Part 3 - First Key Message

- The new financial powers require a more strategic approach to Scottish public financial management and reporting. This includes an overarching, medium-term financial strategy underpinned by clear policies and principles for managing the financial powers. The Scottish Government is developing its approach to financial management within the fiscal framework. This has included longer-term analysis and assessment to support decision making. Once final agreement is reached with HMT on borrowing rules, ~~I~~it now needs to finalise policies and principles for borrowing and reserves, and further develop its longer-term financial scenario planning. Making such policies and scenarios ~~plans~~ publicly available will enhance financial transparency. Transparency of budget information and medium-term financial planning are key issues that the Budget Process Review Group are considering with a final report due in Summer.

Paragraphs 81 to 84 - "A longer-term approach supports decision-making and financial sustainability"

81. As noted above global standards for public financial management highlight the importance of longer-term approaches. In the UK, the Chartered Institute of Public Finance and Accountancy (CIPFA) has highlighted the importance of long-term or strategic planning to aid decision making, and in providing a framework upon which budgets should be produced. A longer-term approach to finances provides a context for current decisions and, along with a clear set of financial strategies and principles, creates an overall framework for financial decision-making and sustainability.

82. The Scottish Government acknowledges the benefits of taking a longer-term view and has been developing its capabilities, including staff resource, and processes to reflect the fiscal framework. It undertakes longer-term analysis and assessment to support financial decision making. This has included, for example, modelling scenarios to assess the potential impact on tax raising and spending projections. It has not yet finalised an overarching approach for managing Scotland's public finances which reflects its new financial powers.

83. ["Exhibit 7 (page 34) sets out the main components … paragraph unchanged]

84. The new financial powers add more dimensions to scenario planning and modelling involving a wider-range of variables and assumptions. Publishing medium and longer-term models, projections and plans as they are more fully developed will provide the Parliament, public sector bodies and the wider public with the information they need to have a fuller understanding of the overall financial position.

Paragraph 87 - "Fiscal policies and principles support public financial management and longer-term sustainability"

85. The Scottish Government has applied such an approach for its infrastructure and investment programme since 2011. To provide assurance that its capital financing commitments on future revenue budgets are affordable and sustainable it set a limit to ensure that its payments for Private Finance Initiatives (PFI), non-profit distributing (NPD) schemes and borrowing do not exceed five per cent of its resource budget. This principle was re-examined for the 2017/18 draft budget reflecting on the additional borrowing powers. The Scottish Government will keep this approach under review.

Borrowing and reserves

The Scotland Act 2016 and accompanying fiscal framework increased the Scottish Government's capital and revenue borrowing powers to help it manage the increased risk and volatility its budget is now exposed to. The Scottish Government to date has not borrowed any money. But it has estimated it will need £30 million in 2017/18 to start repaying what it plans to borrow in 2016/17 (see table).

The Scotland Act 2016 also changed the rules in relation to reserves. The Scotland Reserve replaces both the Scotland Act 2012 cash reserve and the Budget Exchange Mechanism.

	Annual limit *	Overall limit *	Planned 2016/17 Annual limit	Planned 2017/18 Annual limit
Capital borrowing	15% of overall borrowing limit	£3 billion	£333 million ** £333 million	£450 million ** £450 million
Revenue borrowing	£600 million	£1.75 billion	TBD ** £500 million	TBD** £600 million
Scotland Reserve	£350 million	£700 million	TBD** £125 million	TBD** £350 million

* The Scotland Act 2016 increases the annual limits. For capital borrowing it increases from 10% of its capital budget in the Scotland Act 2012 to 15% of its borrowing limit in the Scotland Act 2016 from 2017/18 onwards.
** All decisions on borrowing and use of reserves will be taken over the course of the year as circumstances change and develop

Paragraphs 91 to 93 – "The Scottish Government has not finalised policies and principles for managing its borrowing and reserve powers"

91. The Scottish Government is refining its longer-term analysis (paragraph 82) and is developing high level principles for capital and revenue borrowing covering key aspects such as affordability, sustainability and transparency. It is considering whether the principles should include other caps or limits. Once agreement is reached with HM Treasury, ~~T~~the Scottish Government needs to finalise these as a matter of urgency to support the management of its finances within the fiscal framework and to inform the preparation of the 2018/19 draft budget.

92. Making the principles and related information publicly available represents an important contribution to financial transparency. This will facilitate the Parliament's and taxpayer's understanding of public financial management and the parameters with which the Scottish Government operates by, for example, setting out:

- under what conditions the Scottish Government will use capital and revenue borrowing

- how the Scottish Government will demonstrate decisions are affordable and sustainable
- what processes the Scottish Government will put in place to assess and respond to forecasting errors or a Scotland-specific economic shock
- how the Scottish Government will report borrowing and use of its reserve against the limits set in the fiscal framework
- any additional limits or targets, other than those in the fiscal framework, the Scottish Government puts in place to ensure there is scope to deal with unexpected economic events.

93. Reserves involve setting aside money for future financial periods, in anticipation of future spending or to smooth the effects of peaks and troughs in tax revenues or unanticipated spending. The Scottish Government has initially decided that it will manage the Scotland Reserve throughout the budget cycle as events arise and to support Scottish Government priorities. As indicated in paragraph 86, the details of how the Scotland Reserve will be applied and operate in practice have yet to be finalised. It will be important to establish clear policies, principles or parameters for the management of reserves within the fiscal framework limits to underpin future financial decision making.

Paragraphs 111 to 115 – "The Scottish Government is committed to further developing financial reporting"

111. Continuing work is ~~needed~~ in progress to build a comprehensive picture of Scotland's public finances. As the Auditor General for Scotland has previously reported, this includes a more rounded account of the Scottish Government's overall performance. It needs to be clearer what spending is aiming to achieve and how this contributes to the Scottish Government's overall purpose and specific outputs and outcomes.

112. The Scottish Government is further developing its financial reporting in the context of the new powers, addressing commitments it has previously made. A short guide to public finances and annual Scottish Administration outturn information were both published in December 2016. The short guide covered 2016/17 spending plans and key facts about the Scottish Administration budget, with helpful infographics. The outturn statement provided high level information on actual spend across the Scottish Administration in 2015/16. ~~The two publications did not~~Further work to consolidate ~~include~~ balance sheet information, a snapshot of what is owed and owned, which is important for understanding the overall financial position, is now in progress.

113. The Scottish Government also intends to publish a 'tailored-for-Scotland' 2016/17 consolidated account to show a more aggregated picture of the Scottish public finances. The scope, format and content of the accounts are currently under consideration, with a commitment to agree this by April 2017. The Scottish Government should demonstrate

publicly the progress it is making toward introducing these accounts even where all the required information is not immediately available. This may include, for example, trial runs involving groups of public sector bodies and individual key elements of public finances that will in time be reflected in consolidated public accounts.

114. As part of its ongoing work to further enhance financial reporting, the Scottish Government continues to review its annual accounts to identify opportunities for improvements. In its 2015/16 accounts it explained how the Scottish budget as a whole is funded and made links with other relevant accounts. There is scope for more detailed and consistent explanations for differences between budgets and outturns. This would assist understanding of key developments such as the impact of in-year changes and other factors that affect the budget, and the Scottish Government's response. It would also facilitate understanding and scrutiny in key areas of spending, including in education and health.

115. In summary, the Scottish Government continues to develop its financial reporting making a number of welcome improvements and providing evidence of its commitment to enhanced financial transparency. Delivering on this is critical to develop understanding, build confidence and support effective scrutiny at this time of unprecedented change to Scotland's public finances.

Part 3: Public financial management and reporting

Key messages

- **The new financial powers require a more strategic approach to Scottish public financial management and reporting. This includes an overarching, medium-term financial strategy underpinned by clear policies and principles for managing the financial powers. The Scottish Government is further developing its approach to financial management within the fiscal framework. It now needs to finalise policies and principles for borrowing and reserves, and develop longer-term financial plans. Making these publicly available will enhance financial transparency.**
- **The Scottish budget is becoming increasingly complex, with substantial changes to key components including the block grant from the UK Government. The budget will be more reliant on forecasting than ever before and more adjustments likely to be needed throughout the budget cycle. The Budget Process Review Group is reviewing current arrangements and is assessing what is needed to support Parliamentary scrutiny in the future.**
- **Clear reporting on all parts of the budget cycle is important; from the budget itself to reporting on outturn and performance. The Scottish Government is increasing the availability of financial information to provide a more transparent and comprehensive picture of Scotland's public finances. More work is required to meet the information needs of the Scottish Parliament and the public as the new financial powers come into force. This will enable the Parliament and wider public to fully understand and scrutinise the Scottish Government's decisions.**

The new financial powers require a step-change in public financial management and reporting

1. Public financial management involves maintaining a sustainable fiscal position, and effectively raising revenues and allocating resources to ensure the efficient delivery of public goods and services.[1] It covers all parts of the budget cycle from planning and preparation to reporting on outturn, performance and the achievement of outcomes. The Scottish Government has a central role in managing Scotland's public finances and operates as a devolved administration within a wider UK context. In doing so, it has to manage its finances within the agreed fiscal framework.

[1] *Public Financial Management and its Emerging Architecture*, International Monetary Fund, April 2013

2. The Scottish Government and the Scottish public sector more generally have a good record of financial management and reporting. [2] The new tax raising and spending powers represent a significant shift in emphasis for the Scottish Government. As a result public financial management and reporting is fundamentally changing. From a position which mainly involved managing expenditure within budgets, the Scottish Government now manages increasingly complex budgets alongside more volatile revenues from taxes.

3. The new financial powers provide opportunities for different approaches to managing public finances. This includes more choices on raising revenues and spending, and the balance between these elements. The performance of the Scottish economy relative to the rest of the UK will have a direct bearing on Scotland's public finances. This exposes Scotland's public finances to increased risk of volatility and uncertainty compared to the position before the new powers came into effect. In particular, tax revenues and social security spending may be more or less than forecast and this will have to be managed within the budget cycle and the fiscal framework (paragraph 3).

4. Effective management of public finances will increasingly rely on robust economic and financial forecasting and modelling. Forecasts need to be based on unbiased and reliable data, using sound methodologies. But they are by their nature uncertain. There will always be forecasting errors - in time, forecasts will prove to be pessimistic or optimistic - and errors will differ in scale and size. What is important is that the Scottish Government identifies and manages the variations through its budget proposals and by applying its new borrowing and reserve powers over the medium to long-term as it considers necessary.

5. The change from a spending budget to a tax-raising and spending budget is significant and requires a close understanding of the underlying factors that affect each element and how they interact. It also requires enhanced reporting. The International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD) highlight the importance of medium and longer term plans and frameworks to provide an overview of long-term policy objectives, projected revenues and spending, economic forecasts and assumptions, and how all these are aligned. They also highlight the importance of comprehensive, reliable and timely reporting on past, present and the longer-term state of public finances for effective financial management and accountability. [3] [4]

6. The Scottish Parliament requires good quality information to enable effective scrutiny of the Scottish Government's budget proposals. More generally, the Scottish Parliament and tax payers need good financial information, to understand and assess the health of Scotland's public finances and the Scottish Government's progress in achieving its priorities and desired outcomes.

7. Engaging with public bodies and tax payers can help with making informed decisions about public finances and prioritisation of resources. An important part of this process will be

[2] *Update on developing financial reporting*, Audit Scotland, March 2015

[3] *Fiscal Transparency Code*, International Monetary Fund, 2014

[4] *Best Practices for Budget Transparency*, OECD, 2002

outlining multi-year financial plans which will also help public bodies take a longer term view and consider financial sustainability.

8. This part of the report considers the impact of the new financial powers on public financial management and reporting and assesses the Scottish Government's progress in these key areas.

The Scottish Government is further developing its approach to financial management

A longer-term approach supports decision-making and financial sustainability

9. As noted above global standards for public financial management highlight the importance of longer-term approaches. In the UK, the Chartered Institute of Public Finance and Accountancy (CIPFA) has highlighted the importance of long-term or strategic planning to aid decision making, and in providing a framework upon which budgets should be produced. [5] A longer-term approach to finances provides a context for current decisions and, along with a clear set of financial strategies and principles, creates an overall framework for financial decision-making and sustainability. The Scottish Government acknowledges the benefits of taking a longer-term view but has not yet finalised an overarching approach for managing Scotland's public finances which reflects its new financial powers.

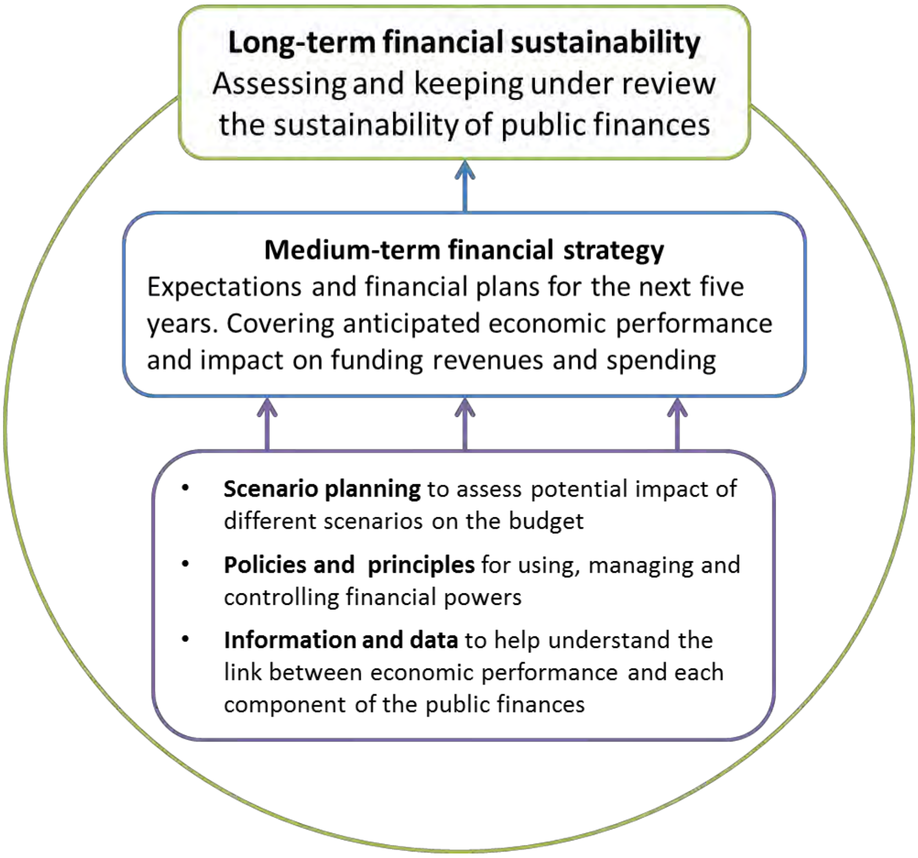
10. Exhibit 7 (page 34) sets out the main components of strategic financial management. A key element is a medium-term financial strategy setting out the expectations and broad financial plans for the next five years. This should be underpinned by clear policies and principles for using, managing and controlling the available financial powers. Scenario planning based on economic forecasts and financial information will be increasingly important in assessing the range of potential impacts on the Scottish budget and will in turn aid financial planning, management and decision-making.

11. The new financial powers add more dimensions to scenario planning and modelling involving a wider-range of variables and assumptions. The Scottish Government is refining its processes and continues to provide information to support Ministerial decision-making. Publishing medium and longer-term models and plans once developed will provide the Parliament, public sector bodies and the wider public with the information they need to have a fuller understanding of the overall financial position.

[5] *Looking forward: Medium-term financial strategies in the UK public sector*, CIPFA, October 2016

Exhibit 7

Key components of strategic financial management



Source: Audit Scotland

12. The Scottish Government will need to assess and keep under review the long-term sustainability of the Scotland's public finances, drawing on these key aspects. This includes considering the longer-term implications of policy decisions and how these sit alongside existing commitments and anticipated changes in the economy, revenues and spending.

Fiscal policies and principles support public financial management and longer-term sustainability

13. The fiscal framework sets out agreed rules and limits within which the Scottish Government will manage its finances and the related economic and funding risks. They include rules for block grant adjustments, annual and overall limits for borrowing and the Scotland Reserve. The Scottish Government and HM Treasury are finalising details of how borrowing and the Scotland Reserve will be applied in practice.

14. More detailed, well reasoned fiscal principles support day-to-day financial management and decision-making as well as the response to specific events. For example, in addition to those prescribed in the fiscal framework, the Scottish Government could set out high-level targets or limits for key measures. This might include limits for the level, type and timing of borrowing. It could also include principles for the operation of the Scotland Reserve and how

it will be maintained to support planned spending over time and in the event of forecasting errors, or unexpected economic or fiscal events.

15. The Scottish Government has applied such an approach for its infrastructure and investment programme since 2011. To provide assurance that its future capital commitments are affordable and sustainable it sets a limit to ensure that its payments for Private Finance Initiatives (PFI), non-profit distributing (NPD) schemes and borrowing do not exceed five per cent of its resource budget. The Scottish Government is re-examining this principle in the context of the new financial powers.

Borrowing and reserves

The Scotland Act 2016 and accompanying fiscal framework increased the Scottish Government's capital and revenue borrowing to help it manage the increased risk and volatility its budget is now exposed to. The Scottish Government to date has not borrowed any money. But it has estimated it will need £30 million in 2017/18 to start repaying what it plans to borrow in 2016/17 (see table).

The Scotland Act 2016 also changed the rules in relation to reserves. The Scotland Reserve replaces both the Scotland Act 2012 cash reserve and the Budget Exchange Mechanism.

	Annual limit *	Overall limit *	Planned 2016/17 / Annual limit	Planned 2017/18 / Annual limit
Capital borrowing	15% of overall borrowing limit	£3 billion	£316 million / £316 million	£450 million / £450 million
Revenue borrowing	£600 million	£1.75 billion	0 / £600 million	0 / £600 million
Scotland Reserve	£350 million	£700 million	0 / £350 million	0 / £350 million

* The Scotland Act 2016 increases the annual limits. For capital borrowing it increases from 10% of its capital budget in the Scotland Act 2012 to 15% of its borrowing limit in the Scotland Act 2016 from 2017/18.

The Scottish Government has not finalised policies and principles for managing its borrowing and reserve powers

16. Borrowing can be used for capital purposes (to create assets such as schools, hospitals, roads and bridges) and for revenue purposes (to deal with unexpected shortfalls in revenues from taxation). Creating assets can help boost the economy by providing jobs which in turn can increase the money raised from taxation. All borrowing decisions have consequences for future budgets as repayments have to be made. This reduces the amount of money available for priorities in future budgets.

17. The fiscal framework sets an annual limit for capital borrowing of 15 per cent of the overall limit of £3 billion. The framework also allows the Scottish Government to borrow up to £600 million each year for revenue purposes within an overall limit of £1.75 billion for:

- in-year cash management
- forecasting errors in relation to taxes and demand-led social security spending that affect the block grant adjustment
- a Scotland-specific 'economic shock'. [6]

18. In December 2015 we recommended that the Scottish Government progress its strategy for capital borrowing, setting out details of decision-making processes and procedures for borrowing.[7] Since then CIPFA and the Fraser of Allander Institute have also called for a clear borrowing strategy setting out how the Scottish Government will use its powers and what it will use them for.[8]

19. The Scottish Government is developing high level principles for capital and revenue borrowing covering key aspects such as affordability, sustainability and transparency. It is considering whether the principles should include other caps or limits. The Scottish Government needs to finalise these as a matter of urgency to support the management of its finances within the fiscal framework and so they are available to inform the preparation of the 2018/19 draft budget.

20. Making the principles and related information publicly available represents an important contribution to financial transparency. This will facilitate the Parliament's and wider public's understanding of public financial management and the parameters with which the Scottish Government operates by, for example, setting out:

- under what conditions the Scottish Government will use capital and revenue borrowing
- how the Scottish Government will demonstrate decisions are affordable and sustainable
- what processes the Scottish Government will put in place to assess and respond to forecasting errors or a Scotland-specific economic shock
- how the Scottish Government will report borrowing and use of its reserve against the limits set in the fiscal framework
- any additional limits or targets, other than those in the fiscal framework, the Scottish Government puts in place to ensure there is scope to deal with unexpected economic events.

21. Reserves involve setting aside money for future financial periods, in anticipation of future spending or to smooth the effects of peaks and troughs in tax revenues or unanticipated spending. As indicated in paragraph 86, the details of how the Scotland Reserve will be

[6] The fiscal framework defines a Scotland specific shock as being "*triggered when onshore Scottish GDP growth in real terms is or is forecast to be below 1% on a rolling 4 quarter basis and at least 1 percentage point below actual or forecast UK GDP growth in real terms over the same period.*"

[7] *Implementing the Scotland Act 2012: An update*, Audit Scotland, December 2015

[8] *Scotland's Budget 2016*, Fraser of Allander Institute, September 2016

applied and operate in practice have yet to be finalised. Beyond the limits set in the fiscal framework, no principles have been developed to support decisions about the operation of the Scotland Reserve.The Scottish budget is more complex than ever before

22. The Scottish budget is becoming increasingly complex, with more components such as revenues from taxes and new expenditure such as social security payments. While the block grant from the UK Government remains a key component, the Scottish Government will have more options available to it - including its approach to taxation, borrowing and use of reserves - in bringing forward budget proposals, and as it implements and manages the budget.

23. The complexity and the inter-relationships between elements of the budget is illustrated by considering the block grant and Scottish tax receipts. The block grant is the funding that the Scottish Government receives from the UK Government every year.

24. The fiscal framework states that the Barnett formula will continue to be used to calculate the overall block grant.[9] It is based on the previous year's grant plus or minus any changes, or 'consequentials' calculated using this formula. As each of the new financial powers is implemented a further adjustment needs to be made to the block grant, known as a block grant adjustment (BGA). Exhibit 8 summarises, in general terms, how funding for the Scottish Government's budget is now calculated.

Exhibit 8

How the funding for the Scottish budget is determined

Source: Audit Scotland

25. BGAs represent tax revenues foregone, or spending power no longer available to the UK Government. The fiscal framework sets out how the initial baseline adjustment will be made in each case for the year the tax or benefit is devolved. For taxes, it will be based on forecast Scottish tax revenue in the year prior to devolution. For all social security spending, except for cold weather payments, it will be based on forecast equivalent spending in Scotland.

26. As the initial BGAs will be based on forecasts an adjustment may be needed if the actual revenues collected or spending is less than forecast. In some cases actual revenues will not be known until nearly two years after the initial BGA was made. As an example, Exhibit 9

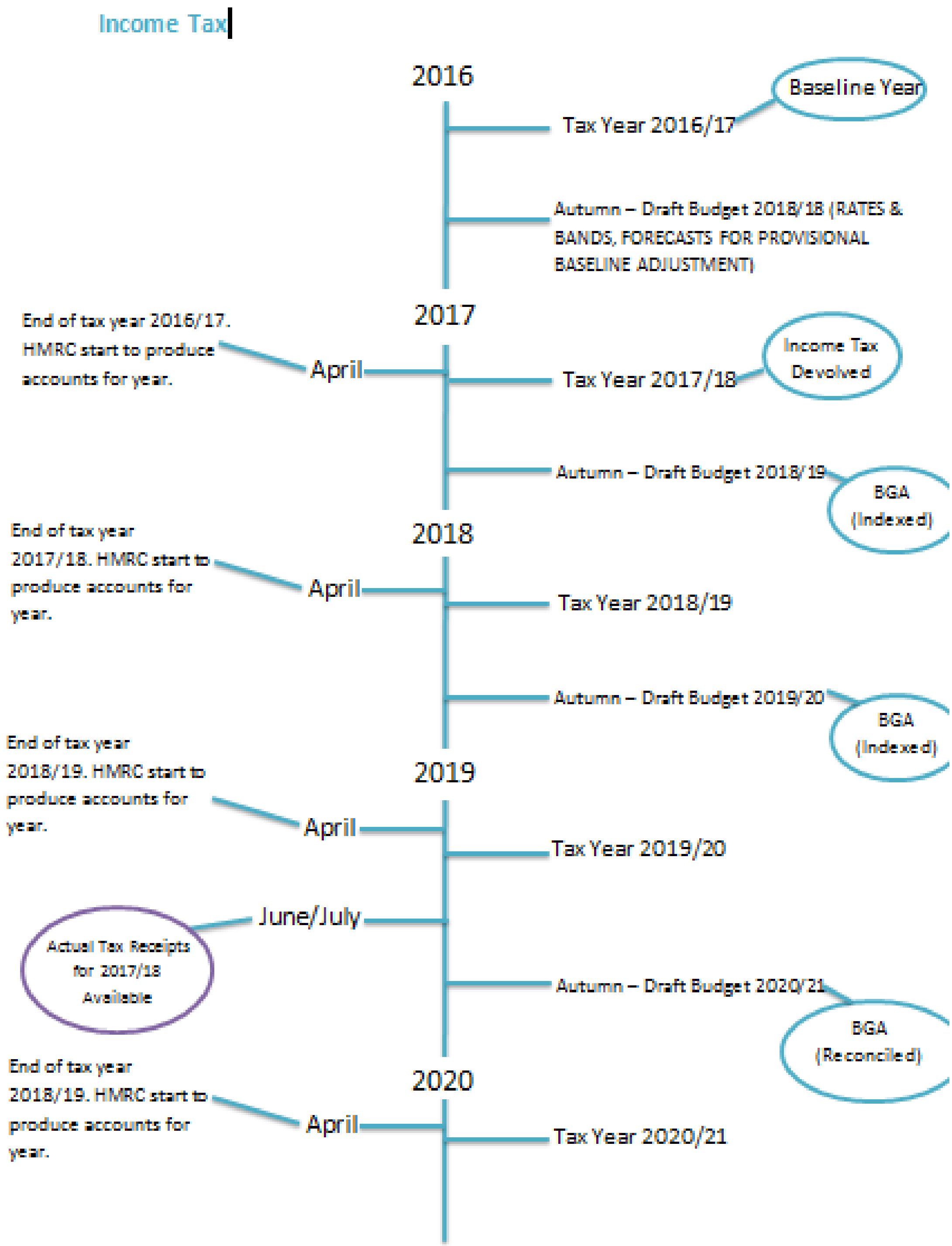
[9] The Barnett formula is a mechanism used by HM Treasury to automatically adjust the amounts of public expenditure allocated to the devolved administrations of Northern Ireland, Scotland and Wales to reflect changes in spending levels allocated to public services in the UK.

(page 39) summarises how the process will work for Non-Savings Non-Dividend (NSND) income tax.

27. All this adds to the complexity of the budget process with a number of adjustments and reconciliations going on in any one year as actual receipts and spending are reconciled to the BGAs. For example, if actual revenues are less than forecast, the BGA in the following year will be adjusted accordingly. The Scottish Government would then have to decide whether to use revenue borrowing, or the Scotland Reserve to cover any shortfall or to adjust spending plans.

Exhibit 9

Block grant adjustment process for non-savings non-dividend income tax



Source: Audit Scotland

The Scottish Parliament's budget process is under review

28. In view of the far-reaching changes to public finances flowing from the new financial powers, it was widely recognised that the budget process would need reviewed. In September 2016, the Scottish Parliament's Finance and Constitution Committee announced a fundamental review of the budget process, taking into account the devolution of further powers. It set up the Budget Process Review Group (BPRG) consisting of Scottish Parliament and Scottish Government officials and external experts, including the Auditor General for Scotland.

29. The BPRG is considering the budget timeline as well as what type of reports and information would be most effective for scrutiny. The BPRG is also considering the impact on the Scottish budget process of changes to the timing of UK Government budget statements. The group is expected to report its findings to Ministers and the Finance and Constitution Committee later this year.

The Scottish Government is providing more financial information and is committed to enhanced financial transparency

30. The Scottish Parliament approves the Scottish Government's proposed spending plans and tax rates before the start of each financial year. Effective Parliamentary scrutiny is critical to ensure that budget proposals are thoroughly tested and independently reviewed. This improves decision-making and contributes to public trust in government.

31. The Scottish Parliament's role in scrutinising the Scottish Government's policies, budgets and performance has never been more important. To fulfil its role, the Parliament requires reliable and timely information about the Scottish Government’s objectives, plans and progress. This includes comprehensive information about how it intends to use the money available to it, how it was spent and what was achieved as a result.

32. The Scottish Government's draft budgets have included a separate chapter on devolved taxes since 2015/16. The draft budget for 2016/17 also included information on the Scottish Rate of Income Tax (SRIT). The actual devolved tax receipts for 2015/16 were reported in the Devolved Taxes Account published by Revenue Scotland for the first time in September 2016. Scottish income tax receipts will be disclosed in Her Majesty's Revenue and Custom's accounts from 2016/17 onwards.

Clear and comprehensive reporting on all parts of the fiscal framework is needed

33. It will be critical for the Scottish Government to provide clear information on how all parts of the fiscal framework operate in practice including the basis of its decisions on key aspects of public financial management and a clear overall picture of Scotland's public finances. This will help to determine how sustainable Scotland's public finances are. This includes reporting clearly on:

- how anticipated spending is funded from anticipated revenues

- movements in the Scottish block grant arising from the application of the Barnett formula, baseline adjustments and indexation for each element of the block grant
- revenue and spending forecasts, and reconciling these to actual amounts when they are known
- actual spending against budget and the reasons for variations
- the impact of any capital and revenue borrowing, and movements and balances in the Scotland Reserve
- what has been achieved from public spending
- other commitments, guarantees or potential liabilities that may impact on future budgets.

34. The Scottish Government reports this information in a variety of documents including budget documents, audited annual accounts, and economic and performance reports. It is important this information is presented in such a way that is easy to understand and navigate. This provides a basis for ongoing engagement with the tax payers and helps the Parliament to build a comprehensive picture of Scotland's public finances. This allows the potential consequences of policy choices and decisions on long-term financial sustainability to be better understood.

The Scottish Government provided additional information to support the 2017/18 draft budget

35. The Scottish Government set out its commitment to enhancing transparency and to clearly explain how public finances work in its Open Government Partnership National Action Plan in December 2016. [10] It published additional financial, economic and performance information alongside the publication of its 2017/18 draft budget. This included:

- a short guide to Scotland's public finances explaining how the budget is funded, what money is spent on, the fiscal framework and the timeline for new tax and spending powers [11]
- a report explaining the methodologies and assumptions relating to the devolved tax forecasts underpinning the draft budget. This included details of actual tax revenues to date and a medium-term assessment of devolved tax revenues and forecasts over a five year period to 2021/22 [12]
- an update setting out how the Scottish Government is performing against national outcomes and performance indicators. [13]

36. In addition, the taxation chapter within the draft budget document was expanded to include an explanation of the new tax powers and fiscal framework. Information on tax forecasts, block grant adjustments and borrowing were also included.

[10] *Open Government Partnership Scottish Action Plan,* Scottish Government, December 2016
[11] *Scotland's Finances: Key Facts and Figures*, Scottish Government, December 2016
[12] *Scottish Budget - Draft Budget 2017-18 Devolved Taxes Methodology Report,* Scottish Government, December 2016
[13] *Scotland Performs Update*, Scottish Government, December 2016

37. Overall, the 2017/18 draft budget contains most of the information listed at paragraph 106, although there is scope to enhance the amount of detail and to make the explanations easier to understand. As the budget becomes increasingly complex it will be important for the Scottish Government to further develop this document. For example, it needs to clearly explain and link the different sections of the budget so it is more transparent and understandable. For example:

- While the total Departmental Expenditure Limit (DEL) funding and total DEL spending plans are clearly set out, there are some adjustments that are not fully explained and any carry forwards from the previous year are not separately identified. [14] This makes it difficult to understand how the total funding covers spending plans.
- An annex to the budget states that the full amount of capital borrowing will be used for investment in infrastructure and how capital repayments have been modelled. It does not show the effect of the proposed borrowing against the overall limit of £3 billion in the fiscal framework.
- There is no commentary on the use of reserves other than an explanation of the rules as set out in the fiscal framework

38. While the draft budget provided tax revenue forecasts for the next five years and total funding for the next three years, there is not yet a medium-term financial plan (Exhibit 7, page 33) which would provide a longer-term context for the annual budget. No commentary or explanations are provided beyond 2017/18.

The Scottish Government is committed to further develop financial reporting

39. More work is needed to build a comprehensive picture of Scotland's public finances. As the Auditor General for Scotland has previously reported, this includes a more rounded account of the Scottish Government's overall performance.[15] It needs to be clearer what spending is aiming to achieve and how this contributes to the Scottish Government's overall purpose and specific outputs and outcomes.

40. The Scottish Government is continuing to review and further develop its financial reporting in the context of the new powers. In addition to the short guide to public finances (paragraph 108) and annual Scottish Administration outturn information, both of which were published in December 2016, other commitments include a 'tailored-for-Scotland' 2016/17 consolidated account. [16] [17] This is provided that non-departmental bodies and local authorities commit to data sharing for this purpose and that their accounts are fully compliant with International Financial Reporting Standards. The scope, format and content of the accounts is to be

[14] Departmental Expenditure Limit is the element of the Scottish budget that covers programme expenditure and running costs.

[15] *The 2015/16 audit of the Scottish Government Consolidated Accounts*, Audit Scotland, September 2016

[16] The Scottish Administration is the Scottish Government its executive agencies, Crown Office and Procurator Fiscal Service, NHS territorial and special boards, and Statutory Office Holders

[17] *Scottish Government written response to the Scottish Parliament Public Audit and Post Legislative Committee,* 22 November 2016

agreed by April 2017.The short guide to Scotland's finances covered 2016/17 spending plans and key facts about the Scottish Administration at a budget level, with helpful infographics. The outturn statement provided high level information on actual spend across the Scottish Administration in 2015/16. The two publications did not include balance sheet information, a snapshot of what is owed and owned, which is important for understanding the overall financial position.

41. The scope, format and content of the 'tailored for Scotland' aggregated accounts is currently under consideration. The Scottish Government should demonstrate progress in developing these accounts, even where all the required information is not yet available. This may include, for example, trial runs involving groups of public sector bodies and individual key elements of public finances that will in time be reflected in consolidated public accounts.

42. As part of its ongoing work to further enhance financial reporting, the Scottish Government continues to review its annual accounts to identify opportunities for improvements. It is increasingly important to clearly explain how the Scottish budget is funded and continue to make links to other accounts, for example, the Devolved Taxes Account prepared and published by Revenue Scotland. There is also scope for more detailed and consistent explanations for differences between budgets and outturns. This would assist understanding of key developments such as the impact of in-year changes and other factors that affect the budget, and the Scottish Government's response. It would also facilitate understanding and scrutiny in key areas of spending, including in education and health.

43. In summary, the Scottish Government continues to develop its financial reporting; providing a timeline for how and when it intends to do this provides further evidence of its commitment to enhanced financial transparency. It now needs to deliver on its commitments, in the knowledge that at a time of unprecedented changes to Scotland's public finances transparent reporting develops understanding, builds confidence and supports scrutiny.

Appendix

Audit methodology

We reviewed a range of information during our audit, including the following:

- Papers and official reports of the Scottish Parliament Finance and Constitution Committee and Social Security Committee
- The Scottish and UK Government's fourth annual reports on progress in implementing the Scotland Act 2012
- The Fiscal Framework and accompanying technical annex
- OECD Principles for Independent Fiscal Institutions
- Scottish Government Draft Budget 2017/18
- Papers and minutes from the Scottish Government Audit and Assurance Committee
- Papers and minutes from the Fiscal Framework Implementation Programme Board and programme management documentation
- Programme management documents of the Scottish Government's Social Security Programme and the Scottish Fiscal Commission Transition Programme
- Minutes of the Joint Ministerial Working Group on Welfare
- Papers and minutes from the Revenue Scotland Board and Audit and Risk Committee
- Revenue Scotland Annual Audit Report and devolved taxes and resource accounts 2015/16

We spoke to representatives from:

- Scottish Government
- Revenue Scotland
- Scottish Fiscal Commission

We considered the National Audit Office's planning and approach to its audit work on the Scottish rate of income tax.

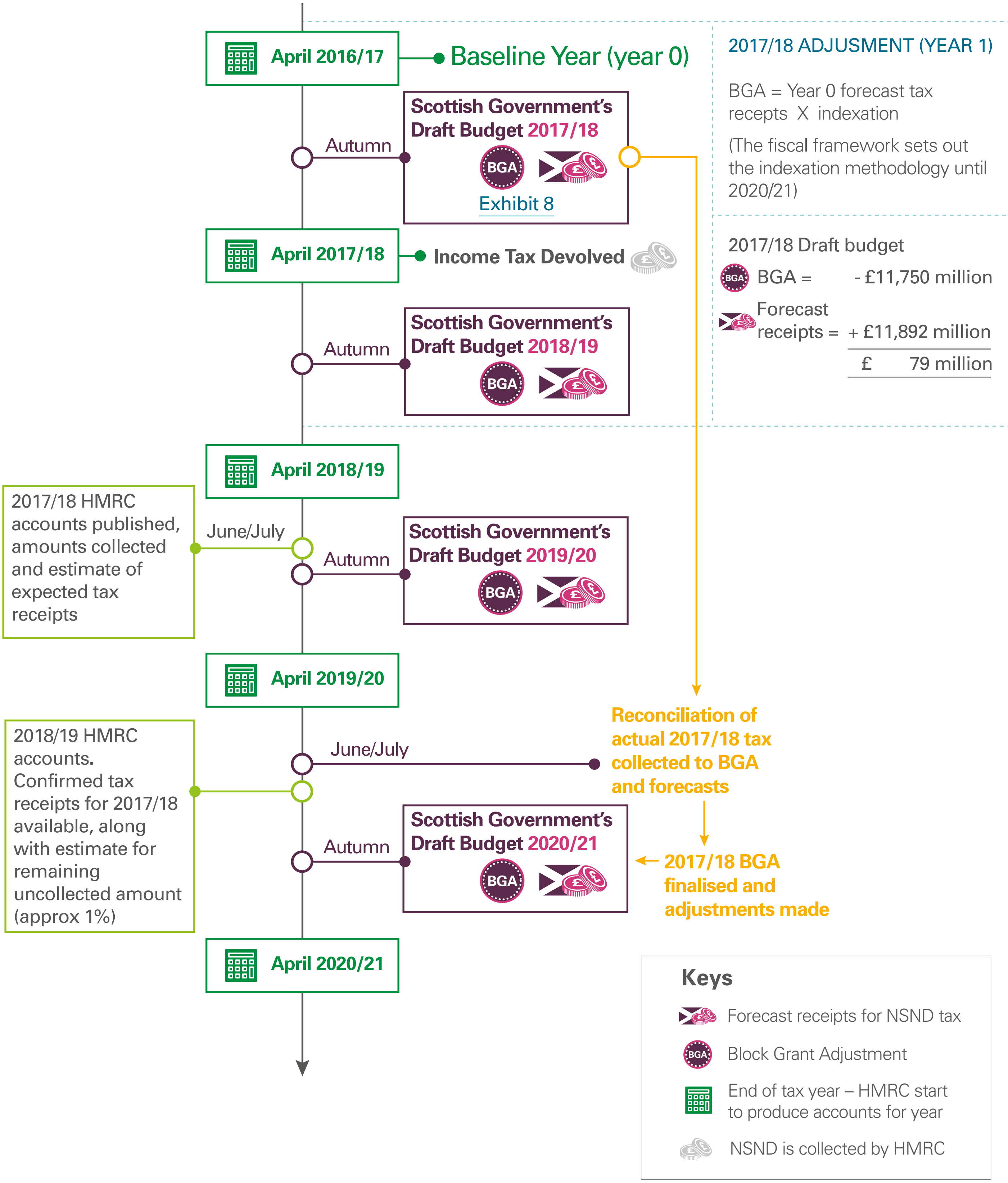
We reviewed the NAO's documentation and the basis for its findings and conclusions. In particular, we considered:

- the NAO's approach to identifying the key risks to successfully implementing of the SRIT
- the NAO's audit working files, with particular focus on the audit evidence underpinning the key findings and conclusions in its report
- the NAO's arrangements for ensuring the quality of the audit work and reporting.

Exhibit 8
How the funding for the Scottish budget is determined

Source: Audit Scotland

Exhibit 9
Block grant adjustment process for non-savings non-dividend income tax for 2017/18



Source: Audit Scotland

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20 February 2017

Dear Caroline

Thank you for your letter of 31 January 2017 enclosing the clearance draft of your report *Managing new financial powers: an update*. Colleagues met on 9 February and had a helpful discussion.

You sought confirmation that we were satisfied with the factual accuracy of the report. We undertook to provide some written comments and have set these out in the Annex to this letter. We would be happy to consider a revised draft reflecting our feedback should you think this would be helpful. I also go on below to make some more general points with regards to the report.

The Budget Review Group established by the Finance and Constitution Committee is an important process that has yet to conclude; in view of the Parliament's important role in the scrutiny of budgets. It is our view that Audit Scotland should avoid any appearance of seeking to pre-empt that important process; some of the text in Part 3 of the report, however, appears to do that.

Regarding resource borrowing and the Scotland Reserve, we are currently working with HM Treasury to agree a shared understanding of the practical arrangements. Most recently, officials spoke on 17 February to further progress our discussions and considerations. Whilst we have no immediate plans to use the new resource borrowing powers which commence on 1 April, the SG will need to have the flexibility to choose to use these where devolved tax receipts fall below forecast and the funding available to support spending plans would fall short were it not for access to resource borrowing.

In that situation, officials would provide advice to Ministers on the available options for borrowing and their impact. These options can be mixed, depending on Ministers' priorities and the overall financial position and outlook at the time. Factors to take into account would include the balance in the Reserve; the scale of the shortfall; whether the shortfall is one-off or likely to be recurring; the amount of outstanding resource borrowing, if any; the economic outlook; the relative ease or difficulty with which spending reductions could be effected in-year; and the outlook for funding in future years (is the profile rising, which would point to borrowing being a sensible solution; or it falling, in which case reducing spending would be considered).

The Infrastructure Investment Plan (IIP) published in December 2015 set out the Scottish Government's capital investment priorities over the current Spending Review period and beyond, focusing on delivering sustainable economic growth, the transition to a lower carbon economy, high quality public services and supporting employment. Following the recession and cuts to the capital budget, the Scottish Government has sought to maximise infrastructure investment through a variety of funding methods, including capital borrowing. The ambition set out in the IIP, coupled with historically low interest rates and current challenges in the economy, mean that there is a strong rationale for borrowing to support infrastructure investment.

Despite increases in conventional capital budgets announced in the Autumn Statements in 2015 and 2016, our Capital DEL budget in 2020-21 will still be 8% lower in real terms than it was in 2010-11. Maintaining overall levels of investment and supporting jobs is a key objective and the Government's intention to utilise its full borrowing powers to maximise capital investment was clearly set out in the IIP and in the 2016-17 and 2017-18 Draft Budgets.

We are currently planning to use borrowing in 2017-18 to support our overall capital programme rather than individual projects. This is a common approach for governments to take. The repayment arrangements remain consistent with the Scotland Act 2012 and will be finalised in a revised Memorandum of Understanding between the Scottish Government and UK Government following the implementation of the Scotland Act 2016. Under the current arrangements, the term of any loan would normally be for 10 years but could be increased, should the borrowing be attributed to a specific asset, and repaid over the time of the asset. Consideration will be given to aligning borrowing to specific projects and repaying over the life of the asset but at this stage it is prudent to consider the impact and affordability of the shorter term repayment term. The projected costs of repaying planned borrowing are affordable within the 5% cap we apply to long-term investment commitments.

As Audit Scotland will be aware, the 2016-17 capital borrowing facility was utilised for the notional capital costs of certain NPD infrastructure projects, following the ONS classification decision on the Aberdeen Western Peripheral Route. No cash drawdown was required.

I am aware that members of AS met with SG officials on 16 February to be shown some of our long term financial planning and borrowing analysis, which supported advice to Ministers and decisions on the Draft Budget. I hope your colleagues found this informative and useful background to the activity being undertaken within the SG.

The text in relation to the Scottish Fiscal Commission and Revenue Scotland relates to operational matters which the Scottish Government cannot comment on. I note from your letter that you were clearing relevant sections with these bodies and I presume they have commented on any issues of factual accuracy.

I am grateful for your indication of your intended publication date for the report and should this change I would be grateful if you could let me know.

Yours sincerely

Gordon Wales

OFFICIAL - SENSITIVE

Suggested Comment and Changes to Draft Report

General Comments - It would be very useful if the report could be much more clear that social security powers are now being considered alongside the financial powers – and so is fundamentally different from the previous reports. In the summary of recommendations the report refer to 'the powers', 'financial powers' and 'social security powers' but thereafter, references to 'financial powers' seems to include the 'social security' powers and its therefore not clear which is meant. As a result there is no 'increase' in costs to the previously known financial powers. These costs are in fact reducing (as shown in Exhibit 2). It is the establishment of new social security powers that is ***introducing*** some significant new costs.

Some of the territory that AS cover in this report (e.g. the material around the medium term financial planning) is currently part of the focus of the Scottish Parliament's Budget Process Review Group which will wish to make its own recommendations and consideration as part of their report likely to be published in May.

Specific Comments and tracked changes to text

Page 9, Exhibit 1 - Responsibility for 11 social security ~~powers~~ benefit ranging from Disability Living Allowance to W~~w~~inter F~~f~~uel P~~p~~ayments, and the power to top up reserved benefits and create new ones.

Page 9, Exhibit 1 – Suggest that colours need to much more clearly show the Social Security figure to be a spend figure or even have a negative value. Scottish Landfill Tax shows an estimate of £147m for 15/16 from GERS and reports an actual of £147m; both are actuals. Also, we are not clear why the table includes GERS 15/16 estimates for SRIT and further income tax as more up to date / relevant forecasts are available, could this be reflected in the Notes column? Agreed revenue from SRIT is to be £4.9bn, not £4.3bn.

Page 11, Exhibit 2 - We are not clear what the 2015/16 £6.4m LBTT and SLfT tax costs cover, if it included RS running costs then it isn't consistent to show the £16.1m and £12m budgets against this item as RS now has its own separate budget line which isn't included in Exhibit 2.

Page 13, Para 18 - Alongside the cost of implementing and administering the new powers, the Scottish Government will need to consider the impact of specific policies on its budget. For example, ministers need to know how much a decision to increase carers allowance ~~or child benefit~~ by a certain amount would cost overall, so long-term budget implications can be fully understood. The Scottish Government is modelling the costs of ~~some~~ all social security powers, to help inform policy decisions.

Comment [u1]: Child benefit is not being devolved

Page 13, paras 20 – 23 – tracked changes below

> **20.** The Scottish Government also needs to deliver its current business and respond to the potential impact of the UK leaving the EU. At end March 2016 the core Scottish Government had 5,152 directly employed FTE staff ~~In~~

~~2015/16, the core Scottish Government employed 7,047 people.~~ a reduction of ~~This number has decreased by~~ six per cent ~~per cent from a peak of 7,566 staff in 2010.~~ from end March 2010 (5,491 FTE). Successfully implementing and managing the new powers will require enough staff with the right knowledge and skills. Recruiting staff with the technical experience required, for example in finance and programme management, may prove difficult. The Scottish Government recognises that it needs to adapt to meet the demands and challenges it faces, including making best use of existing money and people.

21. The Scottish Government has an ongoing change programme ~~concluded a year-long wide-ranging organisational review in October 2016.~~ Ccalled SG2020. It aims to change the way the Scottish Government works to ensure it can continue to deliver ministerial priorities and take on additional responsibilities within limited resources. SG2020's 'matching resources to priorities' workstream aims to create a more flexible and responsive workforce by reallocating people and money to new or increased priority areas. ~~Its six priority areas are:~~ In particular, decisions are ensuring that necessary resources are available to support work as a result of new powers - including tax, social security and employability - manage the implications of the EU referendum and expand support to build inclusive economic growth.

- ~~New powers in the Scotland Act 2016~~
- ~~Tax~~
- ~~Social security~~
- ~~Employability~~
- ~~Economy~~
- ~~EU implications~~

22. The Scottish Government is making organisation-wide changes to support the movement of people and funding to meet these priorities. It has revised its promotion policy, developed policies and systems to support more flexible deployment ~~working~~, and is assessing opportunities for redeploying and retraining staff.

23. Individual Directorates ~~departments~~ and programmes are also identifying the staff and skills they need to implement and manage the financial powers in the Scotland Acts. In doing this, it is important that the Scottish Government considers both the staff needed to set-up the new powers and those needed to manage them in the longer-term. The finance team is reviewing its role, structure and functions, to allow it to deliver additional responsibilities resulting from the new financial powers through to 2020. Additional budget has been allocated to develop the size and skills of the finance team.

Page 14, Para 27 – The terms of reference for the Social Security Programme Board were agreed at the meeting in January 2017

Page 15, Para 28- "For example, the ~~chair~~ SRO of the Social Security Programme Board is a member of the Fiscal Framework Implementation Board, and updates that board on the social security programme."

Page 16, Para 30 - The Joint Ministerial Working Group on Welfare was established in February 2015. It met twice in 2016 to agree how the two governments will work together to manage the transfer of social security powers and to discuss progress to date.

Page 16, para 31, 2nd last sentence - the name of the HMRC Programme Board that oversees SRIT, is HMRC's Scottish Devolution Programme Board, may be useful to add that title.

Page 17, Exhibit 4- The diagram shows the following sharing of information on social security:

- Scottish Government to DWP
- DWP to Scottish Government
- DWP to Scottish Fiscal Commission

It should also include information sharing on social security from Scottish Government to SFC.

Page 22 - Shared and assigned taxes box- Is linked to 2nd bullet point at Exhibit 1 Page 9 above, quotes £4.3 billion as the SRIT estimate, but this is the GERS estimate for 2015/16 the year before the SRIT powers were available, £4.9 is the OBR SRIT forecast for 16/17 the first year the SA2012 powers were available.

Page 24, para 56: General point is right but it will be Scottish income tax rates and thresholds that might differ in the future. Current plans are to have a different higher rate threshold in Scotland in 2017/18. The Scottish Rate of Income Tax is relevant in 2016/17 only i.e. has been superseded by the SA2016 powers. The report includes a number of references to SRIT when it should now be "SRIT and/or Scottish income tax".

Page 27, Para 65- "It published the findings of the consultation in February 2017 [*to confirm*]" We can confirm this will be correct.

Page 27, Para 66- Implementing these changes may involve using DWP systems in the interim, and the Scottish Government will need to ~~reimburse~~ agree with DWP ~~for~~ the costs of those changes which it ~~th~~is prepared to bear.

Page 28, Para 71 - The Scottish Government ~~intends to~~should share its approach to delivering the social security system with the Scottish Parliament in due course. ~~Sharing its approach~~Doing so will help support Parliamentary scrutiny and provide members of the public with more certainty about when they may be likely to see changes that affect them.

Part 3 Key Messages - Presume that these will be looked at in the light of the discussion and further audit work. Bullet 3 – the first sentence here reads as if the SG doesn't currently report on all parts of the budget cycle and that is clearly not the case. Perhaps the wording might be adjusted to make the point that there is still more to do here.

Step-change in financial management and reporting and longer-term approach
Para 74 - The statement that the new powers require a step change may itself be factual, but any inference that the Scottish Government has not recognised this is misleading – especially in view of the changes that have already made and the reporting in Draft Budget 2017-18 which reflects commitments previously made (as the report on the SG accounts acknowledged).

Para 75 - Similarly the commentary here. It would also be helpful to acknowledge the context of the SG within the UK public expenditure framework.

Para 76 – the language used here is capable of misinterpretation:
It seems odd to state that forecasts are by their nature uncertain, then refer to variations as "errors"; While it is accurate to state that forecasting will play a more significant role; effective <u>management</u> is not about the accuracy or otherwise of the forecasts but about identifying and responding to variations. The Scotland Reserve, which replaces the Budget Exchange mechanism, will operate within the parameters set by the Fiscal Framework to support multi-year financial management.

Para 77 (and para **79**) – these do not recognise the role of the Programme for Government in setting out the Scottish Government's Plan for the new parliament. Audit Scotland should also be aware that the preparation of the PfG also formed an important part of 'The One Project' - a strong example of SG2020 in action working across directorates, to streamline and align the delivery of the budget process, Programme for Government and Matching Resources to Priorities.

Paragraph 79 – the final sentence could be better worded, maybe just separating the two statements into different sentences would be enough;

Paras 79, 80 and Exhibit 7 – as above, it would be helpful to place this model in context.

Paras 80 and **81** - A reader could reasonably infer that there is no current consideration of forecasts etc. and the longer term consequences of policy decisions, which is not the case. Advice to Ministers reflects such work.

Page 33, Diagram Typo - the overall limit on revenue borrowing is stated as £1.75 <u>million</u>, it should be £1.75 <u>billion</u>.

Fiscal Policies and Principles
Para 82 and **83**– it is important to recognise that there are points of detail on the interpretation and application of the Fiscal Framework which are not settled, and which would therefore impact on what is suggested here. SG Finance are working with HMT to resolve these asap.

Para 84 – while the 5% cap originated in respect of the Infrastructure Investment programme, it is not simply an approach to capital investments; it is about the wider principles associated with financial sustainability that para 83 is talking about, looking at the consequences of the liabilities (specifically including borrowing) associated with the funding of infrastructure, and setting this as a sustainable proportion of the resource budget. The Draft Budget has clear statements on this.

The SG has not fully developed policies and principles
Para 85 – the heading is one of negative judgement, yet what the table highlights is that the new financial powers are at a very early stage. This, along with the point above about some aspects still to be bottomed out, could helpfully be recognised.

Para 87 reserves – the presentation is of "setting aside", which may be an element, but is not the substantial part of how reserves may accumulate. The Fiscal Framework effectively determines "strategy", at least in part, by setting out how reserves may arise and be deployed. The Scotland Reserve only comes into operation from 1 April 2017, and it will be for Ministers to make specific choices about the use of such funds in the future, within the FF rules, and in the context of financial management and budget-setting.

Paras 88 and **89** - As discussed, the Draft Budget sets out Ministers' clear intentions (with the transparency of that borrowing and its repayment to which Ministers had previously committed) and is also transparent in relation to the 5% cap.

Para 89 – we discussed. As drafted this implies that there has been no thinking or preparation in these areas, which is not accurate.

- In relation to the first bullet, it is not accurate to suggest that these are simply a matter of SG decision; the Fiscal Framework conditions must apply. It is also relevant here that there are elements of detail yet to settled with HMT, in particular in relation to resource borrowing (detail and reference in the Draft Budget document - http://www.gov.scot/Publications/2016/12/6610/4
- The Draft Budget intentions for capital borrowing sit within the Fiscal Framework arrangements and are consistent with Ministers' policy on infrastructure investment in the current economic climate, as set out in the Infrastructure Investment Plan, with the sustainability aspect captured in the explanation of the 5% cap.
- The SG financial management processes have adapted progressively to accommodate the new financial powers; this will include identifying variations from forecast and providing related advice to Ministers; similarly the assessment of and response to, a Scotland-specific economic shock.
- The 4th bullet could be read as indicating that there has been borrowing that has not been reported; commitments have, however, been made that there will be transparent reporting on these matters.

The Scottish Budget is more complex
Paras 90 to 96 – this is factual commentary; as drafted, however, the effect may be to suggest that the Scottish Government is not prepared or is not being transparent about this (e.g. the Draft Budget deals with the block grant adjustment in detail). There is nothing here to reflect the audit work of the programmes in place within the SG to manage the transition.

Paragraph 90 – I wondered whether the final sentence could also benefit from a reference to the SG's ability to set its own distinctive approach to taxation - as that too is one of the options in addition to the block grant for raising revenues to underpin spending decisions. This is acknowledged in the previous sentence, but I think it has a place here too;

Para 93 – current wording is unclear that a Year 0 approach is being taken to the baseline adjustments for tax and social security; it would be helpful if this could be clarified by adding a reference along the lines of "for the year the tax/benefit is devolved"

Para 94 – reference should be to Non-Savings Non-Dividend income tax; text has other way round but acronym as NSND

Page 36 Exhibit 9 - doesn't include the forecast of income tax receipts done by SG for 2017/18 and to be done by SFC in future.

Paragraph 97 – The first sentence should be adjusted to read, "In view of the far-reaching changes to public finances flowing from the new powers, it was widely recognised that the Scottish Parliament's budget ~~review~~ scrutiny process would need reviewed"

Financial Transparency
Page 40 – In referencing some of the positive developments that the SG is progressing on financial reporting/transparency, Audit Scotland could also reference the SG's recent publication of our "Open Government Partnership - Scottish National Action Plan" (http://www.gov.scot/Resource/0051/00511323.pdf), which contains a specific commitment on Financial Transparency, to "*clearly explain how public finances works and provide an accessible presentation of public financial flows into and out of the Scottish Government, including to local authorities, commercial and third sector organisations; and develop, with partners, ways to provide financial, procurement and commercial information that is coherent, consistent and in a format that is useful and easy to understand for communities, the 3rd sector and citizens - this will include consideration of how national budget information could complement participatory budgeting at local and national levels*."

Para 102 and **103** seem confused, with some elements of 103 predating 102; an implication that action was taken only in response to a recommendation is inaccurate; the plan to report on Devolved Taxes in a separate account was developed as part of Scotland Act 2012 implementation and the financial year 2015/16 was the first year of operation to be reported.

Paras 104 – if the intention is that paras 107-110 "report against" what is outlined in 104 to 106, this is not clear and omits as a result to acknowledge the commitments that have been made to report transparently, where reporting takes place other than in the Draft Budget (e.g. the Infrastructure Investment Plan; annual accounts) and where circumstances have simply not yet arisen

Para 107 – the draft does not presently provide links to where these publications can be found? The outputs listed seem to fit with the criteria set out earlier but there is no commentary other than in respect of the Draft Budget.

Para 109 – in relation to the specific point about capital borrowing, is there perhaps a misunderstanding here? Any borrowing will support the investment programme as a whole. *Check with Joe -* Repayments have been estimated on the basis of the Fiscal Framework borrowing arrangements and, given that this would be the first year, the impact is straightforward. Although the Scotland Reserve comes into effect on 1 April 2017, the balance on the reserve at that point will only be finalised retrospectively when the HM Treasury reporting process is complete; the 2017-18 Budget sets out spending plans, and does not make statements about the Reserve because the plans do not assume excess taxes to be put in the Reserve, nor anticipate underspends or overspends. Any variations will of course need to be managed, and as set out, the Scotland Reserve is the vehicle which provides a degree of flexibility across financial years going forward.

Broadening Financial Reporting

Para 112 and **113**– the short guide to Scotland's public finances mentioned at para 107 is an important element of the commitments made, so it would be helpful to link this here. What was produced in December went beyond the explanatory guide originally envisaged, and included the key facts and figures "snapshot" for the financial year (at the Scottish Budget level, to minimise any confusion). SG Finance has been progressing work on a journey to further consolidated accounts – it may be helpful to discuss how this is presented here, or simply to note that Audit Scotland are involved in this process as part of their annual accounts audit work?

Para 115 – does not acknowledge that this happened in the 2015-16 accounts.

Para 116 - we would welcome a discussion on what is intended here: the annual accounts are required to report the outturn compared to the Budget authorised by the Parliament; while more detailed reporting could be included, there could be a question over the value and purpose of focussing at a detailed level on variation from budgets, which are of course estimates of planned spend rather than targets and will necessarily have to flex according to demand and or in year financial management decisions.

Para 117 – the text is unclear, particularly as key dates have been given for elements. The final sentence refers to "the state of Scotland's public finances"; the Scottish Government can only manage and report on devolved matters.

Scottish Government

Borrowing Principles and Associated Arrangements

Working version: Nov 2016

Introduction

1. This document sets out the broad principles that the Scottish Government will follow in relation to capital and resource borrowing. It is based on the agreement reached with the UK Government on the operation of a Fiscal Framework[1] in February 2016 and the subsequent Scotland Act 2016, following the *Report of the Smith Commission for further devolution of powers to the Scottish Parliament* published in November 2014.

2. Decisions on capital borrowing are a feature of Scottish Government Spending Reviews, taking account of prevailing economic circumstances and the incumbent government's spending plans. Plans for the borrowing for a specific year are published annually as part of the Draft Budget process, together with a report on capital and resource borrowing undertaken to date.

Background

3. Limited borrowing powers to support current spending were first introduced by Scotland Act 1998 but management of the budget was such that those powers did not need to be utilised. Scotland Act 2012 significantly extended these powers from April 2015 allowing Scottish Ministers to borrow for the following purposes:

- For capital expenditure, up to £2.2 billion, subject to an annual limit of 10% of the annual capital budget (currently approximating to around £300 million p.a.); and,

- For meeting shortfalls in receipts from devolved taxes, up to £500 million, subject to an annual limit of £200 million

4. Ministers may borrow from the National Loans Fund[2], commercial banks or issue bonds to fund capital investment and from the National Loans fund only for resource borrowing.

5. Following the Smith Commission's recommendations and resulting Fiscal Framework, the increased financial risk required additional flexibility in these arrangements. Agreement was therefore reached to increase the Scotland Act 2012 limits. These arrangements apply from 1 April 2017.

Fiscal Framework Borrowing Arrangements

6. The Fiscal Framework responds to the Smith Commission's recommendations on borrowing powers for capital investment, on tools to manage risks of volatility in revenues and resource expenditure, and to ensure budgetary stability in the event of an economic shock, by putting in place the following arrangements.

- For the purposes of capital expenditure, a statutory limit of £3 billion has been put in place subject to an annual limit of 15% (therefore £450 million).

[1] http://www.gov.scot/Resource/0049/00494765.pdf
[2] http://www.dmo.gov.uk/index.aspx?page=PWLB/About_PWLB

Borrowing terms are normally 10 years, but can be shorter or longer depending on the lives of the assets being purchased. Repayment arrangements will be finalised in a revised Memorandum of Understanding between HM Treasury and the Scottish Government.

- For the purposes of managing volatility in revenues and in resource expenditure, a statutory limit of £1.75 billion has been put in place. This is subject to an annual limit of £500 million for in-year cash management purposes and £300 million for Scottish Government forecast errors on demand-led social security and/or receipts from devolved and assigned taxes and corresponding UK forecasts for the Block Grant Adjustment. The overall annual limit is set at £600 million within the statutory limit.

- The in-year limit for forecast shortfalls rises from £300 million to £600 million where there is forecast to be, or there is, a Scotland-specific economic shock[3]. This applies to the year in which the borrowing is triggered plus up to two subsequent financial years. Subject to agreement with HM Treasury, the Fiscal Framework also includes an escape clause to this limit when a higher level of cyclical borrowing is expected.

- The borrowing term is flexible within 3-5 years at the discretion of Scottish Ministers.

7. The remainder of this document sets out the principles that will be applied by the Scottish Government in determining whether borrowing should be undertaken, how much should be borrowed, the source of those funds and the timescales that might be applied. Due to the differences in the arrangements and associated triggers for capital and resource borrowing, each is dealt with separately.

Principles for Capital Borrowing

8. Capital borrowing will support the government's capital investment plans set out in the Infrastructure Investment Plan and wider Government Economic Strategy for supporting the development and growth in Scotland's economy. The following standing principles will be considered as part of each Spending Review and applied in each financial year as Ministers plan the Draft Budget:

- **Applicability** – Decisions to borrow will be taken by Ministers on a strategic basis, will be based on the overall capital infrastructure investment plan and/or for the purposes of economic stimulus and will be informed by the advice of the Director General Finance and his/her immediate deputies. This means that borrowing will only be undertaken as part of a carefully planned and executed programme of activity that supports Scotland's infrastructure needs and to deliver appropriate support for Scotland's economic needs. Borrowing periods are, where appropriate, matched to the needs of specific projects subject to agreement with HM Treasury.

[3] Triggered when onshore Scottish GDP is below 1% in absolute terms on a rolling 4 quarter basis, and 1 percentage point below UK GDP growth over the same period.

- **Affordability** – Since borrowing has a revenue cost implication and has to be serviced and repaid from tax receipts, borrowing will be subject to consideration of affordability in the context of its ability to be repaid. This will take into account projected future Resource DEL funding available from the Scottish Block Grant along with assigned and devolved tax receipts and the fixed payments associated with other forms of infrastructure investment (e.g. PPP/NPD projects) and other fixed contractual obligations. Borrowing will normally be at the lowest economic cost to the taxpayer, taking account of prevailing interest rate forecasts over the projected repayment period and method of raising finance. Borrowing from sources other than those offering lowest economic cost of borrowing would be considered where justified by reference to other criteria. **[REDACTED]**

- **Sustainability** – The overall capital borrowing limit is £3 billion, with the change in the limit each year being the net effect of new borrowing undertaken less repayments made, taking account of the annual limit on new net borrowing of £450 million. In the early years of use of the borrowing facility the rate at which borrowing is undertaken will exceed that which is repaid. Consequently, decisions to undertake new borrowing will not therefore be based solely on the maximum available in any given year but also by consideration of the funding profile required to satisfy the demands of Ministers' infrastructure investment plans over the medium to long-term.

- **Transparency** – Ministers publish their borrowing plans annually in the Draft Budget and report monthly to HM Treasury on their in-year plans. As part of the suite of financial reporting supporting the production of the Annual Report and Accounts, the Scottish Government will also set out how it has adhered to these principles and alongside publish detailed information on what has been borrowed in-year and the level of debt stock, including information on the sources of funds, aging, maturity, interest rate banding etc. This will support the government's overall transparency agenda and ensure that there is a full record of its level of indebtedness in the public domain.

Principles for Resource Borrowing

9. Resource borrowing arrangements operate to enable the Scottish Government to manage volatility in receipts and demand-led expenditure, most particularly devolved and assigned taxes and social security powers, all of which have been introduced through either Scotland Act 2012 or Scotland Act 2016. Scotland Act 2016 also introduces the Scotland Reserve, a new facility in which accumulated budget underspends and tax receipts above forecast can be held and deployment in future years, subject to specific limits.

10. The following standing principles will apply to all resource borrowing:

- **Certainty -** Decisions to borrow will be taken by Ministers on advice from the Director General Finance and his/her immediate deputies. This will be on the basis of overall income and expenditure forecasts and the associated tax and social security spending forecasts specifically produced by the Scottish Fiscal Commission. Borrowing decisions arising from an economic shock will be taken on the basis of official statistics[4] that clearly set out how the parameters to trigger borrowing have been met.

- **Prudence -** Borrowing will only be undertaken where it is necessary to do so and after other options have been considered, including reducing in-year current expenditure and drawing on the funds held in the Scotland Reserve. The level of borrowing undertaken will be the minimum amount necessary to ensure that the Scottish Government meets its most critical obligations and priorities..

- **Affordability** – Borrowing will be undertaken at the lowest economic cost to the taxpayer and repaid as quickly as is feasible to minimise servicing costs, subject to the maximum period of 5 years. This will ensure that decisions are taken in the best long-term interests of the Scottish economy and will avoid creating unnecessary financial burdens that may prove to be unaffordable in the medium to longer term.

- **Transparency -** As part of the suite of financial reporting supporting the production of the Annual Report and Accounts, the Scottish Government will set out how it has adhered to these principles and alongside publish detailed information on what has been borrowed in-year and the level of debt stock, including information on the sources of funds, aging, maturity, interest rate banding etc. This will support the government's overall transparency agenda and ensure that there is a full record of its level of indebtedness in the public domain. Scottish GDP statistics are already published on a quarterly basis and official forecasts will be produced by the Scottish Fiscal Commission. These will be used as the key determinant of whether an economic shock triggering access to relevant borrowing powers has been or will be experienced.

Sources of Borrowing

11. There are three sources of borrowing available to Ministers, all of which must be undertaken in Sterling:

- National Loans Fund (NLF), via HM Treasury - Draw-down arrangements and associated practices for this form of borrowing were agreed as part of Scotland Act 2012 and are consequently established in procedures. All resource borrowing must be undertaken through this route, with the repayment period ranging from 3-5 years. Capital borrowing may also be undertaken from the NLF where Ministers deem it appropriate, taking into account the borrowing principles set out earlier in this document.

- Commercial Loans – Ministers may borrow directly from commercial banks or other relevant financial institutions on directly agreed terms. Although these arrangements do not operate through HM Treasury, they are subject to the relevant annual and overall caps on borrowing set out earlier in this paper and

[4] The Scottish Fiscal Commission will be responsible for producing official Scottish GDP forecasts from April 2017.

would be notified through established reporting procedures. This form of borrowing applies only to capital expenditure

- Bonds – the Scotland Act 1998 (Variation of Borrowing Power) Order 2015, approved by the UK Parliament in March 2015, gave Scottish Ministers the power to borrow through the issue of bonds, extending the arrangements set out in Scotland Act 2012. Issuing bonds would require the issuing of a formal credit rating by one or more of the established credit ratings agencies, followed by an offering to the capital markets. Again, although these arrangements do not operate through HM Treasury, they are subject to the relevant annual and overall caps on borrowing set out earlier in this paper and would be notified through established reporting procedures. This form of borrowing applies only to capital expenditure.

Further Information and Technical Arrangements

12. Alongside the Fiscal Framework is published further detail on its operation and governance[5]. Amongst other matters, it sets out the key elements of the framework in relation to the trigger for resource borrowing and how the Scottish and UK Governments will ensure there is transparency on the overall budgeting and associated borrowing arrangements. In addition, it also sets out arrangements for Ministerial oversight through the Joint Exchequer Committee which will oversee the implementation of the Fiscal Framework and make arrangements for its review, which will be informed by an independent report with recommendations presented to both Governments by the end of 2021. It is intended that the borrowing principles contained within this documented will be reviewed alongside and, where necessary, amended in light of established practice and/or following any changes made to the Fiscal Framework.

Conclusion

13. The arrangements set out in this paper form the basis of the Scottish Government's intended approach to borrowing under the arrangements agreed through the Smith Commission and subsequent Fiscal Framework. They are established following the referendum on EU membership and the resulting economic uncertainty that might emerge and so have their foundations in a previous fiscal regime.

14. There may therefore be changes to these arrangements that are required before the formal review of the Fiscal Framework in 2021. Consequently, the Scottish Government will remain vigilant to the need to adapt and amend the principles as is necessary to suit the prevailing economic climate in Scotland and wider UK.

[5] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/508102/Fiscal_Framework_-_Text_-_Annex_to_the_fiscal_framework_-_15th_March_201....pdf

FOR INFORMATION **SGAAC(16)10**

SCOTTISH GOVERNMENT AUDIT AND RISK COMMITTEE

DG FINANCE QUARTERLY UPDATE

Introduction

1. [redacted – out of scope]

Financial Accounts and related reporting for the Year Ended 31 March 2016

2. [redacted – out of scope]

- "**Scotland's Finances**" key facts and figures, was published on 14 December and is available at http://www.gov.scot/Resource/0051/00511587.pdf . A review of this output will be conducted in due course - comments from SGAAC members on the presentation and information included would be welcome.

3. [redacted – out of scope]

External Reporting and Publications

[redacted – out of scope]

Financial Management 2016-17

[redacted – out of scope]

Infrastructure Investment

[redacted – out of scope]

Fiscal Framework Implementation Programme

4. The Fiscal Framework Implementation Programme is progressing well and work is on track for the transfer of new functions and powers from April 2017.

5. An initial Gateway 0 review was conducted early in July. The outcome of this was an Amber/Green rating. A follow-up review is being planned for February 2017.

6. Discussions with HM Treasury on operational aspects of the fiscal framework have taken place, and a programme of work has been agreed. Ministers met as the Joint Exchequer Committee in November and agree the Block Grant

Adjustment mechanism for the 2017-18 draft Budget, the initial transfer of administration and implementation costs and baseline transfers for functions being devolved in 2017. JEC(O) and JEC will meet in Spring 2017 to agree final details in advance of new functions and powers commencing.

7. Audit Scotland (AS) is conducting an audit of the Scottish Government's readiness to take on the new financial powers and functions. Finance, Welfare and other SG officials have been meeting with Audit Scotland as part of this review. The report is likely to be published in Spring 2017 and AS have undertaken to share their findings with us, on a factual basis, in advance.

- **Land and Building Transactions Tax (LBTT)**

8. The Finance and Constitution Committee published a report of their inquiry into the first year of LBTT on 5 December 2016. Whilst the Committee's focus was on 2015/16, the report also sets out recommendations on the operation of the Additional Dwelling Supplement (ADS) introduced on 1 April 2016.

9. The report, which we consider to be comprehensive, fair and reasonable, suggests that various further work needs to be done in areas related to forecasting, behavioural impacts, presentation and publication of data and analysis of LBTT's market impact. It also invites the Scottish Government to provide an update on its view on grace periods for the ADS and to confirm a timescale for review of the Supplement. We will consider the recommendations and a response to the report will be issued in due course.

- **Air Passenger Duty**

10. In March, the Scottish Government published a policy consultation on proposals for a replacement for Air Passenger Duty (APD). The consultation closed on 3 June 2016 with over 150 responses received from organisations and members of the public. A consultation analysis report and the responses received to the consultation were published on 29 July 2016. Policy development for a Scottish APD is supported by a stakeholder forum, chaired by the Cabinet Secretary for Finance and the Constitution. The next meeting will take place on 12 January 2017.

11. Subject to the agreement of the Minister for Parliamentary Business, a Bill to legislate for a replacement tax was introduced to the Scottish Parliament on 19 December and published on 20 December. The new tax is due to come into effect from 1 April 2018. Revenue Scotland's business case for the collection and management of the new tax has now been approved and they are progressing with the plan for implementation.

- **Scottish Rate of Income Tax and Scottish Income**

12. The Scottish rate of income tax (SRIT) came into effect on 6 April 2016. SRIT was established by the Scotland Act 2012, which gave the Scottish Parliament power to set a rate of income tax, applicable at the same level across basic, higher and additional UK rate bands, on the non-savings, non-dividend income of

Scottish taxpayers. The Scottish rate is set alongside a 10p carve-out from each of the three rate bands. The Scottish Parliament agreed a Scottish rate of 10p in a Scottish rate resolution in February 2016, exactly replacing the carve-out. The estimated yield from the Scottish rate has been added to Scotland's block grant for 2016-17. This is compensated for by a downward adjustment to the block grant based on an estimate of the revenue effects of the 10p carve-out. The net effect on the Scottish budget in 2016-17 is zero, because the Scottish rate was set equal to the carve-out.

13. Scottish taxpayers are defined as UK taxpayers with their main residence in Scotland, plus Members of the Scottish Parliament, Members of Parliament with constituencies in Scotland, and Members of the European Parliament with constituencies in Scotland, even if their main residence is not in Scotland. HMRC are responsible for administering SRIT, including identifying Scottish taxpayers. The Scottish Government meets the associated administrative costs. HMRC had not separately identified Scottish taxpayers and they began this work in summer 2015, primarily by reference to taxpayers' residence address post codes held on the income tax master file. Where addresses and post codes were found to be invalid, inconsistent or incomplete, these have been cleaned. HMRC has also undertaken cross-checking with other sources of address information from third parties. Taxpayers identified as Scottish taxpayers have received letters from HMRC informing them of this.

14. The HMRC Additional Accounting Officer for Scottish income taxes met with DG Finance on 15 November as part of a biannual review of HMRC performance with regards to implementation and operation. At the meeting HMRC noted the progress that had been made in particular with the successful implementation of the strategic solution to a taxpayer identification issue. Further work is being undertaken to improving an estimated 6% identification gap identified when testing Scottish payroll data. The HMRC AAO appeared before the Scottish Parliament's Finance Committee to provide evidence on the implementation of Scottish income tax on 14 December.

15. The National Audit Office planned to publish their annual report on HMRC's implementation and operation of the Scottish taxes on **19 December**. It is understood that it will comment on the taxpayer identification issue, which the strategic solution was developed to fix. Audit Scotland will also publish their report on the NAO findings at the same time.

16. SRIT will be replaced from April 2017 by new Scottish income tax arrangements recommended by the Smith Commission and legislated for in the Scotland Act 2016. The new arrangements give the Scottish Parliament powers to set both the rates and bands for income tax paid by Scottish taxpayers, with the only limitation being that the tax-free personal allowance cannot be reduced below the level for taxpayers in the rest of the UK. Scottish Ministers reconfirmed in the Programme for Government publication, on 6 September, their plans for using these powers with effect from 2017, the main feature of which is to link increases in the higher (40p) rate threshold to CPI inflation in contrast to the position in the rest of the UK where the Chancellor is proposing above-inflation rises in the threshold.

17. The existing Memorandum of Understanding between the Scottish Government and the letters of assurance between the Scottish Government and DWP covering the assurance arrangements for implementing and operating Scottish income taxes have been updated. These will be shared with the Scottish and UK Parliament. A Service Level Agreement between the Scottish Government and HMRC covering the operation of Scottish income taxes in greater detail is also being developed in advance of April 2017.

18. The operation of the block grant adjustment in respect of Scottish income tax from April 2017, which was a key part of the fiscal framework agreement, means that if Scottish income tax receipts per head of population grow faster than the growth of income tax receipts in the rest of the UK, the Scottish budget will be larger than it would have been without income tax devolution. If the rate of growth per head in Scotland is lower, the Scottish budget will be lower. A 1% difference in growth rate per head would cause a difference in the budget of £120m in a single year, which would be perpetuated in future years if growth rates thereafter were the same in both jurisdictions. If a 1% divergence per year was repeated, that is, it became a trend, the difference would cumulate at £120m a year. Over the last 15 years, data suggests that income tax receipts per head in Scotland have grown slightly faster than in the rest of the UK. However this is an average of different results in different years. Past experience is therefore not an indication of likely future performance.

- **Scottish Fiscal Commission**

19. The Scottish Fiscal Commission Act received Royal Assent on 14 April 2016 and it is expected that the Commission will become an office holder in the Scottish Administration from 1 April 2017. The Section 104 Scotland Act Order to deliver this has been instructed and drafted and now sits with the Scotland Office to take through Westminster. Officials are working closely with UK counterparts to help ensure that any delay is avoided.

20. The Commission will become responsible for the production of official forecasts of devolved tax revenues (including income tax), demand led social security expenditure and Scottish Gross Domestic Product (GDP) from the 2018-19 Scottish Budget onwards, in accordance with the fiscal framework agreement. Between now and 1 April 2017, the non-statutory Commission will continue to scrutinise tax forecasts prepared by Scottish Ministers for the 2017-18 budget, as in previous years. Challenge and scrutiny of 2017-18 tax forecasts is already underway.

21. A consultation on draft regulations expanding the functions of the SFC in line with the terms of the fiscal framework recently closed. Officials will work closely with the Minister for Parliamentary Business's Office and the SG Legislation Team to arrange introduction of the regulations in due course and consider the potential issues which may emerge. The SFC has been formally consulted on the draft regulations.

22. The process for appointing two new members to the statutory Commission with effect from 1 April 2017 is now underway. The timetable is very tight and there is

little scope for slippage if we are to ensure sufficient time for parliamentary scrutiny and approval at the end of the process. We are working very closely with the Public Appointments Unit, Commissioner for Ethical Standards in Public Life in Scotland and Finance Committee clerks in developing a process which incorporates parliamentary approval, as required under the Act, and remains compliant with the Code on public appointments. This is the first statutory appointment which will be both regulated by the Commissioner and subject to parliamentary approval.

23. The Fiscal Framework Implementation Board continues to receive regular updates in order to provide the appropriate assurances over the delivery of this project.

Parliamentary Committee Business

[redacted – out of scope]

Conclusion

[redacted – out of scope]

ALYSON STAFFORD
Director General Finance
December 2016

Annex A

[redacted – out of scope]

Annex B

DEVELOPING BUDGET FINANCIAL AND PERFORMANCE REPORTING

Context for Development: new financial powers

The Scottish Government and the Scottish Parliament have come a long way since the first spending plans presented to the Scottish Parliament for financial year 2000-01 by the then Minister for Finance, Mr Jack McConnell, amounting to £16.7 billion.

Since 1999 the reporting of Scotland's Public Finances has evolved with the initial adoption of Resource Accounting and Budgeting, followed by conversion to full International Financial Reporting Standards from (and including) financial year 2009-10.

Recent years have seen rapid and major changes to the Scotland Act; in 2012 [with two new devolved taxes, the Scottish Rate of Income Tax and limited borrowing powers], and in 2016 [more powers over income tax, enhanced borrowing powers, Air Passenger Duty, VAT plus material new areas of spend including some social security devolution]. These have heralded significant changes in the devolved fiscal arrangements for Scotland. The Scottish Government has, in parallel, developed the institutional landscape of Scotland to support the delivery and additional scrutiny of the expanding fiscal powers now in train.

The draft budget for 2015-16 published on 9 October 2014 set out spending plans in excess of £30 billion and included estimates of two new devolved taxes (Land and Buildings Transaction Tax and Scottish Landfill Tax), the subject of the first tax legislation to be enacted in Scotland for over 300 years.

The Scottish Government's accounts for 2015-16 account for £33.3billion expenditure. In 2015-16, of the total expenditure budget available to the Scottish Administration, in the order of 12 % was raised through direct taxes subject to policies and decisions of Scottish Ministers. It is estimated that by 2019-20 that percentage will increase to two thirds, so our emphasis has been to establish the arrangements for income reporting so as to put this on a firm foundation, alongside our expenditure reporting.

Financial Year 2015-16 Developments: reporting on funding and spending

A Fiscal Framework and associated Technical Annexes have been agreed between the Scottish Government and Her Majesty's Treasury and have been published (Fiscal Framework Agreement on 25 February 2016 and Technical Annexes on 15 March 2016) in support of the Scotland Act 2016.

[redacted – out of scope]

We have agreed with Audit Scotland the framework for reporting on Devolved Taxes. In September 2016, Revenue Scotland published an account of its own running costs and a separate account reporting on the two devolved taxes administered by Revenue Scotland. Revenue Scotland has produced its first annual report, and issues monthly stats for Land and Buildings Transaction Tax and Scottish Landfill Tax, as well as quarterly KPIs.

The Scottish Fiscal Commission, established by Scottish Ministers in June 2014 as an independent non-statutory commission, has published its out-turn report on the tax performance for 2015-16 in September 2016, as well as reporting on the forecast estimates included in the 2016-17 draft budget. As noted above, the Scottish Fiscal Commission will become a statutory body and will report to the Scottish Parliament from 1 April 2017 as per the Scottish Fiscal Commission Act 2016 which received Royal Assent on 14 April 2016.

The Scottish Government has prioritised the implementation of new powers, its accountability for income raised through taxation and has set out from the outset a transparent set of measures for the taxes raised and the corresponding block grant adjustment.

With more tax income being raised directly in Scotland, the Block Grant from Westminster has to be reduced to take account of different flows of funds (known as the Block Grant Adjustment). The Scottish Government set out the position in the 2015-16 and 2016-17 Draft Budget documents with specific chapters dedicated to Scotland Act 2012-defined fiscal arrangements. Joint Scottish Government and UK Government Section 33 reports were published in March 2016 to provide a joint transparent account of the progress with fiscal devolution as defined by the 2012 Act.

The Scottish Government has made the following improvements to the "expenditure reporting" in accounts.

a) The content of the Scottish Government's consolidated Accounts has been reviewed to explain how the Scottish Budget as a whole is funded and to make the link to the other accounts now prepared as a consequence of the changing fiscal landscape in Scotland.

b) [redacted out of scope].

c) [redacted out of scope].

These changes have been welcomed by the Auditor General.

Annex C

[redacted – out of scope]

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AUDITOR GENERAL

Gordon Wales, Director of Financial Management
Scottish Government
Victoria Quay
Edinburgh
EH6 6QQ

31 January 2017

Dear Gordon

I have pleasure in enclosing the clearance draft of my report *Managing new financial powers: an update*. The report looks at how the Scottish Government is managing the range of new, devolved financial powers. It examines how the Scottish Government, Revenue Scotland and the Scottish Fiscal Commission are implementing or preparing to introduce the new powers. It also considers how the Scottish Government is developing public financial management arrangements in the context of the new powers.

As the interim Accountable Officer, I would be grateful if you could confirm by 20 February 2017 that you are satisfied with the factual accuracy of the report, including all the data and information provided by or relating to your organisation.

The report covers areas that fall under the remit of other Director-Generals, namely the Scottish Government's social security programme and SG2020 organisational review. I would be grateful if you could ensure that Sarah Davidson and Ken Thomson see a copy of the report, and reflect any comments they may have in your response.

We are also providing relevant extracts of this report to Elaine Lorimer at Revenue Scotland and Sean Neill at the Scottish Fiscal Commission, to check for factual accuracy.

It would be helpful if you could meet the audit team during the three week clearance period, to discuss any comments on the report. The team had arranged to meet Alyson Stafford on 9 February, so I would be grateful if you could liaise with Gordon Smail to confirm or change the date of this meeting (gsmail@audit-scotland.gov.uk or 0131 625 1874). Please also get in touch with Gordon if there are any significant issues that require review.

You may wish to refer to our formal protocol if you require clarification of this process:
http://www.scotland.gov.uk/Topics/Government/Finance/spfm/agsappendixB

The intended publication date for this report is 21 March 2017. I will present the report to the Public Audit and Post-legislative Scrutiny Committee in due course.

Yours sincerely

Caroline Gardner

Caroline Gardner
Auditor General for Scotland

Managing new financial powers: an update

Draft - in confidence

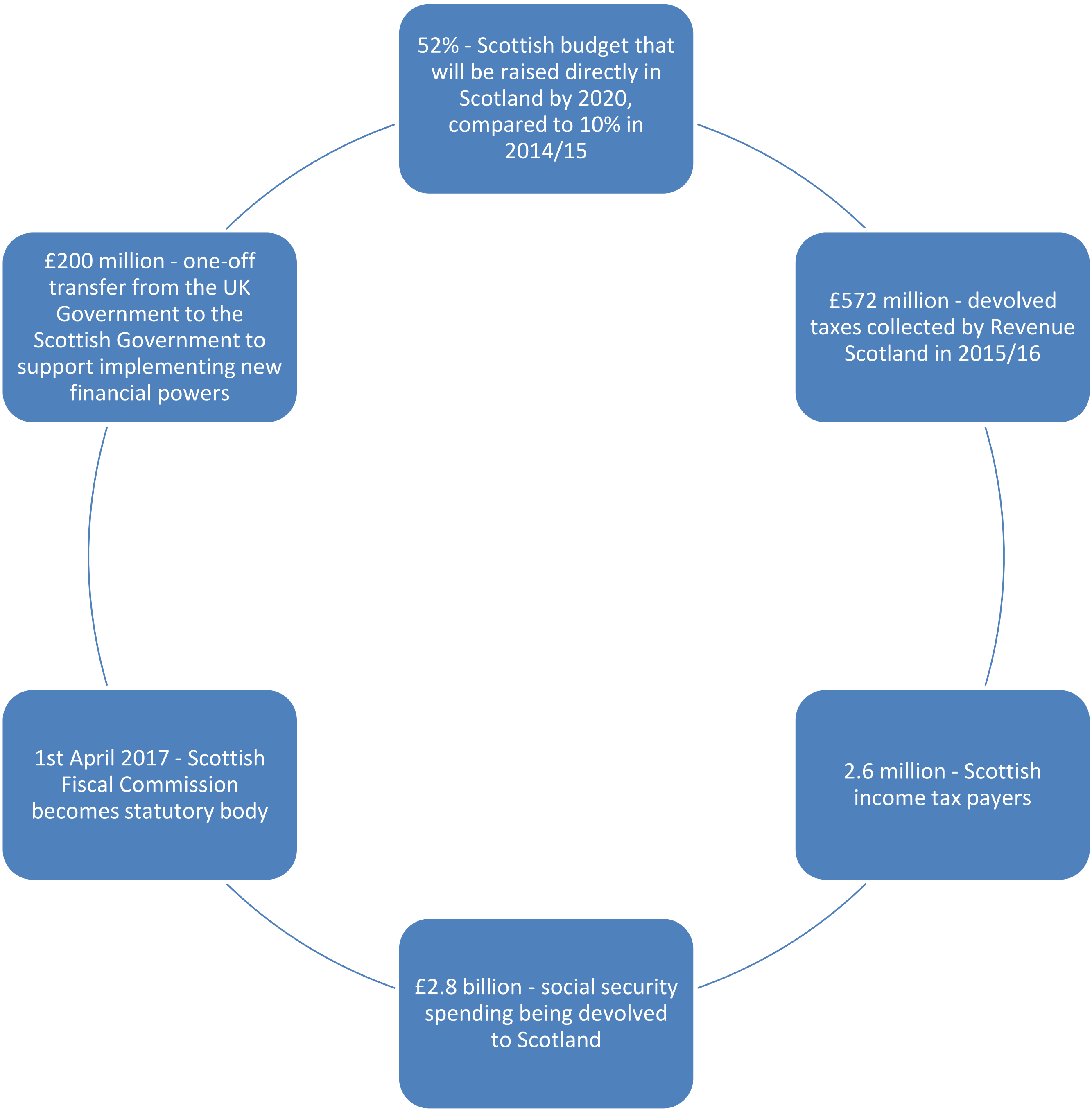
AUDIT SCOTLAND

Prepared for the Auditor General for Scotland
March 2017

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

Contents

Key facts


52% - Scottish budget that will be raised directly in Scotland by 2020, compared to 10% in 2014/15
£572 million - devolved taxes collected by Revenue Scotland in 2015/16
2.6 million - Scottish income tax payers
£2.8 billion - social security spending being devolved to Scotland
1st April 2017 - Scottish Fiscal Commission becomes statutory body
£200 million - one-off transfer from the UK Government to the Scottish Government to support implementing new financial powers

Summary

Key messages

1. **The Scottish Parliament's financial powers are changing substantially, with new responsibilities for taxes, social security and borrowing through the 2012 and 2016 Scotland Acts. The amount of money raised in Scotland will go up from about £4 billion before the Scotland Acts were introduced, to £22 billion by 2020. The scale of the change needed to implement and manage the new powers is significant. The Scottish Government is identifying the staff and skills it needs to set-up and manage the financial powers, although recruiting enough people with the required skills may prove difficult. The Scottish Government spent £18.4 million up to the end of 2015/16 on programmes to implement the new financial powers. Set-up costs will increase significantly during the next four years. It is important that the Scottish Government builds a clearer picture of potential future costs and plans how it will fund implementation of the new powers over the next four years.**
2. **The Scottish Government has updated its structures for overseeing the new powers and has good programme management processes in place. Arrangements are being put in place to ensure data is shared among relevant bodies to provide for effective decision-making, financial planning and scrutiny. The transition of the Scottish Fiscal Commission to a statutory body is being managed effectively.**
3. **Revenue Scotland is collecting two devolved taxes and is making good progress in preparing for further devolved taxes. The National Audit Office found that HM Revenue and Customs (HMRC) did not identify 420,000 Scottish taxpayers before the Scottish rate of income tax was introduced. The Scottish Government worked with HMRC to resolve this and work is ongoing to prepare for further income tax powers. The Scottish Government's social security programme is in the early stages. The next stage, in establishing an agency and implementing the new social security system, will be larger and more complex. Once its approach to delivering the social security system is more established, sharing it publicly will help support Scottish parliamentary scrutiny and provide more certainty about when the public may see changes that affect them. Underpinning this approach with detailed, coordinated project plans will enable oversight of the programme's progress towards delivering the new powers by the end of the current parliamentary session in 2021.**
4. **The new powers require a more strategic approach to Scottish public financial management and reporting, including an overarching medium-term financial strategy underpinned by clear policies and principles. The Scottish Government is further developing its approach to financial management and it also needs to finalise policies and principles for borrowing and reserves, and develop longer-term financial plans.**
5. **The budget process is becoming increasingly complex with more reliance on forecasting than ever before and adjustments being made throughout the budget cycle.**

The Scottish Parliament's Budget Process Review Group is reviewing current arrangements and assessing what is needed to support scrutiny in the future. The Scottish Government is taking steps to enhance financial reporting to provide a more comprehensive picture of Scotland's public finances but more work is required. This will enable the Parliament and wider public to understand and scrutinise the Scottish Government's decisions.

Recommendations

The Scottish Government should:

- **monitor regularly how much is being spent on implementing the powers in the Scotland Acts against what has been planned. The costs of each individual programme, and the total cost, should be reported regularly through existing governance structures (paragraph 16)**
- **develop more detailed estimates of how much it will cost to implement the financial powers in the Scotland Acts, and refine them as policy decisions are made about how the powers will be delivered (paragraph 17)**
- **integrate new approaches to workforce planning, developed through its SG2020 organisational review, into its processes at all levels of the organisation (paragraph 24)**
- **share its approach to implementing the social security powers publicly and underpin this approach with detailed plans for the social security system programme and its projects (paragraph 69 to 71)**
- **develop a medium-term financial strategy setting out (paragraph 80):**
  - **forecast economic performance and its effect on Scotland's public finances**
  - **broad financial plans for the next three to five years**
  - **clear principles for using and managing the new financial powers**
  - **scenario plans**
- **finalise principles for using its borrowing powers and the Scotland reserve as a matter of urgency (paragraphs 89)**
- **explain and better link different parts of the budget, and provide more detailed explanations for differences between the budget and actual outturn (paragraphs 109 and 116)**
- **deliver on its commitment to publish a comprehensive account of Scotland's public finances in 2018/19 (paragraph 117).**

Background

1. The 2012 and 2016 Scotland Acts (the Scotland Acts) devolve a range of powers to the Scottish Parliament. This includes powers over the Crown Estate's economic assets in Scotland, policing of the railways, drink-driving limits and licensing for onshore oil and gas extraction. The Scottish Parliament's financial powers are also changing substantially, with new responsibilities for taxes, social security and borrowing being devolved (Exhibit 1, page 9). This report focuses on these new financial powers.

2. Over the next four years, spending is set to rise from about £38 billion to over £40 billion each year. The amount of money raised in Scotland will go up from about £4 billion before the Scotland Acts were introduced, to £22 billion.[1] This means that around 50 per cent of devolved spending in Scotland will be met by money raised directly, once the Scotland Act 2016 powers are fully implemented. This compares to around ten per cent before the Scotland Act 2012.

3. Management of the Scottish public finances will fundamentally change as the new powers are delivered. Scotland's budget is becoming increasingly complex, and subject to greater uncertainty and volatility than when the block grant from the UK Government was relatively fixed. The new powers give more control over public finances and bring new opportunities and challenges. The Scottish Government will have more choice over tax and spending, and more decisions to make about how and when to use its new borrowing and reserve powers. The strength of the Scottish economy relative to the rest of the UK will have a greater influence on public finances than ever before.

4. In February 2016, the UK and Scottish governments agreed a revised fiscal framework, which sets out the rules for managing the new financial powers in Scotland.[2] This includes the calculations of the grant received from the UK Government, borrowing limits and preparation of fiscal and economic forecasts. It is important that the Scottish Government develops effective arrangements to manage the new powers within the fiscal framework. Its financial reporting also needs to be comprehensive, reliable, timely and transparent: that is, clear, easy to find and understandable.

5. Implementing the financial powers in the Scotland Acts is a huge and complex programme of work for the Scottish Government. It involves developing policy and legislation, establishing new public bodies and introducing new processes. The financial powers in the Scotland Act 2012 have all been introduced. Work will continue to implement the powers in the Scotland Act 2016 until at least 2021 (Exhibit 1, page 9).

6. On 23 June 2016 the UK electorate voted to leave the European Union (EU). It is too early to say what the vote to leave the EU means for Scotland. It is likely to have implications for the

[1] *Government expenditure and revenue Scotland 2015/16*, Scottish Government, August 2016.
[2] *The agreement between the Scottish government and the UK government on the Scottish Government's fiscal framework*, February 2016; and *Operation and governance of the Scottish Government's fiscal framework*, March 2016.

public finances, and changes the context in which the financial powers in the Scotland Acts are being introduced and managed.

About this audit

7. This report looks at how the Scottish Government is managing the range of new, devolved financial powers. It examines how the Scottish Government, Revenue Scotland and the Scottish Fiscal Commission are implementing or preparing to introduce the new powers. It also considers how the Scottish Government is developing public financial management arrangements in the context of the new powers. Our audit assesses progress to January 2017, while acknowledging that substantial activity is ongoing.

8. This report builds on our two previous reports on implementing the financial provisions in the Scotland Act 2012, published in December 2014 and December 2015. We also published a paper in September 2016 highlighting key issues for the Scottish public finances flowing from the new powers. We will continue to report on the progress of the Scottish Government and other public bodies in implementing and managing the new powers, through our annual audits and our programme of performance audits.

9. The report is in three parts:

- Part one examines the Scottish Government's arrangements for managing the implementation of the new financial powers.
- Part two assesses progress in delivering the new powers in the Scotland Acts.
- Part three looks at how financial management and reporting of the public finances are changing as the new powers are introduced.

10. Our findings are based on reviewing documents and talking to representatives from organisations involved in implementing the new financial arrangements. The audit methodology for this report is in the Appendix.

11. All of our work on the financial powers in the Scotland Acts can be found on our website.

Exhibit 1

Financial powers in the Scotland Acts

The Scottish Parliament's financial powers are changing substantially.

Act	Year	Power	Estimate[1]	Notes
Scotland Act 2012	From 2015	Land and Buildings Transactions Tax	£416 million	Actual 2015/16: £425 million
Scotland Act 2012	From 2015	Scottish Landfill Tax	£147 million	Actual 2015/16: £147 million Total LBTT + SLfT = £572 million
Scotland Act 2012	From 2015	Borrowing and cash reserve powers (up to 10% of capital budget each year):		Borrowing can be from: - the National Loans Fund - Commercial banks - Issuing of bonds
Scotland Act 2012	From 2015	• Revenue borrowing	Overall limit – £500 million	
Scotland Act 2012	From 2015	• Capital borrowing	Overall limit – £2.2 billion	
Scotland Act 2012	From 2015	• Cash reserve	Overall limit – £125 million	£74m added to reserve from 2015/16 receipts
Scotland Act 2012	2016	Scottish Rate of Income Tax (SRIT)	£4.3 billion	
Scotland Act 2016	2017	Control over income tax rates and bands	£11.2 billion	
Scotland Act 2016	2017	Increased borrowing and reserve powers over:		Extends 2012 Act powers
Scotland Act 2016	2017	• Revenue borrowing	Overall limit – £1.75 billion	Annual limit £600 million
Scotland Act 2016	2017	• Capital borrowing	Overall limit – £3 billion	Annual limit 15% of overall limit
Scotland Act 2016	2017	• Scotland Reserve	Overall limit – £700 million	Annual limit £350 million
Scotland Act 2016	2018	Air Passenger Duty	£275 million	
Scotland Act 2016	2019	VAT: the first 10p of standard rate of VAT (and 2.5p of reduced rate) raised in Scotland will be assigned to Scottish budget	£5.6 billion	
Scotland Act 2016	By 2021	Responsibility for 11 social security powers ranging from Disability Living Allowance to winter fuel payments	£2.8 billion	A new social security agency will be created. Legislation yet to be passed.
Scotland Act 2016		Aggregates Levy	£53 million	Devolution date to be confirmed

Key
£: revenues £: limits £: spend

Note 1: Estimates for taxes are from Government expenditure and revenue Scotland 2015-16, Scottish Government, August 2016.

Source: Audit Scotland

Part 1: Managing implementation

Key messages

- **By the end of 2015/16, the Scottish Government had spent £18.4 million on programmes to implement the financial powers in the Scotland Acts. Set-up costs will increase significantly during the next four years. It is important that the Scottish Government regularly monitors and reviews how much is being spent against what has been planned. Gaining a better understanding of costs will help it to develop more detailed estimates of potential future costs as policy decisions are made, and plan how it will fund implementation of the new powers over the next four years.**
- **The scale of the change needed to implement and manage the new powers has significant staffing implications for the Scottish Government. It is making organisation-wide changes to support the movement of people and funding to meet its priorities. Individual teams are identifying the specific staff and skills they need to set-up and manage the financial powers, although recruiting enough people with the required skills may prove difficult.**
- **The Scottish Government has updated its structures for overseeing the introduction of the new powers and has good programme management processes in place. It is involved in discussions and decisions with the UK government, the Department of Work and Pensions and HM Revenue and Customs on how the new powers will work in practice. Arrangements are being put in place to ensure data is shared among relevant bodies to provide for effective decision-making, financial planning and scrutiny. The transition of the Scottish Fiscal Commission to a statutory body has been managed effectively.**

The cost of implementing the financial powers in the Scotland Acts will increase significantly during the next four years

12. The Scottish and UK governments are incurring costs in implementing and then managing the financial powers in the Scotland Acts. The revised fiscal framework sets out that the Scottish and UK governments will share the cost of implementing the financial powers in the Scotland Act 2016 as follows:

- The UK Government will make a one-off payment of £200 million to the Scottish budget - £100 million of this will be transferred in 2017/18. This is a contribution towards costs rather than reimbursement for specific areas of spending. The two governments will continue discussions in 2017 to agree when the remaining funds will be transferred.

- The UK Government will transfer up to £66 million each year to the Scottish budget to cover ongoing administration costs - £22 million will be transferred in 2017/18.
- The Scottish Government will meet all costs associated with the devolution of income tax, air passenger duty and the aggregates levy.
- The Scottish Government will meet all costs associated with establishing the Scottish Fiscal Commission.
- The Scottish and UK governments will share equally the costs of implementing and administering the assignment of VAT revenues to the Scottish budget.
- The Scottish Government will meet all other net costs necessarily incurred by the UK government solely as a result of devolution.

13. By the end of 2015/16, the Scottish Government had spent £18.4 million on programmes to implement the financial powers in the Scotland Acts (Exhibit 2). Most of this was to cover HMRC's costs in setting up and operating the Scottish rate of income tax. The Scottish Government budgeted a further £17.7million for 2016/17 and £92 million for 2017/18. The remaining £30 million from the £122 million being transferred by the UK Government in 2017/18 has been allocated to support other work flowing from the Scotland Act 2016, such as employability programmes and the Crown Estate transfer. The draft budget documents do not include any detail on how these funds are allocated. Scottish Government departments and public bodies are identifying potential costs of implementing the new powers, such as staff and IT systems, to help inform the allocation of the 2017/18 budget.

Exhibit 2

Set up costs for implementing the new financial powers

Most of the costs to date are for implementing the Scottish rate of income tax.

Programme	Total cost to 2015/16	Budget (2016/17)	Draft budget (2017/18)
Scottish rate of income tax	£12 million [1]	£16.1 million	£12 million
Land and Buildings transaction Tax and Scottish Landfill Tax	£6.4 million [2]		
Air Passenger Duty	0		
Aggregates Levy	0		
VAT	0		
Social security	*Costs TBC [budget was £0.2m]*	£0.9 million	£80 million [3]
Scottish Fiscal Commission [4]	0	£0.7 million	0
TOTAL	**£ 18.4 million**	**£17.7 million**	**£92 million**

Notes:

1. This includes £11.1 million paid to HMRC and £0.87 million paid to the Department of Work and Pensions.

2. This includes programme costs of £5.5 million to 31 July 2015, and £0.9 million paid to HMRC for costs associated with the devolution of Stamp Duty Land Tax, which was replaced by Land and Buildings Transaction Tax.

3. This is the budget for Scotland Act 2016 non-tax implementation. The Scottish Government expects most of it will be used to fund the social security programme.

4. This is for the programme to manage the transition of the Scottish Fiscal Commission to a statutory body by 1 April 2017, which was established in June 2016. Figures do not include operating costs or budget.

Source: Audit Scotland using information provided by the Scottish Government, Revenue Scotland and Scottish Fiscal Commission.

14. Set-up costs will increase significantly during the next four years. The budget for this work in 2017/18 is over five times more than the previous year (Exhibit 2). The Scottish Government expects that implementation will cost more than the £200 million that the UK government will transfer to the Scottish budget, although it has not identified how much more. The Scottish Government will need to fund the remaining costs alongside existing budget pressures and spending commitments.

Building a clearer picture of future costs will help the Scottish Government plan how it will fund implementation of the new powers

15. The Scottish Government has established individual programmes to introduce the financial powers in the Scotland Acts. The costs of these programmes are recorded separately by the organisations and teams responsible for them. Costs are not collated or reported centrally. The brief for the fiscal framework implementation programme states that programme costs will be monitored monthly by the Scottish Government finance directorate and reported to the Fiscal Framework Implementation Board (Exhibit 3, page 15). To date, the board has not discussed the programme costs.

16. It is important that the Scottish Government monitors regularly how much is being spent overall on implementing the powers in the Scotland Acts, against what has been planned. The costs of each individual programme, and the total cost, should be reported regularly through existing governance structures; for example to the Fiscal Responsibility Steering Group or Scottish Government Executive Team (Exhibit 3, page 15). This will help ensure that there is an awareness of spend across all programmes at a senior-level and that programme teams are accountable for their spending. It will also contribute to a better understanding of set-up costs, which will help the Scottish Government to develop cost estimates for future activity.

17. Building a clearer picture of potential future costs will help the Scottish Government to plan how it will fund implementation of the new powers over the next four years, within its budget. Given the scale of the programme to implement the new financial powers, accurately identifying potential costs is complex. The Scottish Government will need to develop more detailed cost estimates and refine them as policy decisions are made about how to

implement and deliver certain powers. For example, how individual social security powers will be administered, when and by whom. Having a better understanding of what has been spent to date may help with this.

18. Alongside the cost of implementing and administering the new powers, the Scottish Government will need to consider the impact of specific policies on its budget. For example, ministers need to know how much a decision to increase carers allowance or child benefit by a certain amount would cost overall, so long-term budget implications can be fully understood. The Scottish Government is modelling the costs of some social security powers, to help inform policy decisions.

The scale of change needed to implement and manage the new powers has significant staffing implications for the Scottish Government

19. The Scotland Acts introduce additional responsibilities for the Scottish Government, such as developing new policy and legislation, establishing new public bodies and introducing new processes. The scale of the change needed to implement and manage the new powers has significant staffing implications. There will be substantial changes in the type and volume of work the Scottish Government will do. For example, when the social security powers are in place, it expects to process as many transactions in a week as it currently does in a year.

20. The Scottish Government also needs to deliver its current business and respond to the potential impact of the UK leaving the EU. In 2015/16, the core Scottish Government employed 7,047 people. This number has decreased by seven per cent from a peak of 7,566 staff in 2010. Successfully implementing and managing the new powers will require enough staff with the right knowledge and skills. Recruiting staff with the technical experience required, for example in finance and programme management, may prove difficult. The Scottish Government recognises that it needs to adapt to meet the demands and challenges it faces, including making best use of existing money and people.

21. The Scottish Government concluded a year-long wide-ranging organisational review in October 2016. Called SG2020, it aims to change the way the Scottish Government works to ensure it can continue to deliver ministerial priorities and take on additional responsibilities within limited resources. SG2020's 'matching resources to priorities' project aims to create a more flexible and responsive workforce by reallocating people and money to new or increased priority areas. Its six priority areas are:

- New powers in the Scotland Act 2016
- Tax
- Social security
- Employability
- Economy
- EU implications

22. The Scottish Government is making organisation-wide changes to support the movement of people and funding to meet these priorities. It has revised its promotion policy, developed policies and systems to support more flexible working, and is assessing opportunities for redeploying and retraining staff.

23. Individual departments and programmes are also identifying the staff and skills they need to implement and manage the financial powers in the Scotland Acts. In doing this, it is important that the Scottish Government considers both the staff needed to set-up the new powers and those needed to manage them in the longer-term. The finance team is reviewing its role, structure and functions, to allow it to deliver additional responsibilities resulting from the new financial powers through to 2020. Additional budget has been allocated to develop the size and skills of the finance team.

24. The Scottish Government recognises the significant staffing implications of the new powers and the challenges it faces in recruiting staff with the skills it needs. It has started to reallocate existing staff and recruit new people to meet immediate pressures. The Scottish Government now needs to implement longer-term solutions, to ensure it has the staff and skills in place to deliver its current priorities and new responsibilities. It will be important that it integrates new approaches to workforce planning, developed through SG2020, into its processes at all levels of the organisation.

The Scottish Government has updated its structures for overseeing the introduction of the new powers

25. We previously reported that the Scottish Government had developed clear structures for overseeing the introduction of new financial powers.[3] The Scottish Government revised these structures during 2016 to reflect the Scotland Act 2016 and fiscal framework (Exhibit 3, page 15).

26. Each of the programme boards under the Fiscal Responsibility Steering Group has established good programme management arrangements. The remit of the boards and how they interact is clearly documented. Each has its own risk register that is regularly discussed at the relevant programme board. Where necessary, the boards escalate risks for inclusion in the corporate risk register, which is reviewed by the Scottish Government Audit and Assurance Committee. The programmes are also independently reviewed at key stages.

27. The social security programme is in its early stages (see Part 2) and is currently refining its programme governance arrangements. This included reviewing membership of the programme board during the second half of 2016 to ensure it had the right people and skills to fulfil its decision-making role for the next stage of the programme. The board approved its terms of reference at its meeting in January 2017.[*to confirm*]

28. Decisions on individual programmes are made by the relevant board, and the Fiscal Responsibility Steering Group and Scottish Government Executive Team oversee the

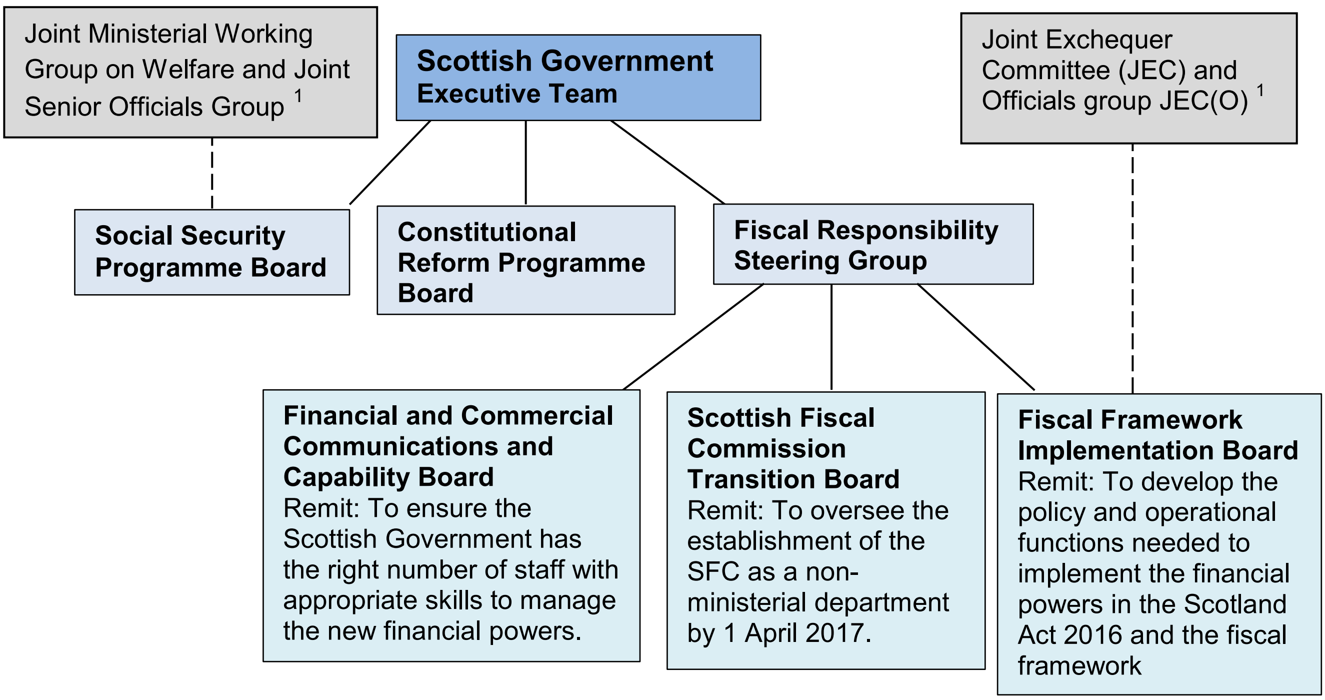
[3] *Implementing the Scotland Act 2012: an update*, Audit Scotland, December 2015.

programme boards. Cross-representation of officials across the boards helps to ensure they are well informed on the different strands of work. For example, the chair of the Social Security Programme Board is a member of the Fiscal Framework Implementation Board, and updates that board on the social security programme.

Exhibit 3

Arrangements to manage the introduction of the new financial powers

There are clear structures in place for overseeing the introduction of the new financial powers.



Note: This is a joint UK and Scottish government forum, with indirect links to the Scottish Government programme boards.

Source: Audit Scotland

The Scottish Government is working with other organisations to implement the powers in the Scotland Acts

29. The Scottish and UK governments co-chair joint-government forums that are responsible for agreeing how aspects of the Scotland Act 2016 and fiscal framework will operate in practice:

- The **Joint Exchequer Committee** (JEC) governs implementing, operating and reviewing the fiscal framework. Through the JEC, ministers from both governments discuss how to implement the powers in the Scotland Acts. The JEC is supported by the **Joint Exchequer Committee: Officials** (JEC(O)) group, which includes officials from both governments, the Department of Work and Pensions (DWP) and HM Revenue and Customs (HMRC).
- The **Joint Ministerial Working Group on Welfare** is responsible for the policy and legislative aspects of devolution of social security powers. It is supported by the **Joint**

Senior Officials Group, including staff from the Scottish Government, Scotland Office and DWP.

30. The JEC met ten times between July 2015 and February 2016 to discuss revisions to the fiscal framework. It has met once more since the fiscal framework was agreed in February 2016, in November 2016. At this meeting ministers agreed how to apply the block grant adjustment and the amount of administration and implementation funding to be transferred for 2017/18. They also discussed progress on further income tax powers and how to assign money raised from VAT. The JEC is due to meet again in early 2017 to discuss further technical details in advance of powers being transferred. The Joint Ministerial Working Group on Welfare was established in February 2015. It met twice in 2016 to agree how the two governments will work together to manage the transfer of social security powers and to discuss progress to date.

31. Ensuring a smooth transition of powers from the UK Parliament to the Scottish Parliament requires officials in the bodies involved to build and maintain effective working relationships. Memorandums of understanding (MOUs) have been agreed between the Scottish Government and DWP and HMRC, setting out their respective responsibilities and how they will work together to implement specific powers. Officials from these organisations are represented on groups that support the joint-government forums (paragraph 29) and on each others programme boards. For example, DWP is represented on the Scottish Government's social security programme board, and the Scottish Government sits on HMRC's programme board for the Scottish rate of income tax. This helps to ensure that senior officials have an awareness of relevant activity in other bodies and are involved in discussions and decisions where appropriate.

Information and data sharing arrangements are being put in place

32. The UK and Scottish governments have agreed to put in place appropriate and reciprocal information-sharing arrangements. This will help both governments, and other relevant bodies, undertake their respective roles in implementing and managing the new financial powers. The Scottish Government had access to all the information it needed to produce the 2017/18 draft budget, and is now taking steps to formalise these arrangements.

33. A variety of information and data will need to be shared between UK and Scottish public bodies to help:

- identify Scottish taxpayers and social security claimants
- inform individuals and organisations and prepare them for implementation of the new powers
- prepare economic, tax and spending forecasts to help prepare the budget and set block grant adjustments
- develop policies on tax and spending and assess if policies are achieving the government's objectives and desired outcomes
- consider taxpayers' behaviours

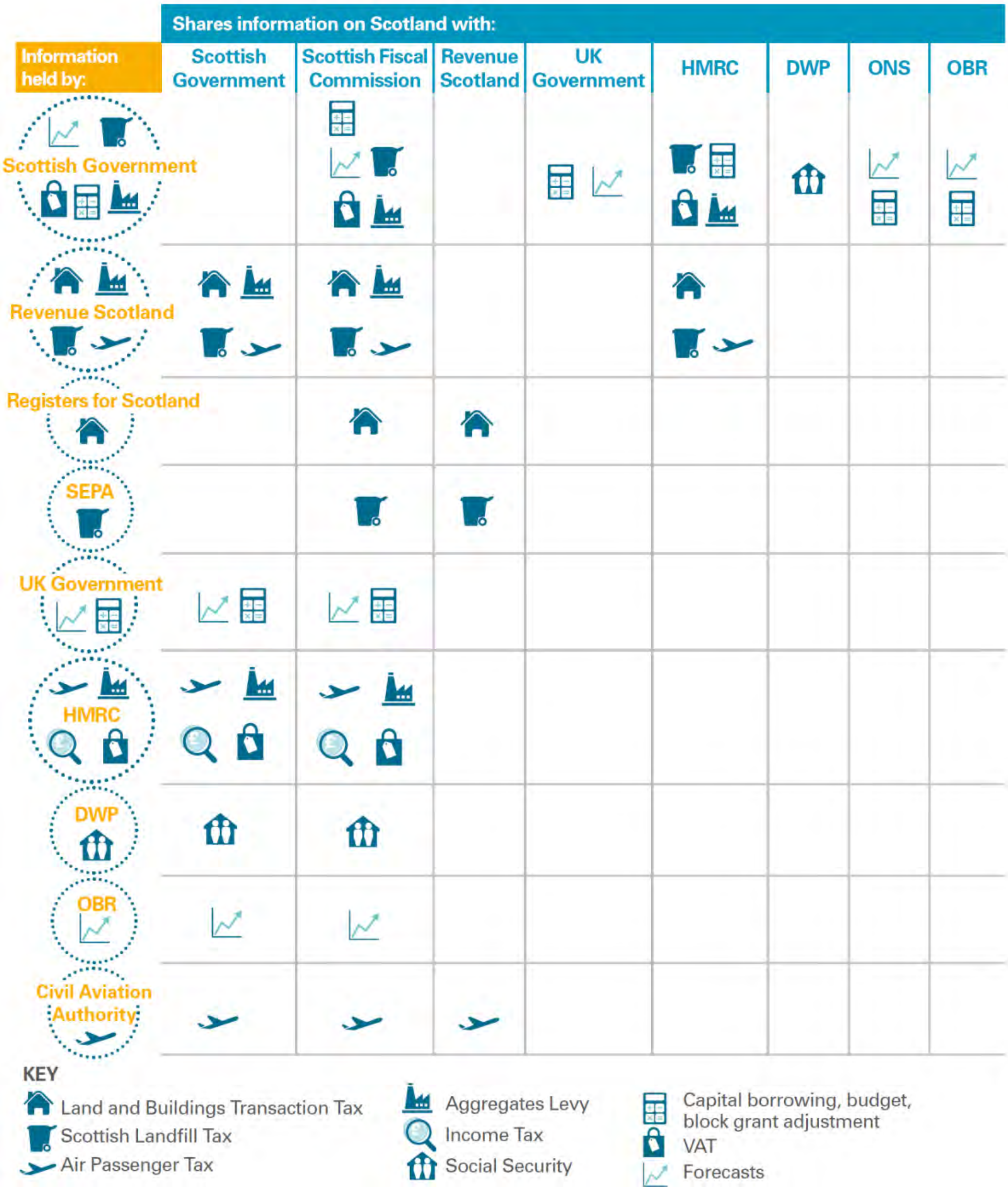
- design and build the supporting IT systems and administrative procedures.

34. Exhibit 4 shows the wide and complicated network of public bodies that need to share information and data to support the new financial powers. MOUs will be developed and refined as powers are transferred and policy choices made. It will be important that in sharing this data careful consideration is given to data protection and security.

Exhibit 4

New data sharing arrangements needed between public bodies

A wide range of data relating to the new powers will need to be shared between UK public bodies.



Note: This exhibit captures some of the new arrangements that will be needed for the Scotland Acts and does not show existing arrangements between other UK public bodies.

Source: Audit Scotland

35. Economic, tax and spending data will be used by more than public bodies. For example, information will be scrutinised and used by independent forecasters. Having more independent forecasts and information available will lead to better informed policy choices and aid budget scrutiny. Independent forecasters and commentators have an important role to play in assessing the reliability and robustness of economic forecasts and the sustainability of the Scottish Government's policy decisions (see Part 3). This will be important given the inherent uncertainty of forecasting.

36. It is also important that the public has access to clear, reliable and easily understandable economic and financial information. This helps to underpin wider scrutiny and public understanding of budget decisions. The Scottish Government currently makes economic and financial data available through its Government Expenditure and Revenues Scotland (GERS) reports. The Scottish Government announced its Open Government National Action Plan in December 2016 reinforcing its commitment to data sharing, transparency and involving the wider public in decisions.

The transition of the Scottish Fiscal Commission to a statutory body is being managed effectively

37. The role of the Scottish Fiscal Commission (SFC) will become increasingly important as new powers are introduced. Since 2014, the SFC has operated on a non-statutory basis and its role has been to independently assess the Scottish Government's forecasts of devolved tax revenues. It reported on the forecasts in the Scottish Government's draft budgets for 2015/16 through to 2017/18.

38. Under the Scottish Fiscal Commission Act 2016, the SFC will be established as a statutory body from 1 April 2017. Its responsibilities will expand to include:

- preparing five-year forecasts of devolved tax revenues, non-domestic rates and Scottish income tax
- preparing five-year forecasts of demand-led social security spending, once devolved
- preparing forecasts of Scotland's onshore gross domestic product (GDP)
- assessing the reasonableness of Scottish Ministers' borrowing projections.

39. The SFC's statutory functions are similar to that of the UK's Office for Budget Responsibility (OBR) and in line with good practice outlined by the OECD for independent fiscal institutions.[4] The main difference is that there is no requirement for the SFC to provide an assessment on the financial sustainability of public finances.

40. From April 2017, the SFC will be responsible for preparing forecasts for inclusion in the Scottish Government's draft budgets. The first of these will be the draft budget for 2018/19, which could be published as early as September 2017. The SFC expects to have a joint

[4] *Recommendation of the Council on Principles for Independent Fiscal Institutions*, OECD, February 2014.

protocol with the Scottish Government in place by 1 April 2017, setting out the forecasting and assessment process. It will be up to the Scottish Government to decide if it uses the forecasts from the SFC or its own forecasts.

41. The SFC established a transition programme to put in place the systems, processes, staff and skills needed for the SFC to operate as a statutory body. The programme has clear plans for this transition. It has a particular focus on establishing the SFC's independence, recruiting staff with appropriate technical skills and securing access to the data it needs to perform its functions. The programme is on track for SFC to have everything necessary in place to operate as a statutory body from 1 April 2017.

42. One of the biggest challenges facing the transition programme is the recruitment of enough staff with the right skills. A recruitment campaign in December 2016 did not fill all posts on a permanent basis, including the chief executive. The SFC implemented its contingency plans and is satisfied that it has the staff in place to deliver its remit in 2017. It appointed an interim deputy chief executive in February 2017 [*to confirm*] to provide leadership through to the appointment of a permanent chief executive. It is important that the SFC continues to identify and fill skills gaps during 2017, and keeps under review the staff it needs to carry out its functions effectively in the longer-term.

Part 2: Delivering the new powers

Key messages

- **Revenue Scotland is collecting two devolved taxes and successfully introduced the Additional Dwelling Supplement in response to a policy change. It is making good progress in preparing for the introduction of Air Departure Tax from April 2018.**
- **The National Audit Office found that HMRC did not identify 420,000 Scottish taxpayers before the Scottish rate of income tax (SRIT) was introduced in April 2016. While this had no direct impact on taxpayers or the Scottish budget in 2016/17, an accurate taxpayer base is critical for devolved income tax to operate effectively. The Scottish Government worked with HMRC to resolve this issue. They continue to work together to further refine the taxpayer base and prepare for further income tax powers from April 2017.**
- **The Scottish Government's social security system programme is in its early stages. It has been taking time to create the environment needed to successfully deliver the social security system. The next stage, establishing an agency and implementing the new social security system, will be larger and more complex. Once its approach to delivering the social security system is more established, sharing it publicly will help support Scottish parliamentary scrutiny and provide more certainty about when the public may see changes that affect them. Underpinning this approach with detailed, coordinated project plans will enable oversight of the programme's progress towards delivering the new powers by the end of the current parliamentary session in 2021.**

Devolved taxes

The Scotland Act 2012 devolved two taxes to Scotland - Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT) on 1 April 2015. LBTT is paid on land and property purchases and SLfT is paid on waste going to landfill. Revenue Scotland collected £425 million in LBTT and £147 million in SLfT in 2015/16.

The Scotland Act 2016 devolves two further UK taxes - Air Departure Tax (charged on passengers flying from Scottish airports) and Aggregates Levy (a tax on importing or extracting sand, gravel or rock from the ground or sea). The Scottish Government estimates £275 million will be collected in ADT and £53 million in Aggregates Levy.

Revenue Scotland is collecting two devolved taxes and is making good progress preparing for further devolved taxes

44. We reported in 2015 that Revenue Scotland had successfully implemented LBTT and SLfT, and began collecting both from 1 April 2015. It collected £572 million in devolved taxes in 2015/16 on behalf of the Scottish Government. From April 2018, Revenue Scotland will also collect the replacement for Air Passenger Duty, Air Departure Tax (ADT).

45. In December 2015 the Scottish Government announced in its 2016/17 draft budget an additional tax on buying second and additional homes in Scotland. Revenue Scotland would collect this Additional Dwelling Supplement (ADS) on the Scottish Government's behalf from April 2016. This announcement came a month after the UK Spending Review and Autumn Statement announced a similar tax on buy-to-let properties and second homes in the rest of UK. Revenue Scotland set up a project team to prepare for the new tax in January 2016 (Case study 1). It successfully made the adjustments necessary to collect ADS from April 2016.

Case study 1

Revenue Scotland's preparation for the Additional Dwelling Supplement (ADS)

Revenue Scotland established a project in January 2016 to implement ADS from 1 April 2016. In doing this, it drew on its experience of implementing LBTT and SLfT. It organised its work into three teams - communication, IT and operational design. Revenue Scotland held roadshows and produced guidance to ensure that stakeholders, such as solicitors, were aware and prepared for the tax change.

Revenue Scotland worked closely with its IT provider to adapt its IT system for ADS. Stakeholders who use the IT system took part in testing to check not only that the new module worked well but also that the changes did not affect other parts of the IT system.

Following the closure of the project, Revenue Scotland completed a lessons-learned exercise to inform its future projects. It has made this available in the Scottish Government's Programme and Project Management Centre of Expertise to share its learning more widely. There were 63 lessons for future projects across the themes of governance, project management, collaboration, stakeholder engagement, policy development and resource management. The learning is contributing to the Air Departure Tax project.

Source: Audit Scotland

Revenue Scotland is making good progress in preparing for Air Departure Tax by April 2018

46. The Scotland Act 2016 devolves Air Passenger Duty levied on passengers flying from Scottish airports from April 2018. The Scottish Government consulted on replacing the tax in March 2016 and introduced its Air Departure Tax (Scotland) Bill in December 2016.

47. Revenue Scotland has made good progress in putting the arrangements in place to prepare for implementing the new tax. It has established a programme structure and recruited to its four projects; programme management and transition, IT, communications and operational design. Their work is overseen by a programme board. Revenue Scotland and HMRC are developing criteria for reviewing their readiness to devolve responsibility for the tax. The programme will begin reviewing its progress against the criteria from the end of 2017.

48. The new tax will be administered through Revenue Scotland's existing online tax payment system. As this is a change from HMRC's paper-based payment system, Revenue Scotland is actively engaging the airline industry in designing the new tax return. It also plans to open its online system before the new tax is introduced to ensure the industry is prepared for the change.

49. Revenue Scotland is expected to be responsible for implementing and collecting the Aggregates Levy once it has been devolved. A date for this is still to be decided as outstanding legal challenges to the UK-wide levy are still to be resolved.

Shared and assigned taxes

The Scotland Act 2012 gave the Scottish Parliament the power to set a Scottish rate of income tax (SRIT) from April 2016. The main UK rates of income tax are reduced by ten pence for each tax band for Scottish taxpayers. The Scotland Act 2016 gave the Scottish Parliament the power to set the rates and band thresholds for all non-savings and non-dividend (NSND) income tax paid by Scottish taxpayers. The Scottish Government estimates £4.3 billion will be collected in SRIT.

Through the Scotland Act 2016, a share of the VAT collected in Scotland will be assigned to the Scottish budget from April 2019. This will be the first ten pence of standard rate VAT and 2.5 pence of reduced rate VAT. The Scottish Government estimates £5.6 billion of VAT collected will be assigned to the Scottish budget.

The Scottish Government is working with HMRC to improve the identification of Scottish taxpayers

50. The Scottish rate of income tax (SRIT) was introduced on 6 April 2016. HMRC is responsible for implementing, collecting and administering the SRIT. This includes identifying Scottish taxpayers, to whom the Scottish rate of income tax applies. The Scottish Government is responsible for paying HMRC for implementing and operating the SRIT and ensuring this represents value for money.

51. The National Audit Office (NAO), which audits HMRC, reported in December 2016 on progress in implementing the SRIT.[5] It reported that an error in the design of HMRC's

[5] *The administration of the Scottish rate of income tax 2015/16*, National Audit Office, December 2016.

taxpayer identification exercise in December 2015 meant that 420,000 potential Scottish taxpayers did not receive a letter notifying them of the change in income tax arrangements. The NAO reported that HMRC did not have effective controls in place to immediately recognise that the full intended population had not received a Scottish taxpayer notification letter. HMRC was notified quickly that some taxpayers had not received notification letters by taxpayers, employers and the Scottish Government. In January 2016 it engaged its IT supplier to determine the scale of the issue and in April 2016 it confirmed the total number of people affected. An interim solution was put in place by June 2016 followed by a permanent IT solution in October 2016 as part of HMRC's biannual IT update.

52. There were no direct financial consequences for the Scottish Government or taxpayers as a result of this error. Identifying Scottish taxpayers is fundamental to effectively operating the SRIT and future devolved income tax. The Scottish Government sought and received assurance from HMRC that the error in identifying taxpayers had been resolved through a series of meetings. It tested this against the taxpayer status of those on the Scottish Government payroll. Work continues to further refine the taxpayer population, for example by sampling the payrolls of other large employers. The Scottish Government has worked with HMRC to develop an action plan for this work, and it receives assurance through regular meetings with HMRC. The NAO will assess and report on the effectiveness of this action plan later this year.

53. Maintaining a correct record of Scottish taxpayers relies on people notifying HMRC of a change of address. The NAO reported that there remains a risk that taxpayers do not update their address details. This could result in taxpayers paying the incorrect amount of income tax. Keeping information up to date will only become established taxpayer behaviour through effective communication. No further spending on SRIT-specific communications was planned from 2016/17 onward. HMRC will continue to communicate through its usual channels with agents and employers to reinforce the importance of keeping address details up to date.

The estimated costs of implementing the SRIT have been revised down

54. The Scottish Government is responsible for meeting HMRC's costs in setting up and operating the SRIT. To March 2016, the Scottish Government paid £11.1 million to reimburse HMRC for costs incurred implementing the SRIT, £8.4 million of which was in 2015/16.[6]

55. As implementation of the SRIT progresses, the estimated set-up costs continue to be revised downwards. In June 2016, HMRC revised its estimate for implementation costs to £30 million, £5 million less than it estimated in March 2015 (Exhibit 5). It now expects IT costs to be more than non-IT costs because the costs of communicating with taxpayers were significantly less than estimated. HMRC used the Scottish Government's communication contracts for radio and newspaper advertising as they provided better value for money, which contributed to reduced publicity costs.

[6] *The administration of the Scottish rate of income tax 2015/16*, National Audit Office, December 2016.

Exhibit 5

Estimated set-up costs for the Scottish rate of income tax

Overall estimated set-up costs continue to be revised downwards, although IT cost estimates have increased.

2010 (£40-45m)	2014 (£35-40m)	2015 (£30-35m)	2016 (£30m)
• Non-IT £30-35m	• Non-IT £25m	• Non-IT £20m	• Non-IT £10m
• IT £10m	• IT £10-15m	• IT £10-15m	• IT £20m

Note: Total estimated set-up costs are for the seven years from 2012/13 to 2018/19.

Source: Third annual report on the implementation and operation of part 3 (financial provisions) of the Scotland Act 2012, UK Government, March 2015; The administration of the Scottish rate of income tax 2015/16, National Audit Office, December 2016.

56. There will be further project costs in 2016/17 to amend HMRC's IT systems. The Scottish Government will also pay an annual running cost to HMRC for administrating the SRIT, estimated at £1.5 million in 2016/17.[7] HMRC has estimated that running costs will increase to around £5 million if the Scottish rate of income tax is different from the rest of the UK.[8]

57. DWP has adjusted its systems and guidance to accommodate the introduction of the SRIT. It estimates this will cost £1.7 million.[9] DWP charged the Scottish Government £870,000 for this work in 2015/16, and expects further costs in 2016/17.

HMRC and the Scottish Government are preparing for further devolution of income tax powers

58. A new HMRC project has been set up to implement the Scotland Act 2016 income tax powers. It reports into existing project and programme structures, which the Scottish Government is part of.

59. In December 2016, the Scottish Government and HMRC revised the MOU previously agreed for the SRIT, to ensure that it reflects the further devolution of income tax powers. They are also working to agree how Scottish income tax will be administered by April 2017, including:

- identifying and maintaining the taxpayer base
- compliance procedures for Scottish income tax

[7] *Scottish Government fourth annual report on the implementation and operation of part 3 (financial provisions) of the Scotland Act 2012*, Scottish Government, March 2016.

[8] *HMRC at scrutiny of the Draft Budget 2017/18*, Finance and Constitution Committee, 14 December 2016.

[9] *Scottish Government fourth annual report on the implementation and operation of part 3 (financial provisions) of the Scotland Act 2012*, Scottish Government, March 2016.

- information to allow the Scottish Government to hold HMRC to account for its performance in administering Scottish income tax
- data for monitoring and forecasting tax receipts.

The methodology for assigning a share of VAT to the Scottish budget is still to be agreed

60. A share of VAT collected in Scotland will be assigned to the Scottish budget from 2019/20. Scottish and UK ministers are still to agree how this will be calculated. HMRC will continue to collect VAT in Scotland. Given the complexity of the work to agree the methodology for assigning VAT to the Scottish budget, it will be important that the Scottish Government and HMRC maintain effective working relationships.

61. HMRC has established a project looking at possible methodologies. It reports through the same structure as its SRIT programme, which the Scottish Government participates in, and will provide recommendations to the JEC. The cost of this project will be shared equally by the two governments. Effective monitoring and scrutiny of project plans and milestones will be needed to ensure implementation in 2019/20.

Social security

The Scotland Act 2016 devolves a number of areas of social security to Scotland. These cover 11 benefits totalling £2.8 billion of spend in Scotland. This equates to 15 per cent of all social security spending in Scotland. The Scottish Government is committed to delivering the 11 social security benefits by the end of the current parliamentary session, in 2021.

The Scottish Government's social security system programme is in its early stages

62. The Scotland Act 2016 devolves responsibility of specific areas of social security spending to Scotland. These include benefits for people with a disability or health condition, carers, parts of the regulated social fund and discretionary housing payments (Exhibit 6). DWP and HMRC will continue to deliver reserved benefits and tax credits.

Exhibit 6
Social security powers being devolved through the Scotland Act 2016

September 2016

Powers to:

- create new benefits in devolved areas
- change employment support
- make discretionary payments and assistance
- make changes to Universal Credit for the costs of rented accommodation, recipients and timing of payments
- top-up reserved benefits.

Claimants and spending: 1 April 2017

- **Discretionary Housing Payment** – additional support for housing benefit recipients having difficulty paying rent.
- Transitional year for devolving employability services. Fully devolved from April 2018.

Claimants and spending: Timing to be agreed

- **Disability Living Allowance (DLA)** – provided to people with a disability or health condition. See **PIP**.

116,000
£49m

303,000
£1.4bn

128,000
£487m

- **Attendance Allowance** – to help people over 65 years with a physical or mental disability to pay for personal care.

78,000
£318m

- **Personal Independence Payment (PIP)** – introduced to replace DLA for people aged 16-64 years.

£2.8 billion
in social security spending to be devolved to Scottish Parliament

68,000
£222m

- **Carer's Allowance** – for people over 16 years who spend at least 35 hours a week looking after someone with substantial care needs.

1,061,000
£181m

- **Winter Fuel Payment** – for people born on or before 5 July 1952 to help pay for heating bills.

£3m

26,000
£87m

- **Industrial Injuries Disablement Benefit** – for people who are ill or disabled as a result of an accident or disease at work or while on employment training scheme or course.

£4m

136,000
£3m

8,000
£51m

- **Severe Disablement Allowance** – for working age people unable to work due to illness or disability. Closed to new entrants.
- **Cold Winter Payment** – paid to certain benefit recipients to help with heating costs when it is on average 0°C or below for seven days.

Spending: Timing to be agreed

- **£4m: Funeral Payment** – paid to certain benefit recipients to help with the cost of arranging a funeral.
- **£3m: Sure Start Maternity Grant** – one-off payment to help towards the cost of a first child for certain benefit recipients.

Note:
1. The figures represent spending 2015/16 and number of recipients. The number of recipients for DLA, PIP, Attendance Allowance, Carer's Allowance, and Severe Disablement Allowance is at February 2016. The number of recipients for Industrial Injuries Disablement Benefit is at March 2016. Winter Fuel Payment, Cold Winter Payment and Discretionary Housing Payment are total payments, 2015/16. The number of grants for Scotland for funeral payments and the Sure Start maternity grant is not available for 2015/16.

Source: Audit Scotland using figures from DWP and Scottish Government

63. The Scottish Government's social security system programme is in its early stages. It has been taking the time to create the environment needed to successfully deliver the social security system. To ensure it gets this right the programme is developing its understanding of the process of managing social security, what will be needed to manage the system well, and modelling costs. For example, the programme is exploring what different users' needs are to help identify:

- what processes and IT systems might be required
- the interdependencies between different benefits and existing systems
- the skills needed to deliver and test any new systems.

64. The Scottish Government is also taking steps to learn lessons from the experience of others. For example, Revenue Scotland has shared its experience of setting up a new body and IT system and the programme team is learning from DWP's experience of using its systems. This knowledge base is helping the programme team to understand the practical challenges and opportunities of managing a social security system.

65. The scope of the work to devolve the social security powers is large and complex. In March 2016 the Scottish Government set out its vision and principles for social security alongside the first stage of an options appraisal.[10,11] This identified setting up an agency to deliver social security as the preferred option. Between July 2016 and October 2016 it carried out a consultation to gather the public's opinions on the devolved benefits and how they should be delivered. It published the findings of the consultation in February 2017 [*to confirm*]. This, and its planned work with panels of current claimants, will contribute to the Scottish Government developing its policies and programme.

66. The Scottish and UK governments have agreed to split the transfer of the legislative and operational responsibilities for social security. This means the Scottish Parliament will be able to legislate on devolved social security areas but take responsibility for administering them in a phased way. The transfer of the legislative responsibilities is expected by summer 2017, by when the Scottish Government intends to have introduced its Social Security Bill. Transfer of the operational responsibilities is anticipated by April 2020. The Scottish Government is exploring with DWP how to enable the Scottish Parliament to implement some social security changes, such as increasing carer's allowance, sooner. It is also consulting on regulations giving people the options to alter the frequency of their universal credit payments and to pay the housing element directly to their landlord. Implementing these changes may involve using DWP systems in the interim, and the Scottish Government will reimburse DWP for the cost of this.

67. We have previously made recommendations on managing ICT programmes in central government.[12] These recommendations are relevant to the social security system

[10] *A new future for social security in Scotland*, Scottish Government, March 2016

[11] *Scottish Social Security, Options Appraisal Part 1: The strategic case for change and the governance of social security in Scotland*, Scottish Government, March 2016

[12] *Managing ICT contracts in central government: an update*, Audit Scotland, June 2015

programme. Any new IT systems will need to work with existing systems to ensure they meet user needs and pay benefits accurately and fairly. The programme recognises the importance of IT to successfully delivering the new social security powers. It has appointed a Chief Digital Officer and located specialists from the Scottish Government's digital team within the social security directorate to ensure closer working with operation and policy colleagues.

68. The Social Security Programme Board oversees the work of the programme (Exhibit 3, page 15). Its membership includes representatives from other Scottish Government directorates including digital, finance and procurement, and DWP also observes board meetings.

69. The programme will be delivered through a number of projects that report to the board. They are being established as decisions are made about how the social security powers will be implemented. Each project should be underpinned by detailed plans setting out the key tasks, milestones and interdependencies. Coordinating the project plans into an overarching programme plan will support the board's oversight and scrutiny of progress towards delivering the social security system by the end of the current parliamentary session, 2021.

70. Devolution of social security powers comes at a time when DWP is implementing a number of reserved policies such as Universal Credit. The Scottish Government is working with DWP to ensure its programme of work is achievable alongside DWP's work programme. Building and maintaining good working relationships will be essential to ensuring the plans are successfully delivered.

71. The programme team is undertaking the next stage in the options appraisal process which will inform the Scottish Government's approach to delivering the social security system. At the same time it is carrying out additional work to model more detailed costs and develop plans and timescales. The Scottish Government intends to share its approach to delivering the social security system with the Scottish Parliament in due course. Sharing its approach will help support Parliamentary scrutiny and provide members of the public with more certainty about when they may be likely to see changes that affect them.

72. 2017 will be a critical year for the programme as it moves into the delivery phase with the introduction of legislation and the use of its new social security powers for universal credit flexibilities. This step-change will significantly increase the amount of work undertaken by the programme team. We will continue to report on the Scottish Government's progress in delivering the social security powers as the programme develops.

Employability transitional service plans are well advanced

73. Devolution of employability services under the Scotland Act 2016 begins from April 2017. The Scottish Government has announced its plans to replace DWP's Work Choice and Work Programme services with two new employability services, Work First and Work Able. These will help up to 4,800 people with a disability or long-term health condition into employment. The arrangements are transitional for 12 months, before the services are fully devolved in 2018. Skills Development Scotland has procured Work Able and will manage the contract. The Scottish Government has completed procurement of Work First and agreed to use DWP

IT systems for the service. The Scottish Government is already planning for the fully devolved service and will begin its procurement in 2017. Effectively managing the contracts and monitoring their performance will help ensure service providers achieve positive outcomes for their clients.

Part 3: Public financial management and reporting

Key messages

- **The new powers require a more strategic approach to Scottish public financial management and reporting. This includes an overarching medium-term financial strategy underpinned by clear policies and principles for using, managing and controlling available financial powers. The Scottish Government is further developing its approach to financial management within the fiscal framework. It needs to finalise policies and principles for borrowing and reserves, and develop longer-term financial plans.**
- **The budget process is becoming increasingly complex, with substantial changes to key components including the block grant from the UK Government. The budget will be more reliant on forecasting than ever before and adjustments will be needed throughout the budget cycle. The Budget Process Review Group is reviewing current arrangements and is assessing what is needed to support Parliamentary scrutiny in the future.**
- **Clear reporting on all parts of the budget cycle will be important; from the budget itself to reporting on outturn and performance. The Scottish Government is increasing the availability of financial information to provide a more transparent and comprehensive picture of Scotland's public finances. More work is required to meet the information needs of the Scottish Parliament and the public as the new powers come into force. This will enable the Parliament and wider public to fully understand and scrutinise the Scottish Government's decisions.**

The new powers require a step-change in public financial management and reporting

74. The new financial powers have wide-ranging implications for how Scotland's public finances are managed. They represent a significant shift in emphasis for the Scottish Government. From a position which mainly involved managing expenditure within budgets, the Scottish Government will now manage more complex budgets alongside revenues from taxes.

75. The new powers provide opportunities for different approaches to managing public finance. They also offer more choices on raising revenues and spending, and the balance between these elements. The performance of the Scottish economy relative to the rest of the UK will have a direct bearing on Scotland's public finances. This exposes Scotland's public finances to increased risk of volatility and uncertainty compared to the position before the new powers

came into effect. In particular, tax revenues and social security spending may be more or less than forecast.

76. Effective management of public finances will increasingly rely on robust economic and financial forecasting. Forecasts are by their nature uncertain, and need to be based on unbiased and reliable data, using a sound methodology. There will always be forecasting errors - in time, forecasts will prove to be pessimistic or optimistic - and errors will differ in scale and size. What is important is that the Scottish Government manages the variations year on year, through its budget proposals and by applying its new borrowing and reserve powers.

77. The change from a spending budget to a tax-raising and spending budget is significant and requires a close understanding of the underlying factors that affect each element and how they interact. The Scottish Parliament requires good quality information to enable effective scrutiny of the Scottish Government's budget proposals. More generally, the Scottish Parliament and the public need good financial information, to understand and assess the health of Scotland's public finances. Engaging with organisations and the wider public will foster informed and inclusive decisions. It will be important for the Scottish Government to demonstrate how it intends to achieve its priorities and desired outcomes in the long-term. An important part of this process will be setting multi-year budgets which will also help public bodies take a longer term view and consider financial sustainability.

78. This part of the report considers the impact of the new powers on public financial management and reporting and assesses the Scottish Government's progress in these key areas.

The Scottish Government is developing its approach to financial management

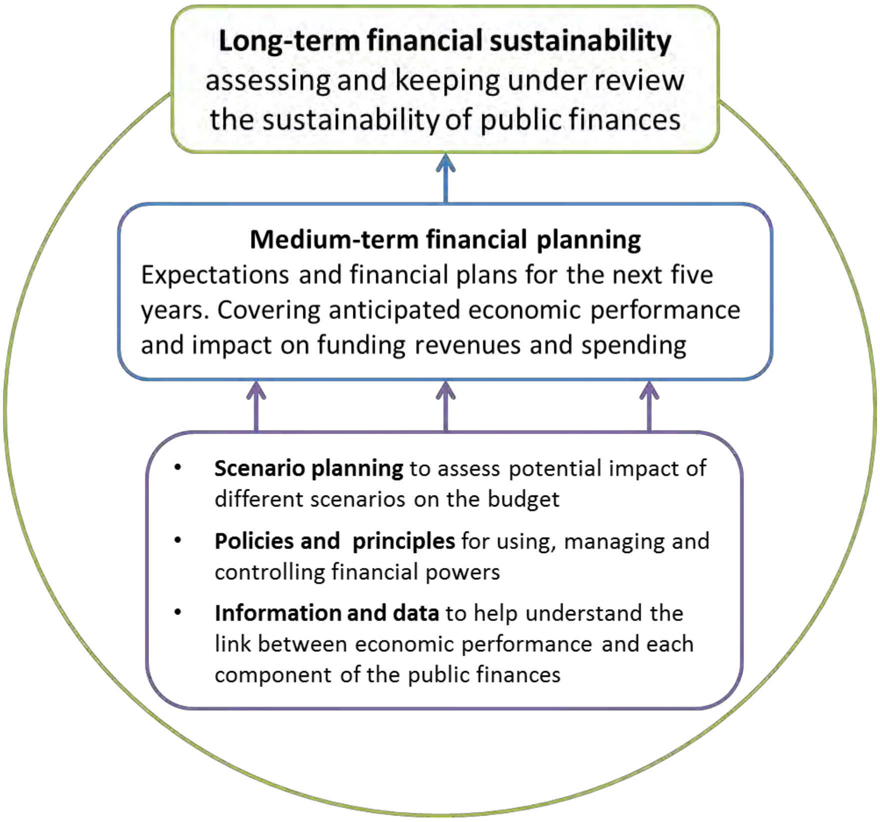
A longer-term approach helps decision-making and financial sustainability

79. A longer-term approach to finances, covering a five to ten year period, provides a context for current decisions and, along with a clear set of financial strategies and principles, creates an overall framework for financial decision-making and sustainability. The Scottish Government acknowledges the benefits of taking a longer-term view but has not yet developed an overarching approach for managing Scotland's public finances in light of its new powers.

80. Exhibit 7 sets out the main components of strategic financial management. A key element is an overarching medium-term financial strategy setting out the expectations and broad financial plans for the next five years. This should be underpinned by clear policies and principles for using, managing and controlling the available financial powers. Scenario planning based on economic forecasts and financial information will be increasingly important in assessing the range of potential impacts on the Scottish budget; improving financial planning, management, and decision-making.

Exhibit 7

Key components of strategic financial management



Source: Audit Scotland

81. These are key aspects which the Scottish Government will need to assess and keep under review the long-term sustainability of the Scottish public finances. This includes considering the longer-term implications of policy decisions and how these sit alongside existing commitments and anticipated changes in the economy, revenues and spending.

Fiscal policies and principles support public financial management and longer-term sustainability

82. The fiscal framework sets out agreed rules and limits within which the Scottish Government will manage its finances and the related economic and funding risks. They include rules for block grant adjustments, annual and overall limits for borrowing and how the Scotland Reserve will operate.

83. More detailed, well reasoned fiscal principles support day-to-day financial governance and decision-making as well as the response to specific events. For example, in addition to those prescribed in the framework, the Scottish Government could set out high-level targets or limits for key measures. This might include limits for the level, type and timing of borrowing. It could also include principles for the operation of the Scotland Reserve and how it will be

maintained to support routine spending over time and in the event of forecasting errors, or unexpected economic or fiscal events.

84. The Scottish Government already applies this approach for capital investments. To provide assurance that its future capital commitments are affordable it sets a limit to ensure that its payments for Private Finance Initiatives (PFI), non-profit distributing (NPD) schemes and borrowing do not exceed five per cent of its resource budget. The Scottish Government is re-examining this principle in the context of the new powers.

The Scottish Government has not fully developed policies and principles for managing its borrowing and reserve powers

Borrowing and reserves

The Scotland Act 2016 and accompanying fiscal framework increased the Scottish Government's capital and revenue borrowing to help it manage the increased risk and volatility its budget is now exposed to. The Scottish Government to date has not borrowed any money. But it has estimated it will need £30 million in 2017/18 to start repaying what it plans to borrow in 2016/17 (see table).

The Scotland Act 2016 also changed the rules in relation to reserves. The Scotland Reserve replaces both the Scotland Act 2012 cash reserve and the Budget Exchange Mechanism.

	Annual limit *	Overall limit *	Planned 2016/17 Annual limit	Planned 2017/18 Annual limit
Capital borrowing	15% of overall borrowing limit	£3 billion	£316 million £316 million	£450 million £450 million
Revenue borrowing	£600 million	£1.75 million	0 £600 million	0 £600 million
Scotland Reserve **	£350 million	£700 million	0 £350 million	0 £350 million

* The Scotland Act 2016 increases the annual limits. For capital borrowing it increases from 10% of its capital budget in the Scotland Act 2012 to 15% of its borrowing limit in the Scotland Act 2016 from 2017/18.
** The Scotland Reserve replaces the cash reserve and budget exchange mechanism.

85. Borrowing can be used for capital purposes (to create assets such as schools, hospitals, roads and bridges) and for revenue purposes (to deal with unexpected shortfalls in revenues raised from taxation). Creating assets boosts the economy by providing jobs which in turn increases the money raised from taxation. All borrowing decisions have consequences for future budgets as repayments have to be made. This reduces the amount of money available for its priorities in future budgets.

86. The fiscal framework sets an annual limit for capital borrowing of 15 per cent of the overall limit of £3 billion. The framework also allows the Scottish Government to borrow up to £600 million each year within an overall limit of £1.75 billion in order to deal with:

- in-year cash management
- forecasting errors in relation to taxes and demand-led social security spending that affect the block grant adjustment
- a Scotland-specific 'economic shock'.

87. Reserves involve setting aside money for future financial periods, in anticipation of future spending or to smooth the effects of peaks and troughs in tax revenues or unanticipated spending.

88. In December 2015 we recommended that the Scottish Government progress its strategy for capital borrowing, setting out details of decision-making processes and procedures for borrowing.[13] Since then, other bodies, such as the Chartered Institute of Public Finance and Accountancy, and the Fraser of Allander Institute have also called for a clear borrowing strategy; setting out how the Scottish Government will use its powers and what it will use them for.[14]

89. The Scottish Government is currently developing principles for borrowing and using reserves. It needs to finalise these as a matter of urgency. This will help the Scottish Government manage the added complexity of its finances within the fiscal framework. Overarching principles might include:

- under what conditions the Scottish Government will use capital and revenue borrowing, and its reserve
- what it will use the money for and how it will demonstrate decisions are sustainable
- what processes it will put in place to assess and respond to forecasting errors or a Scotland-specific economic shock
- how and where it will report borrowing and use of its reserve against the limits set in the fiscal framework
- any additional limits or targets, other than those in the fiscal framework, it will need to put in place to ensure there is scope to deal with unexpected economic events.

The Scottish budget is more complex than ever before

90. Managing the Scottish Government's budget is becoming increasingly complex, with more components such as revenues from taxes and new expenditure such as social security payments. While the block grant from the UK Government remains a key component, the Scottish Government will have more options for borrowing and use of reserves in bringing forward budget proposals.

91. The complexity and the inter-relationships between elements of the budgets is illustrated by assessing the impact of the new powers on the block grant i.e. the funding that the Scottish Government receives from the UK Government every year.

[13] *Implementing the Scotland Act 2012: An update*, Audit Scotland, December 2015
[14] *Scotland's Budget 2016*, Fraser of Allander Institute, September 2016

92. The fiscal framework states that the Barnett formula will continue to be used to calculate the overall block grant.[15] It is based on the previous year's grant plus or minus any changes, or 'consequentials' calculated using this formula. As each of the new financial powers is implemented a further adjustment needs to be made to the block grant, known as a block grant adjustment (BGA). Exhibit 8 summarises, in general terms, how funding for the Scottish Government's budget is now calculated.

Exhibit 8

How the funding for the Scottish budget is determined

Source: Audit Scotland

93. BGAs represent tax revenues foregone, or spending power no longer available to the UK Government. The fiscal framework sets out how the initial baseline adjustment will be made in each case. For taxes, it will be based on forecast Scottish tax revenue. For all social security spending, except for cold weather payments, it will be based on forecast equivalent spending in Scotland.

94. As the initial BGAs will be based on forecasts an adjustment may be needed if the actual revenues collected or spending is less than forecast. In some cases actual revenues will not be known until nearly two years after the initial BGA was made. As an example, Exhibit 9 (page 36) summarises how the process will work for Non Dividend Non Savings (NSND) income tax.

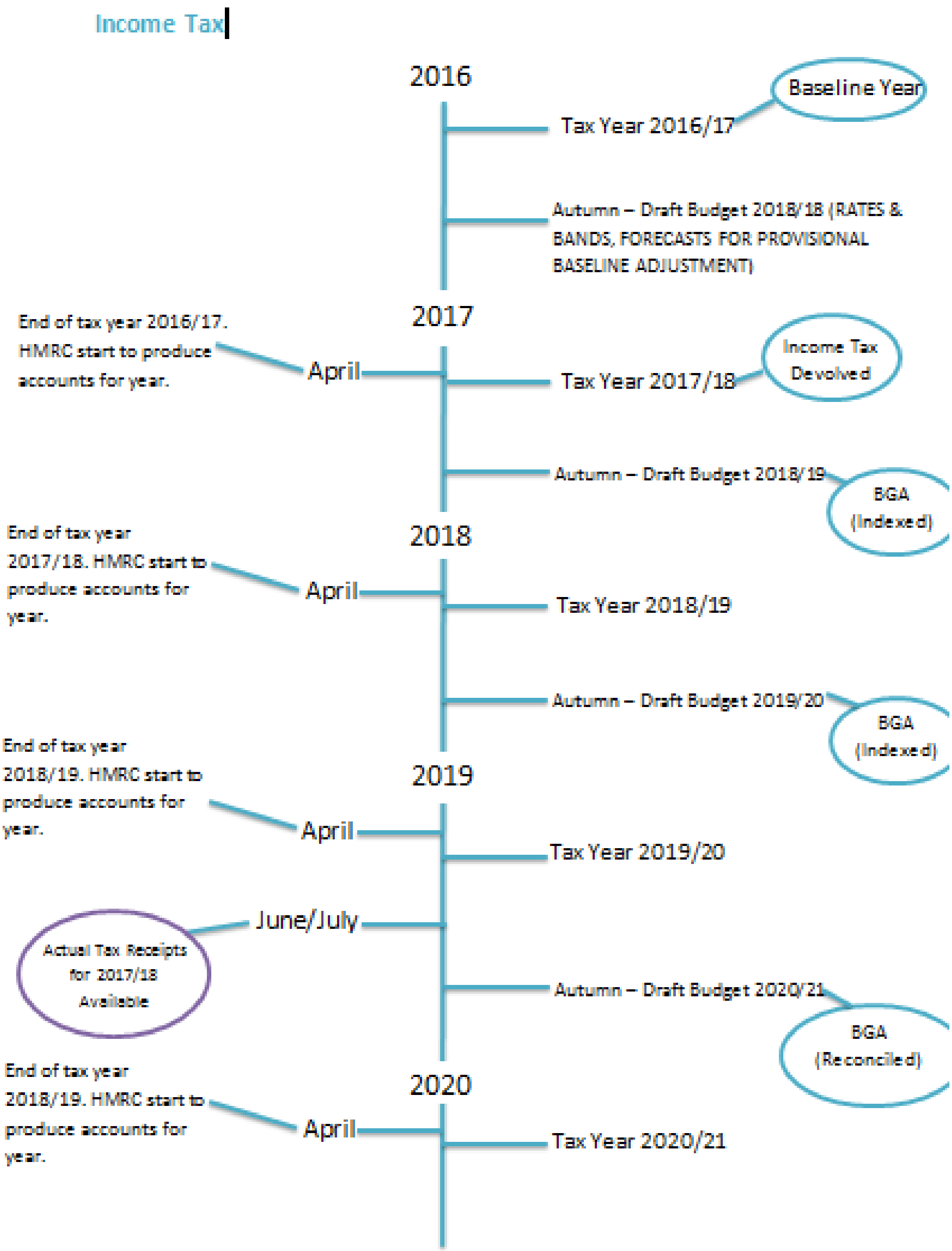
95. All this adds to the complexity of the budget process with a number of adjustments and reconciliations going on in any one year. Adjustments will be made throughout the budget year as actual receipts and spending are reconciled to the BGAs. For example, if actual revenues are less than forecast, the BGA in the following year will be adjusted accordingly. The Scottish Government would then have to decide whether to use revenue borrowing, or the Scotland Reserve to cover any shortfall.

96. Managing these adjustments throughout the budget cycle as a whole, along with its borrowing and reserve powers will be complex. Policies and principles underpinning a medium term financial plan will help the Scottish Government manage this.

[15] The Barnett formula is a mechanism used by HM Treasury to automatically adjust the amounts of public expenditure allocated to the devolved administrations of Northern Ireland, Scotland and Wales to reflect changes in spending levels allocated to public services in the UK.

Exhibit 9

Block grant adjustment process for non-savings non-dividend income tax



Source: Audit Scotland

The budget process is under review

97. In view of the far-reaching changes to public finances flowing from the new powers, it was widely recognised that the budget review process would need reviewed. In September 2016, the Scottish Parliament's Finance and Constitution Committee announced a fundamental review of the budget process, taking into account the devolution of further powers. It set up the Budget Process Review Group (BPRG) consisting of Scottish Parliament and Scottish Government officials and external experts, including the Auditor General for Scotland.

98. The BPRG is considering the budget timeline as well as what type of reports and information would be most effective for scrutiny. The group is expected to report its findings to Ministers and the Finance and Constitution Committee before the 2017 summer recess. [*We will update this once the interim report is available*]

99. The Chancellor of the Exchequer announced that his 2016 Autumn Statement would be the last of its kind. This means that the main UK budget statement will now be made in the autumn instead of March each year. This will have implications for the Scottish Government's budget-setting process and the BPRG is considering this as part of its review.

The Scottish Government is providing more financial information and is committed to enhanced financial transparency

100. The Scottish Parliament considers then authorises the Scottish Government's proposed spending plans and tax rates before the start of each financial year. Effective Parliamentary scrutiny is critical to ensure that budget proposals are thoroughly tested and independently reviewed. This improves decision-making and contributes to public trust in government.

101. The Scottish Parliament's role in scrutinising the Scottish Government's policies, budgets and performance has never been more important. To fulfil its role, the Parliament must get comprehensive, reliable and timely information about the Scottish Government’s objectives, plans and progress.

102. In December 2015, we recommended the Scottish Government progress financial reporting arrangements for devolved tax receipts and capital borrowing liabilities as a priority. This was to ensure that reporting is consistent, transparent and in line with public sector financial accounting frameworks.

103. The Scottish Government's draft budgets have included a separate chapter on devolved taxes since 2015/16. The draft budget for 2016/17 also included information on the SRIT. The actual devolved tax receipts for 2015/16 were reported in the Devolved Taxes Account published by Revenue Scotland for the first time in September 2016.

Clear and comprehensive reporting on all parts of the fiscal framework is needed

104. It will be critical for the Scottish Government to provide clear information on how all parts of the fiscal framework operate in practice. This includes the basis of its decisions on key aspects of its public financial management and a clear overall picture of Scotland's public

finances. A complete understanding of how much money has been committed across government to longer-term investment helps to inform decisions about future tax and spending. Examples of longer-term investment include borrowing, public private partnerships and public sector pensions. This will help to determine how sustainable Scotland's public finances are.

105. This includes reporting clearly on:

- and demonstrating that anticipated spending can be funded from anticipated revenues
- movements in the Scottish block grant arising from the application of the Barnett formula, baseline adjustments and indexation for each element of the block grant
- revenue and spending forecasts, and reconciling these to actual amounts when they are known
- actual spending against budget and the reasons for variations
- the impact of any capital and resource borrowing, and movements and balances in the Scotland Reserve
- what has been achieved from public spending
- other commitments, guarantees or potential liabilities that may impact on future budgets.

106. The Scottish Government reports this information in a variety of documents including budget documents, audited annual accounts, and economic and performance reports. It is important this information is presented in such a way that is easy to understand and navigate. This provides a basis for ongoing engagement with the public and helps the Parliament to build a comprehensive picture of Scotland's public finances. This allows the potential consequences of policy choices and decisions on long-term financial sustainability to be better understood.

The Scottish Government provided additional information to support the 2017/18 draft budget

107. The Scottish Government published additional financial, economic and performance information alongside the publication of its 2017/18 draft budget. This included:

- a short guide to Scotland's public finances explaining how the budget is funded, what money is spent on, the fiscal framework and the timeline for new tax and spending powers
- a report explaining the methodologies and assumptions relating to the devolved tax forecasts underpinning the draft budget. This included details of actual tax revenues to date and a medium-term assessment of devolved tax revenues and forecasts over a five year period to 2021/22
- an update setting out how the Scottish Government is performing against national outcomes and performance indicators.

108. The taxation chapter within the draft budget document was expanded to include an explanation of the new tax powers and fiscal framework. Information on tax forecasts, block grant adjustments and borrowing were all included.

109. The 2017/18 draft budget broadly contains the information we set out in paragraph 105. This is at a basic level and some parts need to be explained better. As the budget becomes increasingly complex it will be important for the Scottish Government to further develop this document. For example, it needs to clearly explain and link the different sections of the budget so it is more transparent and understandable, including:

- Whilst the total DEL funding and total DEL spending plans are clearly set out. There are some adjustments that are not fully explained and any carry forwards from the previous year are not separately identified. This makes it difficult to see and understand how total funding covers spending plans.
- The budget states that the full amount of capital borrowing will be used, but it is not clear for what purpose. It is not clear how capital repayments have been calculated and how this impacts on the total amount of borrowing compared to the limits set out in the fiscal framework.
- There is no commentary on the use of reserves other than an explanation of the rules as set out in the fiscal framework

110. While the draft budget provided tax revenue forecasts for the next five years and total funding for the next three years, there is not yet an overarching medium-term financial plan (Exhibit 7, page 31) which would provide a longer-term context for the annual budget. No commentary or explanations are provided beyond 2017/18.

The Scottish Government has made a commitment to broadening financial reporting

111. More work is needed to build a comprehensive picture of Scotland's public finances. As the Auditor General for Scotland has previously reported, this includes a more rounded account of the Scottish Government's overall performance.[16] It needs to be clearer what spending is aiming to achieve and how this contributes to the Scottish Government's overall purpose and specific outputs and outcomes.

112. The Scottish Government is continuing to review and broaden its financial reporting in the context of the new financial powers. The Permanent Secretary confirmed in a response to the Scottish Parliament's Public Audit and Post-legislative Scrutiny Committee in November 2016 that the Scottish Government would:

- publish a 2016 snapshot of the key facts from the financial statements of the Scottish Administration for the year ended 31 March 2016, in January 2017[17]
- produce a 'tailored-for-Scotland' 2016/17 consolidated account for audit in spring 2018. This is provided that non-departmental bodies and local authorities commit to data sharing for this purpose and that their accounts are fully compliant with International

[16] *The 2015/16 audit of the Scottish Government consolidated accounts*, Audit Scotland, September 2016

[17] The Scottish Administration is the Scottish Government its executive agencies, Crown Office and Procurator Fiscal Service, NHS territorial and special boards, and Statutory Office Holders

Financial Reporting Standards (IFRS). The scope, format and content of the accounts is to be agreed by April 2017.

113. To date the Scottish Government has not published a snapshot of key facts for the Scottish Administration [*update if this changes*]. If the conditions for consolidated public accounts are not met, because IFRS compliant information on councils' highways assets or other information is not available, the Scottish Government should still demonstrate progress in developing these accounts. This may include, for example, performing trial runs involving groups of public sector bodies and individual key elements of public finances that will in time be reflected in consolidated public accounts for Scotland.

114. The preparation and content of financial information at all stages in the budget and financial reporting cycle are important. This includes from the planning, development and preparation of the draft budget through to the suite of annual accounts that are audited and published; as well as other information which the Scottish Government publishes on its progress towards its aims and objectives.

115. As part of its work to further enhance financial reporting, the Scottish Government continues to review its annual accounts to identify opportunities for improvements. It will be important to explain how the Scottish budget is funded, making links to other accounts, for example, the Devolved Taxes Account prepared and published by Revenue Scotland.

116. As part of further developments in annual accounts, there is scope for more detailed and consistent explanations for differences between budgets and outturns. This would assist understanding of key developments such as the impact of announcements that affect the budget and the Scottish Government's response. It would also facilitate understanding and scrutiny in key areas of spending, including in education and health.

117. In summary, the Scottish Government continues to enhance its financial reporting; providing a timeline for when and how it intends to do this is an important step. These are welcome developments. It now needs to deliver these commitments and set out a longer-term vision for how it will report on, and manage its finances. Transparent reporting of information will enable the Scottish Parliament and wider public to fully understand and scrutinise the Scottish Government's decisions and the state of Scotland's public finances.

Appendix

Audit methodology

We reviewed a range of information during our audit, including the following:

- Papers and official reports of the Scottish Parliament Finance and Constitution Committee and Social Security Committee
- The Scottish and UK Government's fourth annual reports on progress in implementing the Scotland Act 2012
- The Fiscal Framework and accompanying technical annex
- OECD Principles for Independent Fiscal Institutions
- Scottish Government Draft Budget 2017/18
- Papers and minutes from the Scottish Government Audit and Assurance Committee
- Papers and minutes from the Fiscal Framework Implementation Programme Board and programme management documentation
- Programme management documents of the Scottish Government's Social Security Programme and the Scottish Fiscal Commission Transition Programme
- Minutes of the Joint Ministerial Working Group on Welfare
- Papers and minutes from the Revenue Scotland Board and Audit and Risk Committee
- Revenue Scotland Annual Audit Report and devolved taxes and resource accounts 2015/16

We spoke to representatives from:

- Scottish Government
- Revenue Scotland
- Scottish Fiscal Commission

We considered the National Audit Office's planning and approach to its audit work on the Scottish rate of income tax.

We reviewed the NAO's documentation and the basis for its findings and conclusions. In particular, we considered:

- the NAO's approach to identifying the key risks to successfully implementing of the SRIT
- the NAO's audit working files, with particular focus on the audit evidence underpinning the key findings and conclusions in its report
- the NAO's arrangements for ensuring the quality of the audit work and reporting.

Freedom of Information – FoI17/01582 – Jackie Baillie- Audit Scotland Report

"Correspondence between the SG and AS relating to the Audit Scotland report entitled *Managing new Financial Powers: an update* between the first draft and the final document released in March 2017

Dates in scope 31 Jan to 23 March 2017

Ordered most recent to eldest

Document 1

From: Audit Scotland [mailto:info@reports.audit-scotland.gov.uk]
Sent: 20 March 2017 10:31
To: DG Finance Mailbox
Subject: Advance copy - Managing new financial powers: An update

You are subscribed to receive email alerts from Audit Scotland.

More work needed in managing historic change in public finances

The Scottish Government is well-organised to deliver game-changing new tax and spending powers but more work is needed to build a clearer picture of what the changes will cost, and how staffing challenges will be addressed in the next stage of financial devolution.

Attached is an advance copy of the Auditor General for Scotland report, 'Managing new financial powers: An update'.

Please note the report is embargoed for publication or broadcast until 00.01 hours on 23 March 2017.

- Managing_New_financial_powers_An_update.pdf

AUDIT SCOTLAND Questions?
Contact Us

KEEP IN TOUCH:

Document 2
From: Director of Financial Management
Sent: 17 March 2017 17:47
To: Mark Taylor
Cc: Wright AG (Aileen); [name redacted]; Grisewood A (Aidan); [names redacted]
Subject: RE: Report Extracts

Mark,

Thanks for these additions and clarifications to the report. On your last point, I'm puzzled about a decision not to include something of such specific importance in aiding Parliament's understanding of progress. Other additional evidence gathered after our first meeting has been included in the report so I'm not clear why there is a distinction with the Gateway report, but I accept this is your decision to make.

Regards

Gordon

Gordon Wales
Acting Director General Finance
The Scottish Government
3C North
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Edinburgh
EH6 6QQ
Tel redacted

Document 3
From: Mark Taylor [mailto:MTaylor@audit-scotland.gov.uk]
Sent: 17 March 2017 17:06
To: Director of Financial Management
Cc: Wright AG (Aileen); [name redacted]; Grisewood A (Aidan);[names redacted]
Subject: RE: Report Extracts

Gordon

Thank you for your e-mail. We have reflected on your comments and suggestions as we finalised the report. This is now concluded and an embargoed copy will be with you at the start of next week, in line with the normal practice.

I would make the following comments in relation to the points you raised:

- We note that there are continuing discussions with HM Treasury about some of the details of how the provisions of the Fiscal Framework operate in practice, and recognise this point in the report. We also recognise the role that the BPRG is playing, and again articulate this in the report. Our view remains that resolution of these processes does not present a prior condition to the Government progressing its policies and principles in the areas set out, and that it is important that these are in place quickly given the powers introduced from 1 April this year. We do recognise that it will be important to keep such policies under review and have added a sentence to paragraph 91 to this effect.
- We recognise that the Scotland Reserve must be operated within the rules set out in the fiscal framework, and have added a clause to paragraph 93 to ensure this is clear.
- We agree that further work is required to consolidate balance sheet information and recognise that work on this has begun. We have amended the last sentence of paragraph 112 to reflect this position.
- We note your comment on the progress of the Fiscal Framework Implementation Programme. We make reference to the programme in part 1 of the report and outline our conclusions in relation to this and other aspects of the governance arrangements in place. Your e-mail outlines the findings of a very recent Gateway review. Given that we have not had the opportunity to examine the full report of the review or discuss the details of its findings with relevant officials we are not in a position to refer to it directly in the report. We highlight in the introduction to the report that, "Our audit assesses progress to February 2017, while acknowledging that substantial activity is ongoing".

Having considered all of your comments carefully, there are no other substantive changes we have made to the report from the text previously shared.

I hope that this response is helpful.

Regards

Mark

From: directoroffinancialmanagement@gov.scot [mailto:directoroffinancialmanagement@gov.scot]
Sent: 15 March 2017 18:25
To: Mark Taylor
Cc: Aileen.Wright@gov.scot; [name redacted]; Aidan.Grisewood@gov.scot; [name redacted]

Subject: RE: Report Extracts

Mark

Thank you for sharing these extracts. You have asked for any comments on factual accuracy; in our view, this includes highlighting were the text is potentially misleading or incomplete and we have also taken the opportunity to suggest, based on the discussions we have had, a few additions. For ease of reference, we have suggested these as track changes in your document, with explanations below:

Key Message 1

- As we discussed on Friday, there are areas where discussions remain on-going with HM Treasury on some of the detail and it would be helpful to a reader to be aware of these (and that progress is being made).
- We spoke about planning, and how this can be in place without outputs in the form of plans.
- Budget Process Review Group – now that the Group has issued an interim report and encourage consultation, it seems sensible to raise its profile here (I would also suggest an appropriate footnote and link at this point).

Para 91 to 93

- The focus here is on what hasn't been completed rather than what has been achieved – see more detail on the Fiscal Framework Implementation Programme below.
- In our view, the use of "as a matter of urgency" in para 91 is unfounded: as noted previously, there are issues of detail to be resolved with HM Treasury and there is presently no immediate operational imperative. As set out previously, the 2017-18 Budget documents clearly articulate Ministers' intentions on borrowing and commitment to transparency around borrowing and the operation of the new Scotland Reserve. On the latter, it is worth reiterating that the first time at which it will be able to have new sums placed in it will be after March 2018.
- Other relevant statements of intent have also been made, for example para 22 of the Scottish Government's Fourth Annual Report on the Implementation and Operation of Part 3 (Financial Provisions) of the Scotland Act 2012 states (http://www.gov.scot/Publications/2016/03/4517/3):

  22. Use of revenue borrowing would not, because of its nature, be planned in advance of the need arising.

  Apologies if this has not previously been drawn to your attention.
- Similarly, therefore, the inference in para 92 that none of these things are in place or will be transparent is misleading, in view of the commitments that Ministers have already made.
- The use of "setting aside" in para 93 suggests that the operation of the Scotland Reserve is a matter of discretion only, rather than that the Fiscal Framework establishes detailed rules for the operation of the Reserve, both in terms of additions to and the use of the Reserve, which will for the most part prescribe its operation in practice.

Developing Financial Reporting

- Para 112 could be read as indicating that balance sheet information was available but simply not included, rather than that further consolidation is required before this could be done (and individual Balance Sheets are of course already available).

For balance and completeness

- As we have discussed, in our view the report does not sufficiently acknowledge or report the progress of the Fiscal Framework Implementation Programme, whose purpose is "*to develop the necessary policy, evidence and operational capacity required to successfully implement the financial provisions of the Scotland Act 2016 and to create a new "business as usual" model of financial processes and procedures*.".
- I appreciate that you would not wish to repeat information on project governance and detail but there is a key point to note: the recent follow-up Gateway Review of the programme which took place on 20 to 22 February and which I have highlighted previously. It has provided a Delivery Confidence Assessment of Green (defined as "successful delivery of the project/programme to time, cost and quality appears highly likely and there are no major outstanding issues that at this stage appear to threaten delivery significantly"). More specifically, the final report noted that "*The workstreams due to*

deliver in 2016-17 and those for operational implementation from April 2017 are all on track or have been delivered. Those with longer-term milestones are making appropriate progress, although as this work gains momentum, the issues of detail are starting to emerge and be addressed." This is externally-derived and wholly independent evidence on which Parliament can take assurance and so is an important part of the story here. It may also be helpful for you to be aware that the FFIB Board meeting on 21 April will consider the Gateway report and also have initial discussion around the transition to "business as usual" for some projects and what governance is required for the remaining workstreams/activity.

- It may be helpful also to note that Ministers will shortly provide their annual report to Parliament on the new powers , scheduled for week commencing 24 April 2017.

I hope this is useful for the final version of the report.

Gordon

Gordon Wales
Acting Director General Finance
The Scottish Government
3C North
Victoria Quay
Edinburgh
EH6 6QQ
Tel redacted

From: Mark Taylor [mailto:MTaylor@audit-scotland.gov.uk]
Sent: 13 March 2017 17:53
To: Director of Financial Management
Cc: Wright AG (Aileen);[name redacted]
Subject: Report Extracts

Gordon

Following on from our conversation on Friday, we have reflected on the additional information and observations on factual accuracy that you provided. We have made a number of changes to wording within part 3 of the report, the key aspects of which are reflected in the extracts attached. These are provided for information. However, please do get in touch by return if there is anything in the text we have added that you consider to be factually inaccurate.

Many thanks and regards.

Mark

Mark Taylor
Assistant Director

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AUDIT SCOTLAND

Document 4
From: Director of Financial Management
Sent: 15 March 2017 18:25
To: Mark Taylor
Cc: Wright AG (Aileen); [name redacted]; Grisewood A (Aidan); [names redacted]
Subject: RE: Report Extracts

Part_3_Final_Revisions - SG comments 15M

Mark

Thank you for sharing these extracts. You have asked for any comments on factual accuracy; in our view, this includes highlighting were the text is potentially misleading or incomplete and we have also taken the opportunity to suggest, based on the discussions we have had, a few additions. For ease of reference, we have suggested these as track changes in your document, with explanations below:

Key Message 1

· As we discussed on Friday, there are areas where discussions remain on-going with HM Treasury on some of the detail and it would be helpful to a reader to be aware of these (and that progress is being made).

· We spoke about planning, and how this can be in place without outputs in the form of plans.

· Budget Process Review Group – now that the Group has issued an interim report and encourage consultation, it seems sensible to raise its profile here (I would also suggest an appropriate footnote and link at this point).

Para 91 to 93

· The focus here is on what hasn't been completed rather than what has been achieved – see more detail on the Fiscal Framework Implementation Programme below.

· In our view, the use of "as a matter of urgency" in para 91 is unfounded: as noted previously, there are issues of detail to be resolved with HM Treasury and there is presently no immediate operational imperative. As set out previously, the 2017-18 Budget documents clearly articulate Ministers' intentions on borrowing and commitment to transparency around borrowing and the operation of the new Scotland Reserve. On the latter, it is worth reiterating that the first time at which it will be able to have new sums placed in it will be after March 2018.

· Other relevant statements of intent have also been made, for example para 22 of the Scottish Government's Fourth Annual Report on the Implementation and Operation of Part 3 (Financial Provisions) of the Scotland Act 2012 states (http://www.gov.scot/Publications/2016/03/4517/3):

22. Use of revenue borrowing would not, because of its nature, be planned in advance of the need arising.

Apologies if this has not previously been drawn to your attention.

· Similarly, therefore, the inference in para 92 that none of these things are in place or will be transparent is misleading, in view of the commitments that Ministers have already made.

· The use of "setting aside" in para 93 suggests that the operation of the Scotland Reserve is a matter of discretion only, rather than that the Fiscal Framework establishes detailed rules for the operation of the Reserve, both in terms of additions to and the use of the Reserve, which will for the most part prescribe its operation in practice.

Developing Financial Reporting

· Para 112 could be read as indicating that balance sheet information was available but simply not included, rather than that further consolidation is required before this could be done (and individual Balance Sheets are of course already available).

For balance and completeness

· As we have discussed, in our view the report does not sufficiently acknowledge or report the progress of the Fiscal Framework Implementation Programme, whose purpose is "*to develop the necessary policy, evidence and operational capacity required to successfully implement the* *financial provisions of the Scotland Act 2016 and to create a new "business as usual" model of financial processes and procedures*.".

· I appreciate that you would not wish to repeat information on project governance and detail but there is a key point to note: the recent follow-up Gateway Review of the programme which took place on 20 to 22 February and which I have highlighted previously. It has provided a Delivery Confidence Assessment of Green (defined as "successful delivery of the project/programme to time, cost and quality appears highly likely and there are no major outstanding issues that at this stage appear to threaten delivery significantly"). More specifically, the final report noted that "*The workstreams due to deliver in 2016-17 and those for operational implementation from April 2017 are all on track or have been delivered. Those with longer-term milestones are making appropriate progress, although as this work gains momentum, the issues of detail are starting to emerge and be addressed*." This is externally-derived and wholly independent evidence on which Parliament can take assurance and so is an important part of the story here. It may also be helpful for you to be aware that the FFIB Board meeting on 21 April will consider the Gateway report and also have initial discussion around the transition to "business as usual" for some projects and what governance is required for the remaining workstreams/activity.

· It may be helpful also to note that Ministers will shortly provide their annual report to Parliament on the new powers , scheduled for week commencing 24 April 2017.

I hope this is useful for the final version of the report.

Gordon

Gordon Wales
Acting Director General Finance
The Scottish Government
3C North
Victoria Quay
Edinburgh
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Tel redacted

From: Mark Taylor [mailto:MTaylor@audit-scotland.gov.uk]
Sent: 13 March 2017 17:53
To: Director of Financial Management
Cc: Wright AG (Aileen); redacted
Subject: Report Extracts

Gordon

Following on from our conversation on Friday, we have reflected on the additional information and observations on factual accuracy that you provided. We have made a number of changes to wording within part 3 of the report, the key aspects of which are reflected in the extracts attached. These are provided for information. However, please do get in touch by return if there is anything in the text we have added that you consider to be factually inaccurate.

Many thanks and regards.

Mark

Mark Taylor
Assistant Director
Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN

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AUDIT SCOTLAND

Document 5
From: Director of Financial Management
Sent: 14 March 2017 08:32
To: [name redacted]; Mark Taylor
Cc: Wright AG (Aileen)
Subject: RE: Report Extracts

Thanks [redacted]. There will be comments and we will have to you by close tomorrow.

Gordon

Gordon Wales
Acting Director General Finance
The Scottish Government
3C North
Victoria Quay
Edinburgh
EH6 6QQ
Tel redacted

From: redacted
Sent: 14 March 2017 07:58
To: Mark Taylor; Director of Financial Management
Cc: Wright AG (Aileen)
Subject: RE: Report Extracts

Hi Gordon,

Further to Mark's email, if there are any factual inaccuracies we would need to know by the close of play on Wednesday as we are now entering the final proofing stages.

Many thanks,

Morag

From: Mark Taylor
Sent: 13 March 2017 17:53
To: directoroffinancialmanagement@gov.scot
Cc: Aileen.Wright@gov.scot; [name redacted]
Subject: Report Extracts

Gordon

Following on from our conversation on Friday, we have reflected on the additional information and observations on factual accuracy that you provided. We have made a number of changes to wording within part 3 of the report, the key aspects of which are reflected in the extracts attached. These are provided for information. However, please do get in touch by return if there is anything in the text we have added that you consider to be factually inaccurate.

Many thanks and regards.

Mark

Mark Taylor
Assistant Director

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
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www.audit-scotland.gov.uk

Document 6
From: Mark Taylor [mailto:MTaylor@audit-scotland.gov.uk]
Sent: 13 March 2017 17:53
To: Director of Financial Management
Cc: Wright AG (Aileen); redacted
Subject: Report Extracts

Gordon

Following on from our conversation on Friday, we have reflected on the additional information and observations on factual accuracy that you provided. We have made a number of changes to wording within part 3 of the report, the key aspects of which are reflected in the extracts attached. These are provided for information. However, please do get in touch by return if there is anything in the text we have added that you consider to be factually inaccurate.

Many thanks and regards.

Mark

Mark Taylor
Assistant Director

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www.audit-scotland.gov.uk

Document 7
From: Mark Taylor [mailto:MTaylor@audit-scotland.gov.uk]
Sent: 09 March 2017 15:01
To: Director of Financial Management; [redacted]
Cc: Grisewood A (Aidan); Wright AG (Aileen); [redacted]; Director of Financial Strategy;[redacted]
Subject: RE: Audit Scotland report - managing new financial powers

Gordon

Thanks for this. We are looking at the detail this afternoon. In advance of that would it be helpful to pencil in either a telephone meeting or a quick face-to-face tomorrow sometime (for half an hour say). As it happens, I'm pretty flexible on timing for most of the day.

Regards

Mark

From: directoroffinancialmanagement@gov.scot [mailto:directoroffinancialmanagement@gov.scot]
Sent: 09 March 2017 11:03
To: [redacted]; Mark Taylor

Cc: Aidan.Grisewood@gov.scot; Aileen.Wright@gov.scot; [redacted] DirectorofFinancialStrategy@gov.scot
Subject: RE: Audit Scotland report - managing new financial powers

Mark,

Thanks for this redrafted report and the changes that have been made. I remain concerned that the report fails to sufficiently acknowledge two significant factors:

- That because there is still on-going discussion with HM Treasury on some aspects of the Fiscal Framework then it is not possible to finalise some aspects of both our advice to Ministers and how that then manifests itself in the strategies and tactics we employ to manage the public finances. In addition, the work of the Budget Review Group is fundamental. Its interim findings are now available and will of course be an influencing factor. It would be inappropriate to have moved ahead with everything you have suggested in the report without failing to acknowledge that its eventual recommendations would have a bearing. The Reserve is a good example.
- There is a need to better distinguish between the work we have done internally to support decision-making by Ministers (the borrowing modelling being a good example) and what is then in public domain. One is a question of processes, systems etc., the other is of transparency. At present the reader is left assuming that your remarks on the latter means that the former is not in hand. It would be useful to gain more acknowledgement for the work that has been done to date (and which I as I have said above, is still being influenced by other factors). It might also be useful for you to know that the Gateway Review of the programme carried out two weeks ago has given the programme a Green assessment.

My fear here is that, on publication in its current format, there is seen to be a gap between what we know we are doing and how that is being conveyed and that would not serve either of us well. I'm therefore attaching a further version with a number of what I believe to be corrections to the position as conveyed and comments requesting further accuracy/clarity on specific points. I would be happy to arrange an urgent discussion if that would be the best way of progressing.

Regards

Gordon

Gordon Wales
Acting Director General Finance
The Scottish Government
3C North
Victoria Quay
Edinburgh
EH6 6QQ
Tel redacted

From: Mark Taylor [mailto:MTaylor@audit-scotland.gov.uk]
Sent: 03 March 2017 17:41
To: Director of Financial Management; Wright AG (Aileen); Grisewood A (Aidan)
Cc: [redacted]
Subject: FW: Audit Scotland report - managing new financial powers

Gordon

Following on from [redacted]'s e-mail please find attached a revised part 3 of our report, which contains some additional content. I should be grateful if you would confirm its factual accuracy in the normal manner by close of play on Wednesday 8 March. If this timetable is likely to prove problematic please do let me know.

You will see that the paragraph numbering of the extract has gone a bit awry due to template/ formatting issues. The first numbered paragraph is number 73 in the full draft. If you have any comments on factual accuracy, its probably best to reference them to the numbers in this extract.

[redacted] is now on leave. Could you direct your reply to [redacted] in the first instance.

Many thanks and regards.

Mark

Mark Taylor
Assistant Director

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
T: redacted **E:** mtaylor@audit-scotland.gov.uk
www.audit-scotland.gov.uk

AUDIT SCOTLAND

From: redacted
Sent: 27 February 2017 17:37
To: directoroffinancialmanagement@gov.scot
Cc: Mark Taylor
Subject: Audit Scotland report - managing new financial powers

Gordon

Many thanks for your letter to the Auditor General, setting out comments on our draft report *Managing new financial powers: an update*.

We met the Auditor General this morning to discuss proposed changes to the report. We are planning to include some additional text in part three (on financial management and reporting), which we will send to you to check for factual accuracy.

I wanted to let you know that we are aiming to get the revised extracts to you by the end of this week, and would be grateful if you could get back to us by the following Wednesday (8 March).

Please also note that we are now planning to publish the report on Thursday 23 March (rather than Tuesday 21).

I will be back in touch later in the week.

Kind regards,
Redacted

redacted
Audit Manager

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
T:redacted **E:** rseidel@audit-scotland.gov.uk
www.audit-scotland.gov.uk

AUDIT SCOTLAND

Document 8
From: Director of Financial Management
Sent: 09 March 2017 11:03
To: redacted; Mark Taylor

Cc: Grisewood A (Aidan); Wright AG (Aileen); [redacted]; Director of Financial Strategy
Subject: RE: Audit Scotland report - managing new financial powers

Mark,

Thanks for this redrafted report and the changes that have been made. I remain concerned that the report fails to sufficiently acknowledge two significant factors:

- That because there is still on-going discussion with HM Treasury on some aspects of the Fiscal Framework then it is not possible to finalise some aspects of both our advice to Ministers and how that then manifests itself in the strategies and tactics we employ to manage the public finances. In addition, the work of the Budget Review Group is fundamental. Its interim findings are now available and will of course be an influencing factor. It would be inappropriate to have moved ahead with everything you have suggested in the report without failing to acknowledge that its eventual recommendations would have a bearing. The Reserve is a good example.
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Regards

Gordon

Gordon Wales
Acting Director General Finance
The Scottish Government
3C North
Victoria Quay
Edinburgh
EH6 6QQ
Tel redacted

From: Mark Taylor [mailto:MTaylor@audit-scotland.gov.uk]
Sent: 03 March 2017 17:41
To: Director of Financial Management; Wright AG (Aileen); Grisewood A (Aidan)
Cc: redacted
Subject: FW: Audit Scotland report - managing new financial powers

Gordon

Following on from[redacted]'s e-mail please find attached a revised part 3 of our report, which contains some additional content. I should be grateful if you would confirm its factual accuracy in the normal manner by close of play on Wednesday 8 March. If this timetable is likely to prove problematic please do let me know.

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Redacted is now on leave. Could you direct your reply to [redacted] in the first instance.

Many thanks and regards.

Mark

Mark Taylor
Assistant Director

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
T: redacted **E:** mtaylor@audit-scotland.gov.uk
www.audit-scotland.gov.uk

AUDIT SCOTLAND

From: redacted
Sent: 27 February 2017 17:37
To: directoroffinancialmanagement@gov.scot
Cc: Mark Taylor
Subject: Audit Scotland report - managing new financial powers

Gordon

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I wanted to let you know that we are aiming to get the revised extracts to you by the end of this week, and would be grateful if you could get back to us by the following Wednesday (8 March).

Please also note that we are now planning to publish the report on Thursday 23 March (rather than Tuesday 21).

I will be back in touch later in the week.

Kind regards,
redacted

redacted
Audit Manager

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AUDIT SCOTLAND

Document 9
From: redacted Scottish Government
Sent: 06 March 2017 17:08
To: redacted Audit Scotland
Cc: names redacted

Subject: RE: 2017-18_Budget_BGAs_workings.xlsx

Hi [redacted]

At our meeting on Friday I agreed to provide a reconciliation of the overall 2017-18 Draft Budget DEL funding and spending plan positions. The DEL figures in table 1.01 differ from the allocations set out in 3.01 as a result of a number of factors.

- Table 1.01 sets out the latest published HM Treasury aggregate funding information following the Autumn Statement; and
- The Spending plans as set out in table 3.01 anticipate further changes to that aggregate total.

The reconciliation of these figures within the 2017-18 Draft Budget is provided below:-

	2017-18 £million
Total DEL funding from Table 1.01	**31,457**
Machinery of Government changes represents areas to be devolved under the Scotland Act 2016 where budget transfers have been agreed with equivalent UK departments but HMT budget aggregates have not yet reflected the change.	31
Anticipated budget transfers from a number of areas where in-year transfers for delivery of specific functions have been agreed with UK departments, but again funding is not yet reflected in HM Treasury aggregates.	156
Budget Exchange planned carry-forward from 2016-17 to support 2017-18 spending.	78
Unallocated Non-Cash DEL where not all of this non-cash budget is needed.	-229
	36
Total DEL Spending from Table 3.01	**31,493**

I trust this information is helpful.

Regards.

redacted

Redacted
Finance Directorate
T: redacted
Scottish Government
Victoria Quay
Edinburgh EH6 6QQ

From: [redacted] Audit Scotland
Sent: 24 February 2017 08:22
To: [redacted] Scottish Government

Cc: redacted
Subject: 2017-18_Budget_BGAs_workings.xlsx

Hi [redacted],

Thanks once again for last week and apologies for coming to you at this busy time, but I have a couple of points of clarification on the back of our session last week. I think these are for Ian, but I know you will be particularly busy, so sending to you Joe too, because I am pretty sure you will know some of the answers anyway.

The first relates to the £36m in the Draft Budget that I queried. You said this was an adjustment related to court tribunals, but I wanted to check whether an element of this was also an adjustment for Crown Estate too? Is there a breakdown anywhere of how this £36m is calculated (It didn't jump out at me in the DB).

I also wanted to check my understanding was correct of the overall 'funding' versus spending plans. So I have attached some workings which you can hopefully make sense of. My understanding is that this £36m is included in the overall BGA figure of 12,450 (as stated in table 1.01, page 3 of the DB). Per the fiscal framework this element of the BGA isn't indexed and is the same as the forecast element- so no net impact. Then the forecast is included as a separate line in the table. Is my understanding correct?

Secondly, overall DEL 'funding' per table 1.01 is 31,457 but table 3.01 on page 23 shows DEL spending of 31,493. The difference being 36. Which I can calculate if I exclude the tribunals BGA but include the forecast within my 'funding' calculation. So, I suppose my question is- is my thinking correct, and if so, why is it done like this?

I appreciate these are very basic questions, but I want to make sure my understanding is correct so if I have to explain it I am doing it correctly!

My last question is, Ian, I appreciate that you might not want to share the budget modelling/scenario planning workbooks you showed us, but is there any way you could summarise the assumptions, scenarios and variables that you used in your modelling? Even a bullet point list would be useful. We could see things like PfG, protected areas, public sector pay variables, tax policies, borrowing commitments. But there were lots more. I think you also said you build in a level of contingency, particularly this time round because of BGA uncertainty, policy uncertainty, and because it is now a minority government. Again, this is out of interest, just to help our understanding more than anything. I wont be quoting or reporting this. There was a lot to take in last week!

Thanks once again,

[redacted]

Document 10
From: Redacted Audit Scotland
Sent: 06 March 2017 16:06
To: Redacted Scottish Government
Subject: RE: Reply required Wed 8th lunchtime - : Audit Scotland draft report - managing new financial powers- comments requested by 7 Feb

Thanks for getting this so promptly.

I've managed to find the link.

redacted

Document 11
From: redacted Scottish Government
Sent: 06 March 2017 15:46
To: Redacted Audit Scotland
Subject: FW: Reply required Wed 8th lunchtime - : Audit Scotland draft report - managing new financial powers- comments requested by 7 Feb

Hi [redacted]

I queried the staffing figures with a colleague and further information is below. Hope it helps.

Redacted

From: Redacted
Sent: 06 March 2017 15:41
To: Redacted
Cc: Redacted
Subject: RE: Reply required Wed 8th lunchtime - : Audit Scotland draft report - managing new financial powers- comments requested by 7 Feb

Redacted

The end March 2016 figure is taken from our workforce information statistics publication. It's a snapshot covering directly employed staff in post in the SG core, and uses definitions consistent with other published workforce statistics, such as those published by ONS in their Quarterly Public Sector Employment Statistics publication.

The end March 2010 figure is comparable with the 2016 figure, and was taken from data submitted in April 2010 to ONS for their QPSES publication.

Directly employed staff covers the following staffing categories:

- Permanent, including those on paid parental leave & outward secondments
- Fixed term appointments (with and without competition)
- Fixed term student placements
- Modern apprentices

Workers not employed by the SG who are excluded from these figures:

- Consultants
- Contractor staff
- Interim managers
- Inward secondment/ SLA
- Temporary agency workers
- Short-term youth employment initiatives
- Other contingent workers
- UK Fast Stream

Apologies for not including links to the published figures – I can't access the internet just now.

Regards

Redacted

Document 12
From: Redacted
Sent: 06 March 2017 12:59
To: Redacted
Subject: RE: Audit Scotland report - managing new financial powers

If you could please that would be great. It's so we are clear on who's included and who's not, particularly as they don't quite match what our team who audit the Accounts had in their working papers. So we need to check this. Hope that makes sense.

Although a small part of the report, staffing numbers are the type of thing that get picked up on.

One other thing, if I may. (And this might be for Joe Welsh and his team). In the extract Mark sent through there is a table which I copy below. We were trying to summarise, as concisely as we could, the borrowing and reserve powers. These were based on draft budget figures. These should've been updated. I now believe that the 2016/17 column is not accurate, so if someone could check this in particular that would be very helpful. I'll phone to explain.

Borrowing and reserves

The Scotland Act 2016 and accompanying fiscal framework increased the Scottish Government's capital and revenue borrowing to help it manage the increased risk and volatility its budget is now exposed to. The Scottish Government to date has not borrowed any money. But it has estimated it will need £30 million in 2017/18 to start repaying what it plans to borrow in 2016/17 (see table).

The Scotland Act 2016 also changed the rules in relation to reserves. The Scotland Reserve replaces both the Scotland Act 2012 cash reserve and the Budget Exchange Mechanism.

	Annual limit *	Overall limit *	Planned 2016/17 Annual limit	Planned 2017/18 Annual limit
Capital borrowing	15% of overall borrowing limit	£3 billion	£316 million £316 million	£450 million £450 million
Revenue borrowing	£600 million	£1.75 billion	0 £600 million	0 £600 million
Scotland Reserve	£350 million	£700 million	0 £350 million	0 £350 million

* The Scotland Act 2016 increases the annual limits. For capital borrowing it increases from 10% of its capital budget in the Scotland Act 2012 to 15% of its borrowing limit in the Scotland Act 2016 from 2017/18.

From: Redacted Scottish Government
Sent: 06 March 2017 12:45
To: Redacted Audit Scotland
Subject: RE: Audit Scotland report - managing new financial powers

Hi [redacted]

No problem re emailing, just in case you need it my number is 244 7501. Thanks for confirmation re Thursday. I know you have print deadlines etc but a few of our key contacts aren't in today so we would struggle to get back to you with a full response by Wednesday

I was given those staffing figures by a colleague in our People Directorate so I don't have the supporting documents/background. I can follow up with my colleague but would be sure the figures given are correct/accurate. Would you like me to do so?

Regards

[redacted]

From: [redacted] Audit Scotland
Sent: 06 March 2017 12:31
To: [redacted] Scottish Government
Subject: RE: Audit Scotland report - managing new financial powers
Importance: High

Hi [redacted],

Please forgive the email, but I wasn't sure what number I could contact you on.

Hopefully you will have seen Mark's email. Thursday is fine- although tight we can work with this.

One point I need to check with you (or someone). In Gordon's original response he provided some information on FTE per paragraph 20 of the report. The information provided was: "5,152 directly employed FTE staff, a reduction of 6% from end of March 2010 (5,491 FTE)."

We've checked with colleagues in our Scottish Government audit team to verify these figures to the underlying working papers for the SG consolidated accounts. We can't quite get the same figures. Please could you supply us with the evidence/supporting documents to support the figures you provided in your return?

Let me know if there are any issues, happy to chat.

Many thanks,

[Redacted]
Audit Manager
Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
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AUDIT SCOTLAND

From: [redacted] Scottish Government
Sent: 06 March 2017 08:18
To: [redacted] Audit Scotland
Cc: directoroffinancialmanagement@gov.scot; Mark Taylor
Subject: RE: Audit Scotland report - managing new financial powers

[Redacted]

Mark provided us with a revised Part 3 of this report late on Friday. Would it be possible to get comments back to you by close Thursday rather than Wednesday? Many of the team with an interest in the report don't work Mondays so won't be available to read it until Tuesday at the earliest and we want to be able to consider it fully.

Thanks also for letting us know that that publication has moved to 23rd rather than 21st.

Regards
[redacted]

From: Mark Taylor [mailto:MTaylor@audit-scotland.gov.uk]
Sent: 03 March 2017 17:41
To: Director of Financial Management; Wright AG (Aileen); Grisewood A (Aidan)
Cc: [redacted]
Subject: FW: Audit Scotland report - managing new financial powers

Gordon

Following on from [redacted]'s e-mail please find attached a revised part 3 of our report, which contains some additional content. I should be grateful if you would confirm its factual accuracy in the normal manner by close of play on Wednesday 8 March. If this timetable is likely to prove problematic please do let me know.

You will see that the paragraph numbering of the extract has gone a bit awry due to template/ formatting issues. The first numbered paragraph is number 73 in the full draft. If you have any comments on factual accuracy, its probably best to reference them to the numbers in this extract.

[Redacted] is now on leave. Could you direct your reply to [redacted] n the first instance.

Many thanks and regards.

Mark

Mark Taylor
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T: redacted **E:** mtaylor@audit-scotland.gov.uk
www.audit-scotland.gov.uk

From: Redacted
Sent: 27 February 2017 17:37
To: directoroffinancialmanagement@gov.scot
Cc: Mark Taylor
Subject: Audit Scotland report - managing new financial powers

Gordon

Many thanks for your letter to the Auditor General, setting out comments on our draft report *Managing new financial powers: an update*.

We met the Auditor General this morning to discuss proposed changes to the report. We are planning to include some additional text in part three (on financial management and reporting), which we will send to you to check for factual accuracy.

I wanted to let you know that we are aiming to get the revised extracts to you by the end of this week, and would be grateful if you could get back to us by the following Wednesday (8 March).

Please also note that we are now planning to publish the report on Thursday 23 March (rather than Tuesday 21).

I will be back in touch later in the week.

Kind regards,
Redacted
Audit Manager
Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
T: redacted **E:** redacted
www.audit-scotland.gov.uk

AUDIT SCOTLAND

Document 13
From: redacted Scottish Government
Sent: 06 March 2017 12:45
To: Redacted Audit Scotland
Subject: RE: Audit Scotland report - managing new financial powers

Hi redacted

No problem re emailing, just in case you need it my number is 244 7501. Thanks for confirmation re Thursday. I know you have print deadlines etc but a few of our key contacts aren't in today so we would struggle to get back to you with a full response by Wednesday

I was given those staffing figures by a colleague in our People Directorate so I don't have the supporting documents/background. I can follow up with my colleague but would be sure the figures given are correct/accurate. Would you like me to do so?

Regards
Redacted

From: redacted
Sent: 06 March 2017 12:31
To: redacted
Subject: RE: Audit Scotland report - managing new financial powers
Importance: High

Hi [redacted],

Please forgive the email, but I wasn't sure what number I could contact you on.

Hopefully you will have seen Mark's email. Thursday is fine- although tight we can work with this.

One point I need to check with you (or someone). In Gordon's original response he provided some information on FTE per paragraph 20 of the report. The information provided was: "5,152 directly employed FTE staff, a reduction of 6% from end of March 2010 (5,491 FTE)."

We've checked with colleagues in our Scottish Government audit team to verify these figures to the underlying working papers for the SG consolidated accounts. We can't quite get the same figures. Please could you supply us with the evidence/supporting documents to support the figures you provided in your return?

Let me know if there are any issues, happy to chat.

Many thanks,

[Redacted]
Audit Manager

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
T: redacted **M:** **redacted** **E:redacted**
www.audit-scotland.gov.uk

AUDIT SCOTLAND

Document 14
From: redacted Audit Scotland
Sent: 06 March 2017 12:31
To: redacted Scottish Government
Subject: RE: Audit Scotland report - managing new financial powers
Importance: High

Hi [redacted],

Please forgive the email, but I wasn't sure what number I could contact you on.

Hopefully you will have seen Mark's email. Thursday is fine- although tight we can work with this.

One point I need to check with you (or someone). In Gordon's original response he provided some information on FTE per paragraph 20 of the report. The information provided was: "5,152 directly employed FTE staff, a reduction of 6% from end of March 2010 (5,491 FTE)."

We've checked with colleagues in our Scottish Government audit team to verify these figures to the underlying working papers for the SG consolidated accounts. We can't quite get the same figures. Please could you supply us with the evidence/supporting documents to support the figures you provided in your return?

Let me know if there are any issues, happy to chat.

Many thanks,

[redacted]
Audit Manager

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
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www.audit-scotland.gov.uk

AUDIT SCOTLAND

Document 15
From: Mark Taylor [mailto:MTaylor@audit-scotland.gov.uk]
Sent: 06 March 2017 12:07
To: Director of Financial Management
Cc: [redacted]; Grisewood A (Aidan); Wright AG (Aileen)
Subject: RE: Audit Scotland report - managing new financial powers

Gordon

Thanks for this. On part 3 of the report, Fiona Campbell has enquired whether close of play on Thursday might work for your reply on any factual accuracy comments. While its tight, I'm please to confirm this will be ok from our perspective.

On parts 1 and 2, we do not normally share a further drafts of the content of section 23 reports unless we are making significant changes as a result of the clearance process. Unlike part 3, the content of these two sections will not be significantly changed from that in the final draft. We are making relevant amendments in each of the areas where you highlighted factual issues in your letter to the auditor general of 20 February. We continue to refine the wording in one or two places, and the specific wording may differ slightly from what was suggested. But we are content we are addressing all of the factual issues you have raised. If you would find it helpful I would be happy to arrange for us to run through some of the more substantive elements of this with you or one of your team. In line with our normal practice we will share an embargoed copy of the full report 2-3 days prior to publication.

In one specific area – the FTE figures used in paragraph 20 - we remain to confirm the figures you have suggested to underlying documentation. Morag Campsie is speaking directly to Fiona Campbell on this with a view to resolving.

Lastly, can I also confirm that we have received replies from both the Scottish Fiscal Commission and Revenue Scotland on the sections that refer directly to them. We are making any factual amendments that are necessary in response to these.

Happy to speak about any of this if you would find it helpful.

Regards

Mark

From: directoroffinancialmanagement@gov.scot [mailto:directoroffinancialmanagement@gov.scot]
Sent: 04 March 2017 07:33
To: Mark Taylor; Aileen.Wright@gov.scot; Aidan.Grisewood@gov.scot
Cc: [redacted]
Subject: RE: Audit Scotland report - managing new financial powers

Mark,

Thanks. We will review over the next few days and come back to you.
In the interim, the comments provided on the first draft were across the whole report – could you let us have the first two parts as well please.

Many thanks

Gordon

Gordon Wales
Acting Director General Finance
The Scottish Government
3C North
Victoria Quay
Edinburgh
EH6 6QQ
Tel redacted

From: Mark Taylor [mailto:MTaylor@audit-scotland.gov.uk]
Sent: 03 March 2017 17:41
To: Director of Financial Management; Wright AG (Aileen); Grisewood A (Aidan)
Cc: [redacted]
Subject: FW: Audit Scotland report - managing new financial powers

Gordon

Following on from Rebdacted's e-mail please find attached a revised part 3 of our report, which contains some additional content. I should be grateful if you would confirm its factual accuracy in the normal manner by close of play on Wednesday 8 March. If this timetable is likely to prove problematic please do let me know.

You will see that the paragraph numbering of the extract has gone a bit awry due to template/ formatting issues. The first numbered paragraph is number 73 in the full draft. If you have any comments on factual accuracy, its probably best to reference them to the numbers in this extract.

Redacted is now on leave. Could you direct your reply to redacted n the first instance.

Many thanks and regards.

Mark

Mark Taylor
Assistant Director

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
T: redacted **E:** mtaylor@audit-scotland.gov.uk
www.audit-scotland.gov.uk

From: [redacted]
Sent: 27 February 2017 17:37
To: directoroffinancialmanagement@gov.scot
Cc: Mark Taylor
Subject: Audit Scotland report - managing new financial powers

Gordon

Many thanks for your letter to the Auditor General, setting out comments on our draft report *Managing new financial powers: an update*.

We met the Auditor General this morning to discuss proposed changes to the report. We are planning to include some additional text in part three (on financial management and reporting), which we will send to you to check for factual accuracy.

I wanted to let you know that we are aiming to get the revised extracts to you by the end of this week, and would be grateful if you could get back to us by the following Wednesday (8 March).

Please also note that we are now planning to publish the report on Thursday 23 March (rather than Tuesday 21).

I will be back in touch later in the week.

Kind regards,
Rebecca

Redacted
Audit Manager

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
T: redacted **E:redacted**
www.audit-scotland.gov.uk

Document 16

From: Mark Taylor [mailto:MTaylor@audit-scotland.gov.uk]
Sent: 03 March 2017 17:41
To: Director of Financial Management; Wright AG (Aileen); Grisewood A (Aidan)
Cc: [redacted]
Subject: FW: Audit Scotland report - managing new financial powers

Gordon

Following on from Redacted's e-mail please find attached a revised part 3 of our report, which contains some additional content. I should be grateful if you would confirm its factual accuracy in the normal manner by close of play on Wednesday 8 March. If this timetable is likely to prove problematic please do let me know.

You will see that the paragraph numbering of the extract has gone a bit awry due to template/ formatting issues. The first numbered paragraph is number 73 in the full draft. If you have any comments on factual accuracy, its probably best to reference them to the numbers in this extract.

Redacted is now on leave. Could you direct your reply to redacted n the first instance.

Many thanks and regards.

Mark

Mark Taylor
Assistant Director

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
T:redacted **E:** mtaylor@audit-scotland.gov.uk
www.audit-scotland.gov.uk

AUDIT SCOTLAND

Managing_new_financial_powers_Part3_up

From: [Redacted]
Sent: 27 February 2017 17:37
To: directoroffinancialmanagement@gov.scot
Cc: Mark Taylor
Subject: Audit Scotland report - managing new financial powers

Gordon

Many thanks for your letter to the Auditor General, setting out comments on our draft report *Managing new financial powers: an update*.

We met the Auditor General this morning to discuss proposed changes to the report. We are planning to include some additional text in part three (on financial management and reporting), which we will send to you to check for factual accuracy.

I wanted to let you know that we are aiming to get the revised extracts to you by the end of this week, and would be grateful if you could get back to us by the following Wednesday (8 March).

Please also note that we are now planning to publish the report on Thursday 23 March (rather than Tuesday 21).

I will be back in touch later in the week.

Kind regards,
redacted

Redacted
Audit Manager

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
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AUDIT SCOTLAND

--=

Document 17

From: redacted
Sent: 01 March 2017 14:21
To: [redacted]
Subject: RE: ex 8 and 9

Great, thanks ever so much [redacted].

Your final point is a good one that I had overlooked, and I'll see if we can factor this into a footnote.

Thanks again,

[redacted]

From: redacted Scottish Government
Sent: 01 March 2017 14:17
To: Redacted Audit Scotland
Subject: RE: ex 8 and 9

Hi [Redacted]

On ex 8, I'd be tempted to add in tax to make the second box read "Adjustment to reflect UK tax revenues foregone", just for greater clarity.

On ex 9, you're right that the income tax forecasts were updated to reflect the deal done with the Green Party. We've published the updated forecasts here http://www.gov.scot/Resource/0051/00514338.pdf and sets out that we forecast £11,857m to be raised in 2017/18. When comparing this to the BGA of £11,750m we forecast an increase of £107m for the SG budget. I would agree that it would be best to use these figures as they reflect our best estimate of what will happen in 2017/18 and will be the amount of money the SG will draw down from HMT.

The reconciliation position is slightly more nuanced in that if the SG draft budget is introduced less than 2 months after the reconciled figures are available then the SG can choose to defer applying the reconciled figures until the following draft budget. This is to avoid any potential large late changes to the budget.

Otherwise it looks good to me.

Happy to discuss.

Thanks
[Redacted]

From: [Redacted]
Sent: 01 March 2017 11:48
To: [redacted]
Subject: FW: ex 8 and 9
Importance: High

Hi [redacted],

I was hoping you might have time to take a quick look at two of the exhibits in our report which our designers have been working on. The first is trying to show (at a basic level) how the BGAs fit into the funding of the Scottish budget.

The second is the NSND process, using 2017/18 DB as the worked through example rather than trying to show all the adjustments over time. As you will see we've added some more detail to it to try (hopefully) and explain the process.

Could you take a look and let me know if there are any factual inaccuracies. In particular:

- You will see we've used figures from the Draft budget for the NSND BGA, and forecast receipts. But I think forecast receipts may now have changed on the back of the agreed tax proposals?
- Related to above, are you happy that we include these figures. I think it helps.
- We have put the main reconciliation as happening when the actuals are know in June/July 2019, but will there also be a reconciliation (or reassessment and subsequent adjustment) before this (after June/July 2018)?
- Should we be referring to other variables- for example I think population variables might be important in the reconciliation process? This might over complicate the diagram however.

There is at least one error on the diagram where the "June/July" in 2019/20 has been put on the purple line instead of the green line. We are rectifying this, but I wanted to get this to you as soon as possible.

Please let me know if anything critical is missing.

I know you are very busy but if you could get back to me by the end of the week that would be great.

Many thanks in advance,
[redacted]

Document 18
From: [Redacted] Audit Scotland
Sent: 01 March 2017 11:48
To: Redacted Scottish Government
Subject: FW: ex 8 and 9
Importance: High

Hi [redacted],

I was hoping you might have time to take a quick look at two of the exhibits in our report which our designers have been working on. The first is trying to show (at a basic level) how the BGAs fit into the funding of the Scottish budget.

The second is the NSND process, using 2017/18 DB as the worked through example rather than trying to show all the adjustments over time. As you will see we've added some more detail to it to try (hopefully) and explain the process.

Could you take a look and let me know if there are any factual inaccuracies. In particular:

- You will see we've used figures from the Draft budget for the NSND BGA, and forecast receipts. But I think forecast receipts may now have changed on the back of the agreed tax proposals?
- Related to above, are you happy that we include these figures. I think it helps.
- We have put the main reconciliation as happening when the actuals are know in June/July 2019, but will there also be a reconciliation (or reassessment and subsequent adjustment) before this (after June/July 2018)?
- Should we be referring to other variables- for example I think population variables might be important in the reconciliation process? This might over complicate the diagram however.

There is at least one error on the diagram where the "June/July" in 2019/20 has been put on the purple line instead of the green line. We are rectifying this, but I wanted to get this to you as soon as possible.

Please let me know if anything critical is missing.

I know you are very busy but if you could get back to me by the end of the week that would be great.

Many thanks in advance,
[redacted]

New Financial
powers_exhibits_8_9.|

Document 19
From: [Redacted] Audit Scotland
Sent: 22 February 2017 13:32
To: [Redacted]Scottish Government
Cc: [redacted]Scottish Government
Subject: RE: Quick query - SRIT costs

Hi [redacted]

Thanks so much for doing some further investigation into this – it's much appreciated.

That's very helpful, and confirms that we should stick to referring to SRIT (or the SRIT project) when we're talking about the estimated costs.

Thanks again for getting back to me so quickly on this.

Best wishes,
[redacted]

From:[redacted] Scottish Government
Sent: 22 February 2017 13:15
To: [Redacted]Audit Scotland
Cc: [redacted] Scottish Government
Subject: RE: Quick query - SRIT costs

[Redacted]

We spoke earlier about the £30m used in the NAO report and I said I would chat to HMRC about their understanding of what that figure may include. They are, like us, slightly reticent to interpret exactly what NAO are including given the interaction between paragraph 1.3 and 1.4 of their report.

HMRC have publically announced that for the 2012 powers the estimate is between £25m-£30m which include the SRIT and RAS aspects through the UK Government's 4th Section 33 report in March last year. HMRC subsequently confirmed this to the Finance Committee on 14 December 2016. These numbers, however, do not include FSITP.

HMRC would suggest, and I would agree, that other than you checking with NAO, if referring to this figure and source, it would be safest to use the wording that the NAO uses to cover the costs of 'the SRIT project', or alternatively you could specifically refer to the 2012 powers implementation estimate of £25m-£30m. However, with this latter approach, there is no public source which separately identifies the estimates for FSITP, but we would expect this to be covered in the UK Government's Fifth Annual Section 33 report which is due to be published in April. That is not to say, as we discussed, that HMRC have not shared with us estimates for our own budgetary purposes – it is just that any public announcement around that has not happened yet.

Is this helpful? Very happy to discuss further . . .

[Redacted]

From: [Redacted] Audit Scotland
Sent: 21 February 2017 14:48
To: [Redacted] Scottish Government
Subject: Quick query - SRIT costs

Hi [redacted]

I hope you are well.

We're currently working through the Scottish Government's clearance comments on our managing new financial powers report. I have a quick query, which I'm hoping you can help with.

Do the estimated set-up costs for the SRIT (the most recent estimate being the £30m cited in the NAO's latest report) include the costs of implementing the further Scottish income tax powers – or will that incur separate / additional costs?

I want to make sure that where the report refers to the estimated costs of implementing the SRIT that's what we mean – or whether it should be the costs of implementing the SRIT <u>and</u> Scottish income tax.

If you were able to get back to me by tomorrow lunchtime that would be fantastic, but I know you're busy so don't worry if it's later.

Many thanks,
Redacted

Audit Manager

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
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AUDIT SCOTLAND

Document 20

From: Redacted Audit Scotland
Sent: 20 February 2017 15:47
To: [redacted] Scottish Government
Cc: Director of Financial Management; [Redacted]
Subject: RE: Audit Scotland draft report - managing new financial powers

[redacted]

Many thanks for your email. I can confirm receipt of the two attachments.

Kind regards,
[Redacted]

From: [redacted] Scottish Government
Sent: 20 February 2017 15:31
To: directoroffinancialmanagement@gov.scot; [redacted]; Caroline Gardner
Cc: directoroffinancialmanagement@gov.scot; [redacted]
Subject: RE: Audit Scotland draft report - managing new financial powers

This time with attachments – apologies.

[redacted]
From: Director of Financial Management
Sent: 20 February 2017 15:18
To: [redacted]; 'cgardner@audit-scotland.gov.uk'
Cc: Director of Financial Management; [redacted]
Subject: Audit Scotland draft report - managing new financial powers

Caroline

Please see attached letter from Gordon Wales, Scottish Government Finance.

Kind regards

[redacted]

Document 21
From: [redacted]
Sent: 20 February 2017 15:31
To: Director of Financial Management;[redacted]; cgardner@audit-scotland.gov.uk
Cc: Director of Financial Management; [redacted]
Subject: RE: Audit Scotland draft report - managing new financial powers

This time with attachments – apologies.

[redacted]

From: Director of Financial Management
Sent: 20 February 2017 15:18
To: redacted; 'cgardner@audit-scotland.gov.uk'
Cc: Director of Financial Management; [redacted]
Subject: Audit Scotland draft report - managing new financial powers

Caroline

Please see attached letter from Gordon Wales, Scottish Government Finance.

Kind regards

[redacted]

Audit Scotland - Suggested Changes.d

Gordon Wales letter to Caroline Gardner -

Document 22
From: Wright AG (Aileen)
Sent: 14 February 2017 12:05
To: [redacted]; [redacted] ; [redacted]
Cc: Gordon Smail; [redacted]; [redacted]
Subject: RE: Audit Scotland - managing new financial powers

Thanks, Redacted Happy to leave it to colleagues to arrange suitable times – and have copied this to [redacted] and [redacted] for that purpose. Conscious that [names redacted] didn't have the benefit of the discussion on Thursday, so I am available to support as necessary.

Aileen
X47355

From: [Redacted]
Sent: 13 February 2017 16:45
To: Wright AG (Aileen)
Cc: [redacted]; [redacted]; [redacted]
Subject: RE: Audit Scotland - managing new financial powers

Hi Aileen

Thanks for getting this arranged so quickly. Thursday would be best for us (ideally in the morning). Depending on timing, it's most likely to be [redacted] and [redacted] coming along.

I've copied them into this email, if it's easier for [redacted] and [redacted] to get in touch with them directly to organise a suitable time.

Many thanks,
[Redacted]

From: Aileen.Wright@gov.scot [mailto:Aileen.Wright@gov.scot]
Sent: 13 February 2017 14:40
To: [redacted] Audit Scotland
Cc: [redacted] Audit Scotland
Subject: RE: Audit Scotland - managing new financial powers

Hello, [Redacted]. The analysis which supports advice on budget matters sits with Financial Strategy colleagues; Alistair B and I spoke to [redacted] on Friday and he has agreed to take you through this. [Redacted] isn't in the office on Wednesday so Thursday or Friday look the best bets. [Names Redacted] are probably best placed to take you through the borrowing modelling, and have availability those days too. Let us know what works for you.

Can you confirm who will be doing this for Audit Scotland, please?

Thanks,

Aileen

From: [Redacted] Audit Scotland
Sent: 13 February 2017 09:16
To: Wright AG (Aileen)
Cc: [redacted] Audit Scotland
Subject: Audit Scotland - managing new financial powers

Aileen

It was good to see you on Thursday. Mark and I thought it was a very helpful discussion.

We discussed the possibility of arranging a 'show and tell', so that we can see the work the finance team is doing on scenario planning and modelling to inform the budget and advice to ministers (e.g. modelling long-term borrowing and funding for policy commitments).

It would be helpful if we could do this in the next week if possible. This would allow us to reflect any changes in the final version of the report that we send to the Auditor General for sign-off.

I'd be grateful if you could send me some possible dates, and we can hopefully get something arranged.

Many thanks.

Kind regards,
[Redacted]
Audit Manager

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
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www.audit-scotland.gov.uk

AUDIT SCOTLAND

Document 23
From: [redacted Audit Scotland]
Sent: 09 February 2017 09:42
To: [redacted Scottish Government]
Cc: Redacted
Subject: RE: NSND exhibit

Thanks [Redacted],

That's very helpful. Once our comms team have developed the diagram I might send it your way again- particularly if we add any additional information/dates to it.

Rebecca and Gordon have a clearance meeting to discuss the report at St Andrews house this afternoon. They'll cover the use of GERS figures in that discussion I think. Essentially it was to try and get consistency for all figures, but always happy to discuss which figures are best to use.

Many thanks,

[Redacted]

From:[redacted Scottish Government]
Sent: 09 February 2017 09:05
To: [redacted Audit Scotland]
Cc: [redacted]
Subject: RE: NSND exhibit

Morning [redacted]

Apologies for the delay on this, things have been as you may expect somewhat busy with budget, but a slight bit of breathing space before the Scottish Rate Resolution and Stage 3 debate.

My team have fed these comments into a wider collection of comments, but really on the exhibit it is just as below.

Income tax exhibit – there is a question as to whether you would want to add in when forecasts are made and recognise that it was the SG's responsibility for 2017/18 and the SFC's responsibility from 2018/19 onwards.

Otherwise from our perspective the exhibit is fine.

We were interested in the use of GERS figures rather than budget forecasts for income tax, but I think I'm overstepping my remit here and others will discuss that with you.

Hope all else is good your way.

Thanks
[redacted]

From: [redacted Audit Scotland]
Sent: 31 January 2017 17:23
To: [redacted Scottish Government]
Cc: Redacted
Subject: NSND exhibit

Hi [redacted],

I hope you are well?

I was hoping that you might be able to look over the attached diagram which our communications team are about to develop for our forthcoming report on the new financial powers. The report has just been sent into clearance with Gordon Wales, but I thought it would be easier to come to you directly.

We are planning to have an exhibit similar to the one we used for SRIT in our first report (which I have also attach "Exhibit 5"), to try and explain visually that the reconciliation process for NSND will take a long time. This sits in a section of the report explaining the block grant adjustments, and that going forward there will be a number of adjustments needed throughout the budget cycle from BGAs to adjustments compensating for differences between forecasts and actuals.

I would really appreciate it if you were able to look at our mock up exhibit for factual accuracy. If there is anything crucial missing please let me know. I had deliberated whether putting the calculation for the NSND BGA at the side of the exhibit in a similar fashion to how we did it for SRIT would help or not. I think this might be too complicated however.

If you were able to get back to us within the next couple of weeks that would be really helpful. The team are due to meet Gordon Wales on the 9th February to discuss the draft report.

Many thanks in advance,

redacted
Audit Manager

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
T: redacted M: redacted **E:** redacted
www.audit-scotland.gov.uk

Document 24
From: Director of Financial Strategy
Sent: 03 February 2017 13:02
To: 'Gordon Smail'
Cc: 'Mark Taylor'; [redacted]; Wright AG (Aileen); [redacted]; Emberson E (Eleanor); Director of Financial Management
Subject: RE: Audit Scotland: new financial powers

Gordon: I refer to my email below (sent on 30 December at 13:52). I said that I'd come back in January on "financial management, borrowing etc and on capacity and capability within the Finance function". It is now February – apologies for lateness – and of course we are now moving into clearance drafts of the work. In the circumstances, I thought I'd draw your attention to some relevant material which wed we can follow up in discussion if helpful

The first item is a paper provided by DG Finance for the last SGAAC meeting on 22 December which summarises progress on a range of issues relevant to use of the new financial powers:

SGAAC(16)10 - DG Finance Quar...

More specifically in relation to borrowing, the Scottish Government's draft budget for 2017-18 reports the approach taken by Ministers. In particular pages 13 to 22 on operation of the fiscal framework and the use of taxation powers includes an explanation (see pages 21 and 22) of the changes to borrowing and the Scotland Reserve, sets out ministerial plans regarding borrowing and provides evidence of planning for repayment of borrowing should that take place in 2016-17. Annex A also explains the 5% ceiling in respect of long-term investment commitments, showing how the measure has been expanded to include borrowing for capital investment under Scotland Act 2016 powers.

When we met on 7 December, Gordon explained the processes supporting the consideration of borrowing decisions. The attachment below is the working version of a document, used by Finance officials, which sets out the Fiscal Framework provisions and broad principles applicable:

Borrowing Paper - Nov2016 (2)....

Separately on audit and accountability arrangements, I understand you and Aileen met recently to discuss a range of matters, including new powers implementation. Specifically on audit etc arrangements, it may be helpful to summarise that we have two parallel strands of work underway. The first is with HMT on production of a guidance paper, where we have had discussions with HMT officials and have provided feedback on an initial draft - we currently await a further draft |(having pressed Treasury again as recently as last week) and once that arrives we can consider further engagement. The second is to review the position in respect of the individual areas of new devolution and we will be commencing that work shortly.

Finally, on capacity and capability within the Finance function, I mentioned in my email below the work underway here, led by Eleanor Emberson. Eleanor next week will return full-time to SG take up the role of Director of Financial Strategy ahead of my retirement in mid-February and she and you may want to catch up at some point thereafter.

I hope this is helpful.

Best wishes

Alistair

Alistair Brown | Director of Financial Strategy | Finance Directorate, Scottish Government | Tel: 0131 244 7282 | Mobile: 07770 827657 | Mail: 3B-45, Victoria Quay, Leith, Edinburgh, EH6 6QQ | Email: DirectorofFinancialStrategy@scotland.gsi.gov.uk

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Document 25

From: [Redacted] Audit Scotland
Sent: 31 January 2017 17:10
To: Director of Financial Management
Cc: Director of Financial Strategy
Subject: Audit Scotland draft report - managing new financial powers

Dear Gordon

Please find attached a letter from the Auditor General and a copy of our draft report on *Managing new financial powers*, for review and comment.

We would be grateful if you could provide a written response by 20 February.

Please get in touch with me or Gordon Smail if you have any queries on the process.

Many thanks.

Redacted
Audit Manager

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
T: redacted **E:redacted**
www.audit-scotland.gov.uk

AUDIT SCOTLAND

Clearance_letter.pdf Managing_new_financial_powers_clearance