a whole.

**Colin Beattie:** Is there any clear guidance on the kind of information that you would expect a medium-term financial strategy to contain? You have touched on one or two key items, such as the implications of ring fencing health and so on, but what other significant information would you expect to be in the strategy that is not there?

**Caroline Gardner:** The report of the budget process review group pulled together good practice from across the world on overall good financial management and strategic financial management and, as part of that, the components of a medium-term financial strategy. Such a strategy obviously needs to cover both the revenue side and the expenditure side. It needs to be looking ahead for a longer period than the annual budget, and we suggested five to 10 years, as experience and expertise builds up. It should include forecasts for tax revenues with different scenarios for the tax streams that are available. It should also forecast expenditure patterns based on current policy and built-in commitments for things such as revenue financing, borrowing repayments and the Government’s priorities, and how they might change the current patterns of spending. It should simply provide an overall picture of what the Government’s finances might look like, recognising the uncertainty but doing the best to forecast what those things might mean for the future choices that the Government and Parliament will need to make.

**Colin Beattie:** If I picked you up correctly, you said you looked at other jurisdictions for best practice.

**Caroline Gardner:** The budget process review group looked at other jurisdictions, yes.

**Colin Beattie:** Did it look at Westminster? Is there something that we can learn there? Is it doing those sort of projections?

**Caroline Gardner:** The group looked at Westminster. It also looked globally, and we found some good practice in countries such as New Zealand, where there is a great deal of transparency about the Government’s finances and what they might look like in the future.

The components of the medium-term financial strategy are there. We know that they are there because they were included in last year's strategy. It is more about giving effect to what the Government started to do last year, rather than there being an answer somewhere else that the Government has not already started to work on. My point is that some of the things that were included last year were omitted this year, which I think is unfortunate.

**Colin Beattie:** Coming back to making comparisons, is Westminster doing the sort of forward planning that we are not doing here? Is it doing a strategic plan that looks five, 10 or 15 years ahead? Put simply, is there a process that we can pick up from there?

**Caroline Gardner:** The Westminster Government process has two elements. First, there is the spending review, and you are right—we do not know when the next Westminster spending review will happen. Secondly, for a number of years the Office for Budget Responsibility has produced a medium-term fiscal outlook, which does many of the same things.

I do not think that there is disagreement about what should be in the strategy. I am commenting on the content of the 2019 fiscal strategy, and specifically the fact that it contains less information than the 2018 fiscal strategy reported.

**Colin Beattie:** I keep coming back to the same thing, but does it contain the same level or less information than Westminster provides?

**Caroline Gardner:** In overall terms, it contains less detail. Specifically, the indicative spending plans and spending priorities are not in this year's Scottish fiscal outlook. They are in the UK document and they were in the Scottish Government's document last year.

**Colin Beattie:** So there is a UK document that looks ahead five, 10 or 15 years.

**Caroline Gardner:** The OBR produces the fiscal outlook, as I have said.

**Anas Sarwar:** Auditor General, I want to turn to financial management, particularly the Government underspend. The report notes that there is a £778 million underspend. How does that compare to previous years? Given the pressure on public services and the scale of cuts that some face, how does the Government justify a £778 million underspend?

**Caroline Gardner:** We say in paragraph 7 that the underspend in 2018-19 was £778 million; in 2017-18 the total underspend was £84 million. The large areas of that are broken down in exhibit 1 on page 6 of the report and you can see where it comes through. There are a couple of things to say. One is that in overall terms, compared to the

budget as a whole, it is still quite a small number. In absolute terms, £778 million is obviously a large figure, but against a budget of £37 billion it is small, and the resources can be carried forward through the Scotland reserve and other mechanisms to future years. I am not concerned about the underspend per se, and I say in the report that financial management operated well during the year.

**Anas Sarwar:** Lots of organisations across Scotland have had to strip back their services by tens of thousands or double that. They might look at the £778 million and be a lot more concerned about that figure than the bigger numbers.

You mentioned the breakdown by portfolio area in exhibit 1. I want to ask a couple of questions about the education and skills budget and the transport infrastructure and connectivity budget. On the education and skills budget there is a £297 million underspend. For clarification, none of that includes any kind of spending that goes into schools, so none of the pupil equity funding comes through that, does it? Is that all in local government?

**Caroline Gardner:** Most of it relates to the specific accounting transactions for student loans, so it has no relation to that.

**Anas Sarwar:** Last week, we had a discussion about the report on universities and the financial pressure on them. We have had a lot of discussion about the challenges and budgetary pressures facing Scotland's colleges. The committee has also had lots of conversations about challenges for the workforce around identifying skills and people, training them appropriately, and getting them into relevant areas. When we have such huge skills gaps in our economy and public services, a gap of £297 million is unbelievable, is it not?

**Caroline Gardner:** The £275 million underspend is related to student loans and it is not cash that would be available for other purposes, such as investing in the workforce or in skills development. I recognise the question, but that cash would not be available for those purposes.

**Anas Sarwar:** Is that all purely underspend on loans? Would you expect to have higher payments on the loans in future?

**Caroline Gardner:** It is a very complex model of accounting. I will ask Stephen Boyle to talk you through the impact of that.

**Stephen Boyle:** The £275 million underspend in respect of student loans broadly reflects the Government's accounting treatment, with the introduction of new accounting standards around longer-term investment assets, in which student loans are categorised, and also the implications of changes in the length of repayment period, which

was reduced from 35 to 30 years. In addition to that was the change in income thresholds upon which those with student loans were required to repay the loan. The Government had anticipated part of this and had provided budget cover for what it expected to be a significant impairment to or reduction in the value of that loan, but expected that most of that would have been applied in the 2018-19 accounts that you have before you.

When it did the review and we looked at that, we thought that part of it would have been better reflected in relation to impairments that should have applied in the number of years prior to that. That is what relates to £255 million of that figure, Mr Sarwar, which would have been better reflected in years prior to 2018-19. The full underspend reflects the fact that the Government had allowed budget cover, but in conversation with us it felt that that would be better reflected in the 2017-18 accounts, which are the most up-to-date accounts available.

**The Convener:** That money is not available for spending on public services. Do you want to go on to transport?

**Anas Sarwar:** On transport, I note that the report says that a lot of the £366 million is rollover money that is committed to future spending. How much of the £366 million is rollover money? Do we know what that is for?

**Caroline Gardner:** We would need to come back to give you the detail. There are two elements. One is, as you say, projects deferred to future years. The other is lower than anticipated unitary payments for revenue finance projects, such as things done under the non-profit distribution model, for example. I would prefer to write to the committee to give you the information rather than—

**Anas Sarwar:** You have helpfully provided the clarification on the £297 million and how much of that would have been available for additional services. Is there a similar figure for the £366 million?

**Caroline Gardner:** We can give you that but I do not think I have it at my fingertips.

**Anas Sarwar:** Would it be to a similar extent as the £297 million in the education and skills budget?

**Caroline Gardner:** No. We are saying that most of it is projects deferred to future years or lower than expected unitary payments. As I say, I would prefer to write to the committee than give you figures that are not accurate.

**The Convener:** That is fair enough.

**Anas Sarwar:** I have one final question on the underspend. There is a perception that the

Government keeps back a slush fund for any issues that might come up through the year, or indeed to buy off a budget deal in future years. Is there a slush fund? What is the scale of it?

**Caroline Gardner:** Within the fiscal framework, the Government is still required to set a balanced budget. In normal circumstances, it cannot borrow for revenue purposes, so it has to set a balanced budget, unlike the UK Government. That means its financial management will generally lead to an underspend, as we have seen for a number of years now. Having said that, in the past, I have reported about the lack of transparency around some of the ways in which money is carried forward from one year to another, including things such as the balance on the non-domestic rate account. I bring that to the committee's attention when I am concerned about it.

I am not concerned about the underspend. The explanations are clear and we have summarised them in the report. The Government could give you more information. The Scotland reserve provides some scope for carrying money forward from one year to another so that it is not lost.

**Anas Sarwar:** Excellent, thank you.

**Willie Coffey:** Sometimes you look at figures in a variation table and you think, "There are big variations, so there must be a story to tell there" but the explanation you gave, Auditor General, about the underspend in education and skills is quite clearly explained on page 67 of the consolidated accounts. The explanation about the student loans is quite technical. Could that kind of issue be simplified for us in your future audit reports to make it a little bit clearer? Your immediate reaction to seeing the figures is, "Oh my goodness, there is £300 million that could go into a slush fund", as Mr Sarwar said, but that is not the case, is it?

**Caroline Gardner:** It is not the case. Accounting for student loans is particularly complicated, but we will do our best in future to explain it to the committee in as simple terms as we can manage.

**Willie Coffey:** When there are higher allocations than were ultimately needed and lower than anticipated expenditure outturn, can that money be taken and used elsewhere? Do the accounts show the difference clearly? That money cannot be used for any other purposes, but if there are items in that sort of category, where you perhaps have higher allocations that are not ultimately needed, surely that money could be invested elsewhere in other services.



10:00

**Caroline Gardner:** I say very clearly in the report that financial management operated effectively during the year. Government is actively looking for areas in which expenditure might be higher or lower than expected and uses the autumn budget revision in particular to make changes where that is required. That is entirely appropriate. It can now carry underspends forward through the Scotland reserve to future years, which is a useful budget management mechanism. As I said in response to Mr Sarwar's question, when I have been concerned that there is less transparency than there should be about that approach, I have reported it and will do so in future.

It is a big and complex budget, as you know. Government must set a balanced budget. Overall, the underspends are not unreasonable and my conclusion is that financial management is working well. It is the transparency that could do with more attention, particularly the longer-term question of the financial strategy that Government is pursuing.

**Bill Bowman:** In your report and conclusion, in the last bullet point in paragraph 57, you say that

"The Scottish Government should ... Ensure its Audit and Assurance Committee provides greater scrutiny and challenge to better support the advice and assurances given to the Permanent Secretary and"

that it should operate

"in line with good practice."

If I was on that audit and assurance committee, I would probably go "Ouch!" at that comment. Who is on that committee and what are they doing wrong?

**Caroline Gardner:** That committee is made up of non-executive directors. Stephen Boyle, who attends every meeting, can give you a bit more information about them. There were four new non-execs appointed during the year, which we welcome. We have reported in the past, and this year, that challenge and scrutiny of management could be stronger to provide the permanent secretary with the assurance that she needs in order to manage the organisation well and to sign off her governance statement. It is a sensitive issue, as members will recognise, but it is an important one. Stephen Boyle will say a bit more.

**Stephen Boyle:** As the Auditor General said, the members of the committee are all non-executives. They are appointed by the Scottish Government. The audit and assurance committee is chaired by a partner in an accountancy firm, and other members include chief executives of third sector charities and people with experience in industry. The Government has recently appointed other new members. To reflect the Government's increasing scope and responsibilities, it brought in

new members who have tax expertise. In the recommendations are two things in particular that we have had a conversation with the audit and assurance committee about: the need for it to produce an annual report on its activities, and the need—as audit committees do when they follow the Government's audit committee guidance—to undertake an annual review of its own effectiveness. We understand that the Scottish Government audit and assurance committee is committed to taking forward those recommendations.

**Bill Bowman:** Are the names of the members in the financial statements?

**Stephen Boyle:** Yes. The remuneration section of the report sets out the members of the corporate board. Its membership flows into membership of the Scottish Government audit and assurance committee.

**Bill Bowman:** What does the comment that I quoted come from? Do you feel that the audit and assurance committee does not really grasp what is going on?

**Stephen Boyle:** We would not say that. We have seen improvement in the Scottish Government's internal governance arrangements over the past 12 months. We particularly point to the fact that it has brought in new skills and expertise through the appointments of additional non-executive members. We have also seen and commented positively on the arrangements for the director-general assurance function. There is almost a second tier of audit through which there is additional challenge.

We would say that there is scope in the audit and assurance committee to replicate in its meetings the level of challenge that we are starting to see at second-tier assurance meetings. Additional structures including the annual review of effectiveness and annual reporting will better achieve that and give that committee the platform from which to do those things.

**Bill Bowman:** Were the things that we and you have homed in on—loans, for example—on the audit and assurance committee's agenda?

**Stephen Boyle:** Such topics are more typically covered at the second-tier assurance meetings. They are on the risk register and are topics on which we think that there is scope for more conversation in the Government's audit committee.

**Bill Bowman:** Are you saying that the audit committee did not discuss such issues?

**Stephen Boyle:** It would be wrong of me to say exactly that. We think that there is scope for more conversation on key items. The Government has been really clear that an escalation process is a

role of the audit and assurance committee. Deep conversation about the matter to which Bill Bowman referred typically takes place in the director-general assurance meetings. There is no question but that there is awareness and understanding in everyone at the table of such matters, but we think that there is a place for that conversation in the audit and assurance committee.

**Bill Bowman:** I think that you are being very diplomatic.

**The Convener:** I trust that Mr Boyle has given his answer to the best of his knowledge, which is fair enough.

**Alex Neil:** Who appoints the non-executive directors of the Scottish Government? Is it the permanent secretary or is the First Minister? Do the appointments fall within the scope of the “Code of Practice for Ministerial Appointments to Public Bodies in Scotland” and the Ethical Standards Commissioner?

Secondly, did I pick Stephen Boyle up right, that the audit and assurance committee is chaired by somebody from one of the big accountancy companies?

**Stephen Boyle:** That is not quite correct. The chair of the audit and assurance committee is a partner in a smaller mid-tier accountancy firm—not one of the big four.

**Alex Neil:** Are there potential conflicts of interests?

**Stephen Boyle:** I would say that there are not, because there is a very clear code on conflicts of interests for senior civil servants and board members.

On the first question about who appoints the committee’s members, that process does indeed follow the public appointments model, which all boards of governance in the Scottish public sector follow. That code applies equally to the Scottish Government audit and assurance committee.

**Alex Neil:** Are members ministerial appointments?

**Stephen Boyle:** They are, to all intents and purposes. The appointments follow that model.

**Alex Neil:** Yes—but are they ministerial appointments?

**Stephen Boyle:** That is my assumption, Mr Neil, but if I am incorrect on that I will get back to the committee.

**Alex Neil:** Could you check and let us know, please?

**Stephen Boyle:** Of course.

**Alex Neil:** I can honestly say that I have held four Government positions and I never came across any of the non-executives at any time.

**The Convener:** Has there been an increase over the past few years? Is that something that you have picked up?

**Stephen Boyle:** I can clarify that the committee has grown in size. The Scottish Government has appointed more non-executives to boost capacity over the past 12 months.

**Alex Neil:** How many are there altogether?

**Caroline Gardner:** There are eight, I think.

**Alex Neil:** Can you supply us with details of who they are, please?

**Caroline Gardner:** The individuals names are on the Scottish Government’s website, but we can certainly summarise that for the committee, if it would be useful.

**Alex Neil:** That is great. Thank you.

**The Convener:** Is there a stipend attached to a non-executive director post?

**Caroline Gardner:** There is. The fees for 2018-19 are shown on page 49 of the annual report and accounts. For the chair, the banding is £10,000 to £15,000; for members, the banding is £5,000 to £10,000.

**The Convener:** Is that per annum?

**Caroline Gardner:** Yes.

**The Convener:** Members have no more questions for the Auditor General and her team on the consolidated accounts. I thank the witnesses very much for their evidence.

10:09

*Meeting suspended.*

10:12

*On resuming—*

### **“The 2018/19 audit of Social Security Scotland”**

**The Convener:** Item 2 is the section 22 report on the 2018 audit of Social Security Scotland. I welcome our witnesses from Audit Scotland to the meeting. Caroline Gardner is the Auditor General for Scotland, Mark Taylor is audit director, Gemma Diamond is audit director, and Kirsty Ridd is a senior auditor in performance audit and best value. I understand that the Auditor General has an opening statement.

**Caroline Gardner:** Thank you, convener. I will be brief. The report brings to the committee’s

attention the appointed auditor's qualified opinion on the regularity of Social Security Scotland's 2018-19 accounts. They are the first accounts for that new body. It is important to be clear from the outset that the auditor has given an unqualified opinion on the information that is reported in the agency's financial statements, which means that he is content that they show a true and fair view, and follow all relevant accounting standards and rules.

The qualification relates specifically to the rules under which the agency's carers allowance expenditure is incurred. The auditor has qualified his opinion on the regularity of carers allowance expenditure because there is not enough evidence to determine whether the expenditure was in line with the relevant legislation. Carers allowance is being delivered by the Department for Work and Pensions, on the Scottish Government's behalf, through an agency agreement. That means that SSS relies on the DWP's estimates of error and fraud, which have not been updated for more than 20 years. The case load of and expenditure on carers allowance have increased significantly in that time. The estimate is also calculated only at UK level and therefore does not reflect any Scotland-specific influences.

Due to those factors, the auditor concluded that the estimate of current levels of error and fraud in carers allowance in Scotland is not reliable. The agency is using different delivery methods to administer the carers allowance supplement, and the best start grant pregnancy and baby payments: those benefits are not affected by that regularity issue. It is, nonetheless, important for the agency to understand the underlying levels of error and fraud in the reserved benefits that affect people's eligibility for Scottish benefits, and the impact of that on the Scottish system.

I have also reported on the agency's wider approach and processes for managing error and fraud within the Scottish social security system. Those are critical in ensuring that people get the benefits to which they are entitled. The agency has established core processes and policies, but they are at an early stage of development and there is much more to be done. It will become increasingly important for the agency to have effective and well-understood arrangements for managing error and fraud as the range and scale of benefits that it is responsible for increase over the next few years. The value of expenditure will increase substantially, and the risk of error and fraud will increase as the agency takes on responsibility for benefits that are paid regularly and that involve complex determinations of eligibility.

As always, convener, we are happy to answer the committee's questions.

10:15

**The Convener:** Thank you very much, Auditor General. Colin Beattie will open questioning for the committee.

**Colin Beattie:** Auditor General, I would like clarification on the carers allowance expenditure. In paragraph 5 of your report, you say:

"The Comptroller and Auditor General of the National Audit Office has qualified the regularity opinion on the DWP's accounts for the last 30 years due to the levels of error and fraud in them."

I presume that you rely on the NAO to do the audit of the area of the carers allowance that is handled by the DWP.

**Caroline Gardner:** Sort of. We do our own audit of the accounts for Social Security Scotland. Within Social Security Scotland, there is a sum of a little more than £150 million for carers allowance this year. In order to reach an audit opinion on that, the independent auditor, Mark Taylor, who is sitting beside me, looks at the arrangements that Social Security Scotland has in place for estimating the levels of error and fraud. Estimates come directly from the DWP because of how that benefit is delivered, and we do no further work to look at how those estimates are being calculated. The estimate on the levels of errors and fraud for the carers allowance is 20 years out of date and because of the amount of change in the population and the expenditure on that benefit since then, the auditor concluded that it was not a reliable estimate in Social Security Scotland's accounts. There is a relationship with the DWP and the NAO, but it is the auditor's own determination, based on Social Security Scotland's accounts.

**Colin Beattie:** Fair enough, but given the history of the NAO qualifying its opinion on this for the past 30 years because of the levels of error and fraud, is it likely that there will be a section 22 report from you every time?

**Caroline Gardner:** Not necessarily. Mark Taylor can talk you through why that is the case.

**Mark Taylor (Audit Scotland):** There are essentially two models for paying benefits. There is the pre-existing UK model, which is based on underlying eligibility criteria. As we set out in the report, if individual payments are made to people who are not eligible, those are, in effect, irregular.

In the Scottish model, which applies to the best start grant pregnancy and baby payments and some of the other benefits that will come along afterwards, as set out in the legislation, the rules are that if a determination is made—in other words, if the agency decides that somebody is entitled to a payment—that payment has to be made. Therefore, the rules apply differently in those two circumstances.

In terms of what it will mean for us in the future, we have to work out what the mix of those two things is. That mix will be quite dynamic as benefit responsibilities transfer from the UK to Scotland and as the Scottish Government takes on responsibility for some of the benefit streams that the DWP will continue to process. We will have to make judgments about that.

The underlying issue for us is to bring to your attention the non-compliance with the rules, but irrespective of which of those two models apply, the agency needs to understand error and fraud and make sure that it is managing things appropriately. There is a technical qualification issue but, behind that, there is a set of issues about how well the agency can manage the error and fraud that is now in Scottish expenditure.

**Colin Beattie:** You have explained the concerns about error and fraud, but paragraph 37 of your report says:

“To support ease of access, less stringent evidence requirements have been adopted by the agency”

such as not requiring the same documentation to evidence a person’s identity and residency as is required for other benefits, such as housing benefit, and accepting photocopies. Is that adequate?

**Caroline Gardner:** As we say in the report, in delivering the new social security system in Scotland, the Government has prioritised dignity, fairness and respect and people’s ease of access to the benefits that they are entitled to. That is a policy choice and we understand it. However, that approach has implications for how the agency goes about safeguarding public money. Both those things need to be managed and the agency needs to understand the impact of its decisions on the possibility of error and fraud and make sure that its safeguards and investigatory capacity are sufficient to recognise the inherent risks of error and fraud in a social security system that is prioritising access.

**Colin Beattie:** If the DWP is seeing levels of error and fraud with more stringent requirements, will relaxing the requirements lead to higher levels of error and fraud?

**Caroline Gardner:** As Mark Taylor said, error and fraud is inherent in a social security system and any system has to balance people’s ability to access the money that they are entitled to with protecting public money.

The problem with the DWP’s estimate for the carers allowance, which is where we started this report, is that it is now 20 years out of date. That is why we concluded that we cannot rely on that in relation to the rules for Scottish benefits. The social security agency needs to rapidly develop its

own approach to managing error and fraud and make sure that it has estimates that we can use in our audit work to come to a conclusion about regularity and the overall financial statements of the agency.

**Colin Beattie:** To clarify, are you saying that the DWP’s estimates of error and fraud are based on 20-year-old data?

**Caroline Gardner:** For the carers allowance, yes.

**Colin Beattie:** Still on the question of security, your report indicates that the agency has not yet developed clear guidance on the meaning of “ordinarily resident”, which seems fairly basic. It is a core criterion for benefits. Is the agency making progress on that? It is fairly important.

**Caroline Gardner:** It is central to the determination of people’s entitlement. Gemma Diamond can expand on that.

**Gemma Diamond (Audit Scotland):** Throughout the audit process, we had a range of conversations with the agency about residency. The main assumption that the agency uses for somebody being resident in Scotland is that they have a Scottish postcode. That is a sensible assumption to make. Particularly for the best start grant pregnancy and baby payments, it is important for the people who are applying and also those people within Social Security Scotland who are making those decisions to be clear about what entitlement means. There should be more guidance about what “ordinarily resident” means, rather than just an assumption being made about a postcode.

**Colin Beattie:** What progress is the agency making? What methods is it using to determine residency?

**Gemma Diamond:** We made that recommendation in our 2018/19 annual audit report on Social Security Scotland. The agency has committed to taking that forward.

**Colin Beattie:** What is the timescale?

**Gemma Diamond:** Let me just check in our annual audit plan.

**Colin Beattie:** If it is such a critical criterion to have, I would hope that the agency would be doing it fairly quickly.

**The Convener:** Ms Diamond, would you like to come back to us on that point?

**Gemma Diamond:** Yes. Sorry, I am struggling to find that. Thank you.

**Liam Kerr:** Gemma Diamond said that the criterion for being “ordinarily resident” is your postcode. Just to clarify, does that mean that by

having a postcode in Scotland, I am “ordinarily resident” for the purposes of claiming certain benefits? Is that right?

**Gemma Diamond:** Yes, your postcode is the main way of assessing residency at the moment.

**Liam Kerr:** Sticking with the issue of error and fraud, you note in your section 22 report at paragraph 39:

“The agency does not yet have an approach to estimating error and fraud levels for the benefits it delivers”

or for those benefits that it will be delivering over the next few years. Do you have any sense of when that approach might be developed and, perhaps more crucially, will the agency have such an approach in place by the time that other benefits come on board, such as the Scottish child payment?

**Gemma Diamond:** As we set out in the report, in its first seven months, the agency has been putting the building blocks in place for its error and fraud team and it has plans for growth within that team. It has set out a number of strategies to date and it has started looking at its investigations code of practice, for example. It is looking at how best it can estimate error and fraud levels within the expenditure limit, and also how that relates to the existing error and fraud within the DWP system in the case of some of the qualifying benefits that people will be on. It will be developing its approach over the next year and we will be monitoring that throughout the audit process.

**Liam Kerr:** Just to pin that down, do you expect that approach to be crystallised over the next year?

**Gemma Diamond:** We would certainly expect the agency to be further forward with that approach over the next year, yes.

**Liam Kerr:** Further forward? Gemma, come on. When will this be done? As Colin Beattie quite rightly points out, it is pretty crucial that we have an approach to error and fraud. When will the agency get this done, do you think?

**Gemma Diamond:** We have not had a firm date from the agency on that. We will be monitoring the progress that it makes against that over the year.

**The Convener:** That is something that we can pursue, perhaps.

**Anas Sarwar:** I have a couple of questions. One is about late payments of the carers allowance supplement. Your 2018/19 annual audit report on Social Security Scotland states that the most recent scan from the DWP in April 2019 showed that in both April 2018 and October 2018, there were people who should have received a payment but did not. Do we know the extent of late payments?

**Caroline Gardner:** I do not think that we can give you that information. You may want to follow that up with the agency.

**Anas Sarwar:** But it is significant enough to be noted as a concern in the annual audit report.

**Gemma Diamond:** We know that all payments were made. Each month, it scans back to make sure that anybody who missed a payment receives one in the next payment month, so we have assurance that all payments were processed.

**Anas Sarwar:** Great, that might be something that we can take away separately.

As you can probably guess, my other question is about the workforce. The report also states that there are 17 full-time equivalent officers in the error and fraud team and the plan is to ramp that up to 47 FTE officers by the end of March 2020 and to go up to 190 FTE staff when we have a fully functional agency. What skills and expertise will be required to fill those posts? Is that train in motion and is it realistic to expect that we will recruit those numbers and find those individuals?

**Caroline Gardner:** We are always talking about a snapshot at a point in time, but Gemma Diamond or Kirsty Ridd can give you a sense of the progress that the agency has made since 31 March.

**Gemma Diamond:** There are highly skilled people in post at the moment, who have a background in error and fraud and are qualified to do that work.

I cannot give you an exact figure in relation to where the agency is at the moment. That would be something to check with the agency, but we will be monitoring progress throughout the year and working out what any shortfall means if the agency cannot get the skills and capacity that it requires. Certainly it has not had the same issues in getting people into the agency as the Scottish Government programme for implementing the powers has had.

**Anas Sarwar:** I have one last question. You mentioned that the people in post have a background in error and fraud. Have those people been taken from the DWP and moved over to the new agency? Is the agency looking at people who perhaps work in the banking sector in error and fraud and recruiting from there? Has there been a direct approach of trying to get people from college and university courses and so on skilled and trained up and into the agency?

**Gemma Diamond:** I do not have all the details on that. We know that people from a wide range of backgrounds are coming into the agency. There are people coming in from the DWP and other UK departments and from the retail sector. The agency is recruiting from a wide range of

backgrounds, but I do not have the details on the error and fraud team.

**The Convener:** Again, that is something that we can raise with the agency.

**Bill Bowman:** The second of your key messages is about error and fraud. Given our earlier discussion, can you tell us something about the audit committee? Who is on it, and how are they doing? It is their first year, so are they really getting in and about things?

**Mark Taylor:** In our overall assessment of the audit committee this year, we reported that it has provided a good level of scrutiny. There are four members of the audit committee—their names are in SSS's accounts. They come from diverse backgrounds: professional audit, the civil service and the third sector, bringing the client perspective. We have reported that they have provided a good level of scrutiny in the first year.

**Bill Bowman:** Could you give us an example of what they have done to keep the organisation on its toes?

**Mark Taylor:** We are content that some of the big issues that feature in the section 22 report and in our wider reporting have been very much the stuff of conversations in their meetings. For example, error and fraud have featured in discussion at the audit committee.

**Bill Bowman:** To go back to an earlier question from Alex Neil, do you know who appoints them?

10:30

**Mark Taylor:** It is the same appointments process that is followed with all public appointments. To pick up on the detail, the process is managed by Social Security Scotland, which identifies the sort of people that it is looking for at that level, but it uses the wider appointments process to access those people.

**Bill Bowman:** I do not have the financial statement in front of me. Are they on the same remuneration bands as the—

**Mark Taylor:** Yes. There is a standard remuneration package for non-executives across Government that uses the same bands. I also do not have the figures in front of me, but their remuneration would be very similar—it would be in the £5,000 to £10,000 range for the basic stipend of a non-executive.

**Willie Coffey:** Auditor General, I refer you to paragraphs 31 and 32 in your report, which deal with the system design for component parts in the software delivery. From memory, the cost of the social security transformation programme is about £300 million, and the information technology component is about £200 million—it is a

substantial amount of the entire transformation cost. At our last meeting on the subject, I think that we were told that all the IT systems were on track. There is a reference in your report to the agency identifying

“some operational weaknesses in its core case management system which raised the risk of error and fraud”,

and some manual processes have been adopted in the meantime. Could you give us a flavour of what is going on and whether there are any further concerns, other than what you have said?

**Caroline Gardner:** I will ask Gemma Diamond to give you a bit more detail. I will preface it by saying that we do not want to say too much in a public setting about the weaknesses that have been identified. Gemma Diamond can give you a sense of where that fits into IT development.

**Gemma Diamond:** Those weaknesses were picked up by management and additional manual controls have been put in place to mitigate them. This has been rehearsed with the committee in previous meetings, but we know that the system design is being built incrementally and is prioritising safe and secure delivery. That means that decisions about priorities are based on what makes a deliverable product.

In our section 23 report earlier in the year, we recognised that the agency needs to have more prominence in the decisions about what should be a priority in the initial system design. What we are seeing is an example of that, in that greater priority needs to be given to some of the operational controls within the system for the initial service design. Those design fixes mean going back into the system so that the system will be improved for those areas, and manual controls will be put in place until it is improved. However, with greater agency involvement in some of those decisions, we hope that some of the operational weaknesses will be fixed in the initial service design.

**Willie Coffey:** I know that you cannot go into too much detail on the subject, but I would like to know whether the software that is being developed is robust enough to manage potential situations. Is there any indication that the weaknesses are being fixed soon, or will there always be a manual element to such spot checking? Are we completely relying on the software to pick up potential problems, or will there always be a manual process that sits on top?

**Gemma Diamond:** Some of the weaknesses were around areas such as audit trails and system alerts for duplicate payments. The manual controls can mitigate an element of that, but obviously a system control is more efficient and effective. It would be appropriate to ask the agency where it is now with fixing the weaknesses in the system.

That is certainly something that we will pick up through the audit process over the next year and into the system design for future benefits.

**Willie Coffey:** Are you keeping track of the software development components that are to be delivered for the entire project? Who is keeping track of the pace of that work for us—and for you?

**Gemma Diamond:** We look at that issue throughout the year. There was a section 23 report earlier this year, and we are following that up in future performance audit work.

**The Convener:** I would like to ask about the financial plan. The Auditor General said that the agency has no long-term financial plan in place. Given how much money it will be spending, that is quite worrying. Can you say a bit more about that, please?

**Caroline Gardner:** I will ask Mark Taylor to pick that up. It is covered in more detail in the annual audit report, so Mark can you give more of a flavour of that.

**Mark Taylor:** We recognise that the agency is a new body, and planning for finances and the workforce is one of the fundamental challenges facing it as it grows through time. There is a clear read-across from that to the previous discussions that we have had with the committee about where Government is, in the round, on the way in which planning works and the approach that has been taken to incremental planning. We have been clear in our view that there is a need for more transparency around the overall cost and the detail around some of those plans. That then translates into that challenge for the agency.

We have reported locally to the agency, which, as it understands what is in store for it and engages in that process, recognises that there is a need for it to build that into its own plans. There is absolutely a need for improved planning and improved insight as to when resources are required, when recruitment needs to happen and when the agency needs to put things in place. It is really about recognising the interplay between what the agency can do and what Government can do, but in the round there is a need to improve in that area.

**The Convener:** Given the extent of Social Security Scotland's spending, when would you expect it, as a new agency, to have that long-term financial plan in place?

**Mark Taylor:** As we enter next year's audit, we will be looking to see development around that. If there is no plan that we can point to, we will be raising that as a concern in the next annual audit.

**The Convener:** So during your audit next year, you will look for the plan to be in development. When do you expect it to be complete?

**Mark Taylor:** We would highlight it as a concern if it was not completed in the next year.

**The Convener:** So, a year from now—thank you.

We know that there has been a bit of restructuring in the leadership team. I think that the chief executive has brought in three new senior people to support him. For a long time, the committee has been concerned about, and has discussed, leadership and leadership teams. Are you confident that this leadership restructure is the right thing to do and that the team has sufficient skills to get the right people in place?

**Mark Taylor:** We understand what the agency is trying to do, which is to skill up as it grows. We understand the need for that. I do not think that we are in a position to provide a view on the competency of the leadership. Through our audit, we identify concerns and how well the organisation is being run, and we capture that across the range of our reporting. We have no specific concerns about that at the moment. Looking ahead, the picture is increasingly challenging and we will keep a close eye on how the agency is performing in relation to those challenges.

**The Convener:** Do members have any further questions or comments on the report?

**Colin Beattie:** Following on from my earlier comments, I have a question about the DWP estimates for error and fraud. Paragraph 22 looks at error and fraud levels in the best start grant qualifying benefits, which range from 3.9 to 8.6 per cent—I presume that it depends on which benefit you are talking about. The carers allowance is 5.5 per cent. The figures seem awfully high as a percentage of an awful lot of money.

**Caroline Gardner:** They are relatively high. As we have said a couple of times, there is an inherent risk of both error and fraud in a system that pays out sums of money to individuals. That risk increases with the scale of the benefit—the amount of money involved—the complexity of the determination of whether someone is eligible or not and how frequently the payments are made. People's circumstances may change between payments that are made monthly, whereas a one-off payment is less prone to that. The agency needs to understand such factors for itself in relation to the Scottish benefits and to make sure that it matches whatever decisions it takes about benefits, how they are delivered and how eligibility is assessed with the checks and balances that it needs to have in place to make sure that while people get what they are entitled to, public money is also protected. That is why this matters.

**Colin Beattie:** The estimates are based on 20-year-old data.

**Caroline Gardner:** For carers allowance only.

**Colin Beattie:** Okay—for carers allowance only. However, 5.5 per cent is millions of pounds as far as Scotland is concerned. I am surprised that the figure is so high. I would have thought that it would have been a fraction of one per cent.

**Caroline Gardner:** I am not sure that, at this stage, there is very much that we can add to what you have said. As you said earlier, the DWP's accounts have been qualified for 30 years. None of us wants Social Security Scotland to be in that position. More important, we want public money to be protected and people to get what they are entitled to. That is why the approach to fraud and error is so important at this point in the system's development.

**The Convener:** Thank you all very much indeed for your evidence. I now close the public part of the meeting.

10:40

*Meeting continued in private until 11:19.*



This is the final edition of the *Official Report* of this meeting. It is part of the Scottish Parliament *Official Report* archive and has been sent for legal deposit.

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