AUDIT SCOTLAND

Scottish Consolidated Fund

Annual audit report 2014/15

October 2015

Prepared for Scottish Government and the

Auditor General for Scotland

Contents

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Key messages

Audit of financial statements	• The independent auditor's report on the 2014/15 Scottish Consolidated Fund (SCF) account is unqualified.
Financial management	• In 2014/15, receipts from the Scotland Office were within the cash drawdown limit of £28.19 billion set by the UK Parliament by approximately £42 million (0.15%). • There was a surplus for the period of £14 million, increasing the overall cash balance in the account to £220 million. The balance does not necessarily represent amounts available to spend via a budget act. • A review of the balance was undertaken in 2014/15. Decisions outlining how the balance should be managed in future years remain outstanding.
Outlook	• In 2015/16, following the implementation of the Scotland Act 2012, the Fund will receive devolved tax receipts and any borrowing undertaken as part of the Scottish Government's expanded financial powers. • Revised procedures for operating and managing the fund, reflecting the new financial powers are in place. These additional receipts and payments will require transparent disclosure in the 15/16 accounts. • The significance of the SCF accounts and its operation will increase in 2015/16. This provides an opportunity for the governance arrangements to be clarified and enhanced.

Introduction

1. This report is a summary of our findings arising from the 2014/15 audit of the Scottish Consolidated Fund (SCF) Account.
2. The Scottish Government is responsible for:
   - preparing the account ensuring it properly presents the receipts and payments for the financial year
   - ensuring the regularity of transactions, by putting in place systems of internal control.
3. Our responsibility, as the external auditor of the Scottish Consolidated Fund is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.
4. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the account; that has been prepared by management with the oversight of those charged with governance. This does not relieve management of their responsibility for the preparation of financial statements.
5. **Appendix II** is an action plan setting out our recommendations to address the high level risks we have identified from the audit. We recognise that not all risks can be eliminated or even minimised. What is important is that the Scottish Government understands its risks and has arrangements in place to manage these risks. The Principal Accountable Officer should ensure that they are satisfied with proposed action and have a mechanism in place to assess progress and monitor outcomes.
6. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures; consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.
7. The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged.

Audit of the 2014/15 financial statements

Audit opinions

Financial Statements	• The financial statements properly present in accordance with the Public Finance and Accountability (Scotland) Act 2000 and directions made thereunder by the Scottish Ministers the receipts and payments of the account for the year ended 31 March 2015 and the balances held at that date.
Regularity	• In all material respects, the sums paid out of the Scottish Consolidated Fund for the purposes of meeting the expenditure shown in the financial statements were applied in accordance with Section 65 of the Scotland Act 1998 and sections 4 to 6 of the Public Finance and Accountability (Scotland) Act 2000.
Other prescribed matters	• Information given in the Foreword for the financial year for which the financial statements are prepared is consistent with the financial statements and our understanding of the fund.

Submission of financial statements for audit

8. We received the unaudited account on 21 July 2015. The working papers were of a high standard and the staff provided good support to the audit team. We substantially completed our audit on 2 October 2015.

Overview of the scope of the audit of the financial statements

9. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in the Scottish Government Annual Audit Plan presented to the Scottish Government Audit and Risk Committee on 11 March 2015.

10. As part of the requirement to provide full and fair disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services.

11. The concept of audit risk is of central importance to our audit approach. During the planning stage of our audit we identified a number of key audit risks which had the greatest effect on the audit strategy, resources and effort. **Appendix I** sets out the significant audit risks identified at the planning stage and how we addressed each risk in arriving at our opinion on the financial statements

12. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

Materiality

13. Materiality can be defined as the maximum amount by which auditors believe the financial statements could be misstated and still not be expected to affect the decisions of users of financial statements. A misstatement or omission, which would not normally be regarded as material by amount, may be important for other qualitative reasons (for example an item contrary to law).

14. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme.

15. Due to the unique nature of the SCF, the most efficient audit approach is to test all receipts and payments into and out of the fund. As a result of our specific opinion on regularity required under legislation, we consider any amount misstated within the Receipts and Payments Account as material.

16. For amounts included as disclosures in the accompanying notes to the account, we applied a level of materiality that was appropriate for the context. No unadjusted misstatements were identified during the course of the audit.

17. A number of presentational adjustments were identified within the financial statements during the course of our audit. These were discussed with relevant officers who agreed to amend the unaudited accounts.

Significant findings from the audit

18. International Standard on Auditing 260 requires us to communicate to you significant findings from the audit:

- The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and disclosures.
- Significant difficulties encountered during the audit.
- Significant matters arising from the audit that were discussed, or subject to correspondence with management.
- Written representations requested by the auditor.
- Other matters which in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

19. During the course of the audit we identified that there are no matters, that we wish to draw your attention in accordance with ISA260

Financial management

Receipts
£32,872m

Payments
£32,858m

Surplus for the Period
£14m

General Scottish Consolidated Fund Reserve
£220m

20. The Scottish Consolidated Fund was established by Section 64 (1) of the Scotland Act 1998. The fund operates as a single account, receiving cash, predominantly from the UK Consolidated fund (via the Scotland Office), and paying cash over to the Scottish Government and other bodies in line with the Budget Act passed by the Scottish Parliament.

21. The fund receives a share of National Insurance contributions from Her Majesty's Revenue & Customs (HMRC). These are paid over to the Scottish Government to provide funding for the Scottish National Health Service.

22. Non-Domestic Rates (NDR) income collected by Local Authorities are paid into the fund, before being passed on to the Scottish Government for redistribution as Local Government funding. Further detail on NDR Income is published in the Scottish Government's Non-Domestic Rating Account. This account is audited separately.

2014/15 Financial Management

23. The fund is operated by the Treasury and Banking Branch (TBB) of the Scottish Government. Following the completion of cash flow forecasting exercises, officials make monthly drawdown requests for funding from the UK Consolidated Fund. These amounts are tracked against a maximum limit set by the UK Parliament through the Central Government Supply Estimates.

24. In 2014/15 the SCF received funding from this source of £28.150 billion, £42 million less than the £28.192 billion limit

stated in the 2014-15 Supplementary Estimate. The limit is set by forecasting the cash requirement for the 14/15 Scottish budget, drawing down less than this limit has no effect on the overall spending power of the Scottish Administration.

25. Payments out of the fund are made to the Scottish Administration and directly funded bodies in line with the cash authorisation limits set out in the Scottish Budget.

26. Payments of £32.74 billion were within the overall limit of £32.80 billion set by the Budget (Scotland) Act 2014.

27. In 2014/15 there was a surplus of receipts over payments of £14 million. This increased the general reserve balance of the Scottish Consolidated Fund to £220 million.

28. Consolidated Fund Extra Receipts (CFER) of £45.5 million were paid into the SCF. These constitute income that cannot be applied by Scottish public bodies in line with applicable legislation. £31 million is classed as designated receipts and was paid over to the UK Consolidated Fund in line with the Designation of Receipts Order 2009.

29. The Queen's and Lord Treasurer's Rembrancer collects the unclaimed sums arising from personal estates and sequestrated companies and after a set period pays them over to the SCF.

30. There is no clear guidance or statutory regulations covering the use of QLTR receipts and non-designated CFERs. They cannot be used to fund additional expenditure without the agreement of Her Majesty's Treasury (HMT). The only arrangement in place covers receipts classed as Proceeds of Crime. These are paid back over to the Scottish Government, recorded as income and applied to fund Cashback for Communities and other initiatives.

31. Following our 2013/14 audit we reported that there were no clear procedures in place for managing QLTR receipts. A review of the SCF balance was completed by TBB in 2014/15. At the time of the completion of our 2014/15 audit no decision had been made by the Scottish Government and HMT about how the balance should be managed going forward.

32. The Scottish Government should seek to agree with HMT clear and comprehensive guidelines covering the treatment of QLTR and other miscellaneous receipts within the SCF and consider setting an appropriate overall balance for the fund.

Refer Action Plan No.1

2015/16 Outlook

33. From 1 April 2015, the implementation of financial provisions in the Scotland Act 2012 has had a significant impact on the Scottish Consolidated Fund. Changes were required to financial management procedures and this will affect amounts and disclosures included in the 2015/16 financial statements.

34. Devolved tax receipts arising from Land and Buildings

Transaction Tax and Scottish Landfill Tax from 2015/16 onwards are paid into the SCF by Revenue Scotland. These receipts will then be used to fund payments to the Scottish Administration, and reduce the amount of money drawn down from the UK Consolidated Fund. TBB has revised their cash flow forecasting arrangements and drawdown procedures to reflect this change.

35. Capital and enhanced revenue borrowing powers are now available to the Scottish Government. Current plans and procedures to utilise these involve undertaking loans from the National Loans Fund (NLF). All loan transactions (receipts and repayments of interest and principal) will flow through the SCF. Formal requests for loan financing are forecasted to be submitted in the final quarter of 2015/16.

36. A template to use for the 2015/16 accounts has been prepared. We will discuss the appropriateness of the accounting treatment and financial reporting disclosures for devolved tax receipts and borrowing as part of our audit of the 2015/16 accounts.

Governance and transparency

Corporate governance

37. The governance arrangements for the Scottish Consolidated Fund operate within the context of the Scottish Government's overall system of corporate governance. Our audit of the 2014/15 Scottish Government's Consolidated Accounts concluded that SG has sound overall governance arrangements in place.

38. At present the Scottish Consolidated Fund account is not formally considered by any of the Scottish Government Audit and Risk Committees. Given the increasing importance of the fund as a result of Scotland's new financial powers, the Scottish Government should consider reviewing and enhancing the governance arrangements for the fund.

Refer Action Plan No.2

Transparency

39. In March 2015, Audit Scotland published an update on "Developing financial reporting in Scotland". The report concluded that Consolidated Scottish public sectors accounts would provide the Scottish Parliament and taxpayers with the full picture and enhance their understanding of Scotland's public finances. The Scottish Government is currently developing proposals to improve and enhance its financial reporting. Any developments will need to reflect the role of the Scottish Consolidated Fund in Scotland's public sector financial framework.

Internal control

40. In its management of the Scottish Consolidated Fund, TBB use the Scottish Government accounting and banking systems.

41. No material weaknesses in the accounting and banking systems were identified during our audit of the Scottish Government's Consolidated Accounts which could adversely affect the organisation's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the SCF accounts.

42. The SCF account includes a note disclosing the annual salary costs for Judicial Salaries. The payroll is operated by a third party payroll provider as part of a contract with the UK Ministry of Justice. Responsibility for administering the payroll in Scotland is currently held by a division within the Scottish Government's Learning and Justice Directorate, with TBB performing monthly reconciliation and accounting controls.

43. As part of our audit work on the SCF accounts we reviewed the

operation of controls over judicial salary payments and do not have any material weaknesses to report.

44. In August 2015 the third party payroll contract was awarded to a new payroll provider, and from April 2016 administration responsibility will pass to the Scottish Courts & Tribunal Service. These new arrangements will be examined as part of our 2015/16 audit.

Arrangements for the prevention and detection of fraud

45. We assessed the arrangements for the prevention and detection of fraud during the planning phase of our audit of the 2014/15 Scottish Government Consolidated Accounts. We concluded that there are effective arrangements for the prevention and detection of fraud.

Arrangements for maintaining standards of conduct and the prevention and detection of corruption

46. Based on our review of the evidence we concluded that there are appropriate arrangements in place for the prevention and detection of corruption and we are not aware of any specific issues that we need to record in this report.

Appendix I – Significant audit risks

The table below sets out the audit risks, how we addressed each risk and our judgement in arriving at our opinion on the financial statements.

Audit Risk	Proposed assurance procedure	Results and conclusions
Financial audit issues		
Management override of controls ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant inherent risk in any audit. This includes consideration of the risk of management override of controls in order to change the position disclosed in the financial statements or make irregular payments.	Financial statements work – detailed sample testing of journals and evaluation of significant transactions that are outside the normal course of business.	We tested all transactions into and out of the Scottish Consolidated Fund and found no evidence of management override of controls
Wider dimension issues		
Operational arrangements for QLTR There is no clear process in place for applying the Queen's and Lord Treasurer's Remembrancer (QLTR) receipts against payments out of the fund. This was to be clarified going forward with the agreement of Her Majesty's Treasury by March 2015.	Review as part of our consideration of governance arrangements. Review of Board and other minutes. Regular meetings with Treasury & Banking function	We confirmed that no agreement has been reached with HMT regarding this matter and we have reported this in the body of our Annual Audit Report.

Appendix II – Action plan

Paragraph	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
32	**QLTR Receipts and the overall SCF Balance** There remains no clear guidance or statutory regulations in place covering the treatment of QLTR and other miscellaneous receipts within the fund. **Risk** *The overall cash balance in the fund continues to accumulate with no clear, agreed processes for how it will be applied.* **Recommendation** The Scottish Government should develop in agreement with HMT, clear and comprehensive guidelines covering all types of receipts within the SCF and consider setting an appropriate overall balance for the fund.	Amounts are paid into and out of the Scottish Consolidated Fund only in accordance with the relevant statutory provisions. The Scottish Government will continue to keep the overall balance in the SCF and its constituent elements under review. As further powers are devolved the Fiscal Framework will be developed and any changes to the operation of the SCF implemented accordingly. This could include consideration of the position of QLTR monies paid into the SCF.	Aileen Wright Deputy Director, Head of Corporate Reporting, Accountancy and Governance.	Update to be provided in respect of the 2015/16 financial year by March 2016

Paragraph	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
38	**Governance arrangements for the SCF** At present there is no formal role in the scrutiny of the SCF for any of the SG's Audit and Risk Committees. Annual audit reports on the fund accounts are not regularly considered by a Corporate Board. **Risk** *Scrutiny of annual accounts by an Audit and Risk Committee and/or a Corporate Board is a feature of good corporate governance, with formal oversight reducing the risk of fraud and error.* **Recommendation** Given the implementation of the Scotland Act 2012, the Scottish Government should consider reviewing and enhancing the governance arrangements for the fund.	The Scottish Administration and the Scottish Consolidated Fund were established separately by the Scotland Act 1998. The SCF is not part of the Scottish Administration, and due to this and its statutory nature does not fall within the Scottish Government's assurance framework. While recognising that the Scotland Act 2012 will increase the complexity of the SCF's operations and reporting, there is no formal role for SGARC in approving the accounts of the SCF. The present informal arrangement, whereby DG Finance keeps SGARC sighted on the accounts and any issues that arise in relation to the SCF, will continue. The Scottish Government Audit and Risk Committee will consider whether to make changes to its Terms of Reference once the Fiscal Framework is settled and this will include consideration of changes to financial reporting.	Aileen Wright Deputy Director, Head of Corporate Reporting, Accountancy and Governance.	Date of next SGARC meeting 17 March 2016