



Scottish Government: Non Domestic Rating Account

Annual audit report 2014/15

February 2016

Prepared for Scottish Government and the
Auditor General for Scotland

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This report will be published on our website after it has been considered by the audit committee. The information in this report may be used by Audit Scotland in any reporting to the Scottish Parliament.

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Key messages

 <p>Audit of financial statements</p>	<ul style="list-style-type: none">• The independent auditor's report on the 2014/15 Scottish Government Non Domestic Rating Account is unqualified.
 <p>Financial management</p>	<ul style="list-style-type: none">• Total non-domestic rates collected during the year were £2,554 million and total sums distributed were £2,781 million. The deficit at the year end was £227 million resulting in a negative balance of £74 million carried forward to 1 April 2015.
 <p>Governance</p>	<ul style="list-style-type: none">• Going forward, in view of the increasing focus on public finances flowing from further financial devolution, the Scottish Government should consider reviewing and enhancing the governance arrangements for the Non Domestic Rating Account.

Introduction

1. This report is a summary of our findings arising from the 2014/15 audit of the Scottish Government Non-Domestic Rating (NDR) Account.
2. The management of the Scottish Government (SG) 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 NDR 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 its 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 SG understands its risks and has arrangements in place to manage these risks. The SG should ensure that it is 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 Schedule 12 of the Local Government Finance Act 1992 as amended by Schedule 13 of the Local Government etc. (Scotland) Act 1994 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 NDR 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 Non-Domestic Rating Account.

Financial management and sustainability

Submission of financial statements for audit

8. We received the unaudited account on 8 September 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 7 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. Based on our knowledge and understanding of the Non-Domestic Rating Account, we set materiality at 1% of the Distributable Amount. For 2014/15 materiality was £26.5 million. No unadjusted misstatements were identified during the course of the audit.
16. 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

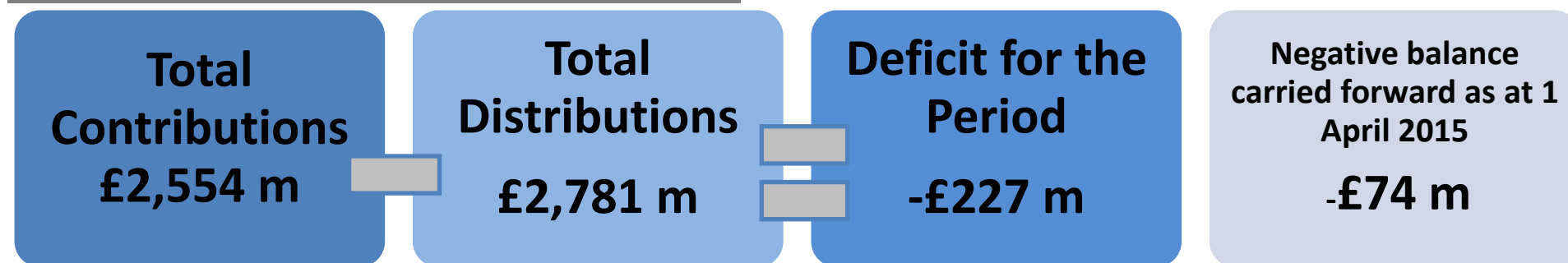
Financial management and sustainability

unaudited accounts.

Significant findings from the audit

17. 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.
18. During the course of the audit we identified that there are no matters, that we wish to draw your attention in accordance with ISA 260.

Financial management



2014/15 Financial management

19. The account is managed by the Local Government Finance Unit of the SG. All NDR income collected by local authorities in Scotland is placed into a notional "pool" and distributed to the local authorities as part of the Scottish Government funding arrangements..
20. The SG guarantees the combined general revenue grant and distributable NDR income figure, approved by Parliament, to each local authority. A drop in non-domestic rate income is compensated for by an increase in general revenue grant and vice versa. Weekly payments are made to local authorities. These payments represent total revenue funding less the apportioned NDR income and any specific revenue grants that

local authorities expect to receive.

21. Total non-domestic rates collected were £ 2,554 of which £44 million is related to prior years. The total amount distributed for 2014/15 was £2,781million, which includes £131 million relating to prior years. The net sum paid at the year end was therefore a deficit of £227 million (2013/14: deficit of £12 million) resulting in a negative balance on the account of £74 million carried forward into 2015/16. As explained in the financial statements there may be a surplus or deficit on the account in any financial year as a result of the NDR pooling arrangements. The deficit in 2014/15 has been carried forward to 2015/16, decreasing the amount available for redistribution in that year. Taking one year with another all NDR rates paid to Scottish Ministers are redistributed to local authorities.

2015/16 outlook

22. NDR forms a key part of how the SG budget is set and in how aggregated funding is distributed to local authorities. The SG therefore needs to have a good understanding of predicted income from NDR over the coming period. Local government funding detailed in the Budget 2015/16 includes an estimate of NDR income of £2,800 million to be collected during 2015/16.
23. With effect from 1 April 2012 the Scottish Ministers introduced the Business Rates Incentivisation Scheme (BRIS). This scheme is intended to incentivise all local authorities to maximise the non-domestic rates collected from their existing businesses and encourage new businesses to start up in their own local areas. Under the terms of the BRIS any local authority that exceeds its non-domestic rate income target, set by Scottish Ministers, will retain 50% of the additional income.
24. The 2012-13 BRIS targets were delayed due to the Scottish Government and COSLA being unable to agree the targets. It has since been confirmed that local authorities that exceeded the SGs targets for 2012/13, amounting to £9 million in total, should retain this amount. Local authorities benefiting from this decision were notified of this decision in Local Government circular 6/2014 and this will be recorded in the NDR account in 2015/16.

Governance and transparency

Corporate governance

25. The governance arrangements for the NDR account 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.
26. At present the NDR account is not formally considered by any of the Scottish Government Audit and Risk Committees. Going forward, in view of the increasing focus on public finances flowing from further financial devolution, the Scottish Government should consider reviewing and enhancing the governance arrangements for the Non Domestic Rating Account.

Refer Action Plan No.1

Transparency

27. 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 NDR account in Scotland's public sector financial framework.

Internal control

28. In its management of the NDR account, Local Government Finance use the Scottish Government accounting and banking systems.
29. 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 NDR account.

Arrangements for the prevention and detection of fraud

30. 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

Governance and transparency

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

31. 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		
<p>Management override of controls</p> <p>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.</p>	<p>Financial statements work – detailed sample testing of journals and evaluation of significant transactions that are outside the normal course of business.</p>	<p>We tested all transactions related to the NDRI account and found no evidence of management override of controls</p>

Appendix I – Significant Audit Risks

Audit Risk	Proposed assurance procedure	Results and conclusions
<p>Business Rates Incentivisation Scheme (BRIS) disclosure: Agreement has now been reached between Scottish Government and COSLA leaders regarding the outcomes of the 12/13 financial year BRIS, with results to be reported in the 14/15 accounts. As this is the first year of reporting BRIS outcomes, there is a risk that the format and content of disclosures is insufficient to provide a clear understanding of the impact of the scheme on the financial statements.</p>	<p>Review disclosure in the financial statements and consider appropriateness.</p>	<p>As reported in our Annual Audit Report local authorities that exceeded the SGs targets for 2012/13, should retain this amount. This has been disclosed in the financial statements and we are content with the disclosure.</p>
<p>Unaudited accounts submission Late submission of the unaudited accounts may lead to failure to meet statutory completion deadlines.</p>	<p>Monitor and report on progress against pre-agreed timetable</p>	<p>Accounts were presented for audit in line with the agreed timetable and statutory completion deadlines were met.</p>

Appendix II – Action plan

No.	Issue/Risk/Recommendation	Management action/response	Responsible officer	Target date
1	<p>Audit and Risk Committee scrutiny of the NDR Account</p> <p>At present the NDR account is not considered by any of the Scottish Government’s Audit and Risk Committees.</p> <p>Risk</p> <p><i>Scrutiny of annual accounts by an Audit and Risk Committee is a feature of good corporate governance, with formal oversight reducing the risk of fraud and error.</i></p> <p>Recommendation:</p> <p>Going forward in view of the increasing focus on public finances flowing from further financial devolution, the Scottish Government should consider reviewing and enhancing the governance arrangements for the Non Domestic Rating Account.</p>	<p>The Non Domestic Rating account is a statutory account, quite separate from the annual accounts of the Scottish Government and is produced and audited in accordance with relevant regulations. The account and related audit reporting may, of course, be provided to the Portfolio Audit and Risk Committee for information. The Scottish Government Audit and Risk Committee will consider whether changes are required to its Terms of Reference once the outcome of the Fiscal Framework negotiations are known and this will include consideration of changes to financial reporting.</p>	Aileen Wright	<p>17/03/16</p> <p>Date of next SGARC meeting</p>

Appendix II – Action plan