AUDIT SCOTLAND

Revenue Scotland

Resource Accounts

Devolved Taxes Account

2015/16 Annual audit report to Members and the Auditor General for Scotland

August 2016

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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 (www.audit-scotland.gov.uk/about/).

Mark Taylor Assistant Director, Audit Scotland is the appointed external auditor of Revenue Scotland for the period 2015/16.

This report has been prepared for the use of Revenue Scotland and no responsibility to any member or officer in their individual capacity or any third party is accepted.

The information in it may be used by the Auditor General in support of her wider responsibilities, including reporting to the Scottish Parliament.

Contents

Key messages

Audit of financial statements	• Unqualified independent auditor's report on the 2015/16 financial statements for (a) Revenue Scotland's Resource Accounts and (b) the Devolved Taxes Account. • The accounts preparation process was more complex and time-consuming than Revenue Scotland had anticipated; it produced several drafts of the accounts for the Resource Accounts and the Devolved Taxes Account before achieving compliance with the FReM (Government Financial Reporting Manual).
Financial management & sustainability	• Resource Accounts: net operating costs of £4.7 million, an underspend of £0.142 million or 3 per cent against budget. • Devolved Taxes Account: net tax revenue of £572 million, £74 million (14.9 per cent) more than Scottish Ministers forecast in the 2015/16 Scottish budget. • Financial management was effective in Revenue Scotland's first year of operation. It should develop longer-term plans to support corporate decision-making and demonstrate financial sustainability.
Governance & transparency	• Revenue Scotland has established effective governance arrangements, including internal audit. • Internal controls supporting the Resource Accounts operated effectively during 2015/16; controls in the tax collection system were reasonable with scope for further development. • Revenue Scotland has established effective arrangements for the prevention and detection of fraud and corruption. • Financial and performance reporting is transparent, timely and balanced although there is scope for further development of the governance statements included in the accounts.
Value for money	• Revenue Scotland has developed a suite of performance indicators for its operational and tax collection activities. • Revenue Scotland should develop its workforce planning activities to support future decision-making about resources and staff costs.

Introduction

1. This report is a summary of our findings arising from the 2015/16 audits of:
   - Revenue Scotland's Resource Accounts. Revenue Scotland was established in January 2015 and 2015/16 is its first year of account. Expenditure prior to April 2015 was reflected in the Scottish Government's 2014/15 accounts.
   - The Devolved Taxes Account. This account is prepared by Revenue Scotland to reflect its activities in the collection and administration of Scotland's two devolved taxes which came into effect in April 2015 i.e. Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT).
2. The management of Revenue Scotland is responsible for:
   - preparing financial statements which give a true and fair view, in accordance with the relevant financial reporting framework and the accounts directions by Scottish Ministers.
   - ensuring the regularity of transactions, by putting in place systems of internal control
   - maintaining proper accounting records
   - publishing annual reports, including performance reports, accountability reports and governance statements for the Resource Accounts and the Devolved Taxes Account, and a remuneration report for the Resource Accounts.
3. Our responsibility as external auditor is to undertake an 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 financial statements 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. A number of reports, both local and national, have been issued by Audit Scotland during the course of the year. These reports are summarised at appendix II and appendix III.
6. Appendix IV is an action plan setting out our recommendations to address the high level risks we have identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response". We recognise that not all risks can be eliminated or even minimised. What is important is that Revenue Scotland understands its risks and has arrangements in place to manage them. The Audit and Risk Committee

should ensure that it is satisfied with proposed action and has a mechanism in place to assess progress and monitor outcomes.

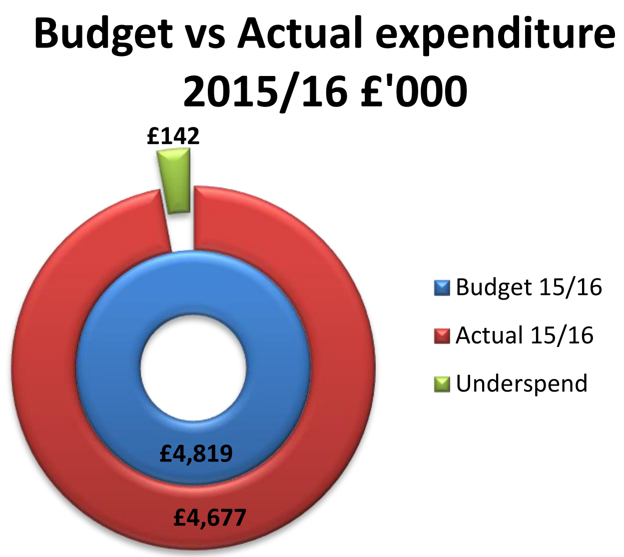
7. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures; consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.

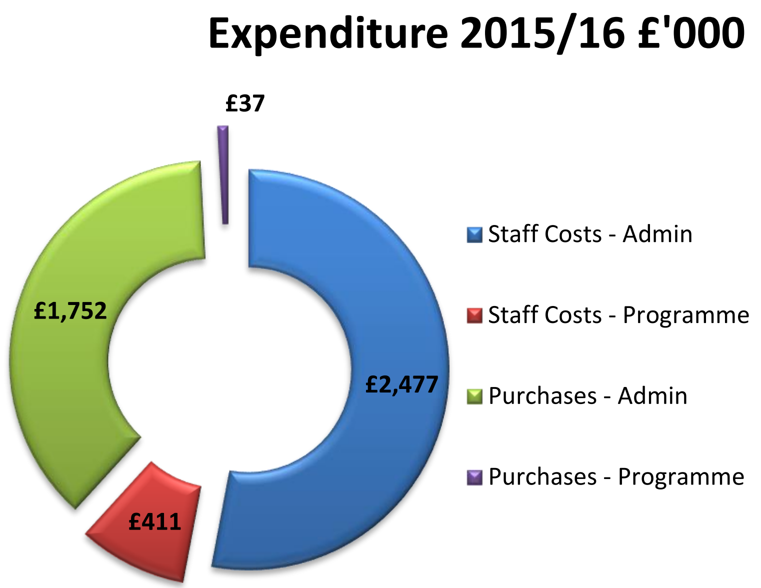
8. The cooperation and assistance afforded to the audit team by all staff at Revenue Scotland during the course of the audit is gratefully acknowledged.

9. 2015/16 is the final year of the current five year public audit procurement round. The next appointment period will run from 2016/17 to 2020/21. From 2016/17 Revenue Scotland will continue to be audited by Audit Scotland and Mark Taylor will continue as the appointed auditor.

Audit of the 2015/16 financial statements

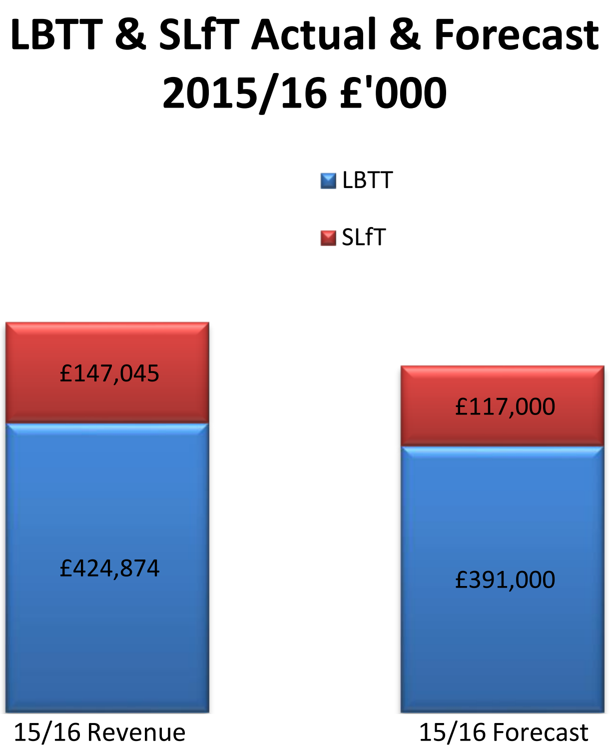
Resource Accounts: Budget and expenditure for 2015/16





Net operating costs for 2015/16 were £4.677 million against a budget of £4.819 million, resulting in an underspend of £0.142 million or 3% of budget. Staff costs accounted for £2.888 million (£2.477 million for administration and £0.411 million for staff involved in preparing for further devolved taxes) or 62% of operating costs, the remainder being the purchase of goods and services, £1.789 million or 38% of the total.

Devolved Taxes Account: Forecast and actual tax revenues for 2015/16



The Scottish Ministers are responsible for preparing forecasts of devolved tax revenues. At the time of the 2015/16 budget, they forecast that revenues from the devolved taxes would be £498 million. The estimate for devolved taxes increased to £508 million in the Spring Budget Revision.

Revenue Scotland is responsible for the collection and administration of the devolved taxes. In 2015/16 tax revenues were £572 million which exceeded Scottish Minister's initial forecast by £74 million and the estimate included for devolved taxes in the Spring Budget Revision by £64 million. In addition to taxes collected, penalties and interest totalling £0.3 million was levied for late or incorrect returns and payments.

Revenue Scotland is required to remit receipts from the devolved taxes to the Scottish Consolidated Fund (SCF). The Devolved Taxes Account shows that £509.719 million of cash generated during 2015/16 from the devolved taxes was remitted to the SCF during 2015/16. The remaining £62.487 million is shown in the Devolved Taxes Account as an amount due to the SCF at 31 March 2016.

Note: LBTT is Land and Buildings Transaction Tax which replaced UK Stamp Duty on 1 April 2015; SLfT is Scottish Landfill Tax which replaced UK Landfill Tax on 1 April 2015.

Audit opinions

Financial Statements	• Revenue Scotland's Resource Accounts for 2015/16 give a true and fair view of the state of its affairs and of its net expenditure for the year. • The Devolved Taxes Account for 2015/16 gives a true and fair view of the tax revenues for the year and the amounts paid and due to the Scottish Consolidated Fund. • We confirm that the financial statements have been properly prepared in accordance with the 2015/16 FReM (Government Financial Reporting Manual) and the requirements of the Public Finance and Accountability (Scotland) Act 2000 and related directions.
Regularity	• In all material respects, the expenditure and income in Revenue Scotland's Resource Accounts were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers, the Budget (Scotland) Act covering the financial year and sections 4 to 7 of the Public Finance and Accountability (Scotland) Act 2000. • Sums paid out of the Scottish Consolidated Fund for the purpose of meeting the expenditure shown in the Resource Accounts were applied in accordance with section 65 of the Scotland Act 1998. • In all material respects, the expenditure and income in the Devolved Taxes Account were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.
Other prescribed matters	• The part of the Remuneration Report in the Resource Accounts to be audited has been properly prepared in accordance with the Public Finance and Accountability (Scotland) Act 2000 and directions made thereunder by the Scottish Ministers. • For the Resource Accounts and the Devolved Taxes Account, the information given in the performance report sections of the respective Annual Reports is consistent with the financial statements.

Submission of financial statements for audit

10. We received the Resource Accounts and the Devolved Taxes Account for audit on 9 May 2016, in accordance with the agreed timetable. The working papers were of a good standard and supporting information was readily available, with the exception of purchase invoices held within Scottish Government processing systems. The first drafts of the annual report sections of the financial statements were incomplete and did not comply with the requirements of the FReM (Government Financial Reporting Manual). Our initial audit work also identified a range of errors and omissions in both sets of accounts.

11. Further drafts were received in June and July. At each stage, we identified further errors and omissions. In particular, adjustments were required to account properly for the tax system operating lease and related invoices and to ensure that the performance and accountability reports met the requirements of the FReM. Management has submitted final drafts of the Resource Accounts and the Devolved Taxes Account to the Board for approval at its meeting on 17 August.

12. As a result of the number corrections and amendments, over the period of the audit we received five separate versions of the financial statements for the Resource Accounts and the Devolved Taxes Account for consideration. This meant our audit work continued for a longer period than planned, until the end of July when we were able to conclude. The accounts preparation process proved more complex and time-consuming than Revenue Scotland had anticipated. This was compounded by the time taken by the Scottish Government to issue Accounts Directions.

Overview of the scope of the audit of the financial statements

13. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan presented to the Audit and Risk Committee on 14 December 2015.

14. At this meeting, the Chair of the Audit and Risk Committee asked us to consider further the potential risk to our independence arising from the fact that she was formerly a Director at Audit Scotland. We consulted the Auditing Practices Board's Ethical Standards, our own Ethical Standards Policy and the Code of Audit Practice and took advice from the Assistant Auditor General who is our Ethics Partner. We concluded that the former role of the Chair of Revenue Scotland's Audit and Risk Committee does not present a threat to our objectivity or independence, real or perceived. We communicated our conclusion to the Chair of Revenue Scotland's Board and to its Chief Executive in January 2016.

15. 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 any non-audit related services. The 2015/16 agreed

fee for the audit was £90,000 (£25,000 for the Resource Accounts and £65,000 for the Devolved Taxes Account). We have accommodated the extended audit timetable highlighted in paragraph 12 and related costs within the agreed fee, and this remains unchanged.

16. 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. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance.

17. Appendix I sets out the audit risks identified at the planning stage and how we addressed each risk in arriving at our opinion on the financial statements.

18. 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

19. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

20. We summarised our approach to materiality in our Annual Audit Plan. Planning materiality was set for the Resource Accounts based on anticipated expenditure and the individual taxes within the Devolved Taxes Account, based on anticipated tax revenues:

Account	Balance and %	Materiality Level
Devolved taxes	1% of £467m	£4.67m
Resource	1% of £4.62m	£0.046m

21. We revised our planning materiality for 2015/16 on receipt of the unaudited accounts to the amounts shown below:

Account	Balance and %	Materiality Level
Devolved taxes	1% of £572m	£5.72m
Resource	1% of £4.676m	£0.046m

22. We also set a lower level, known as performance materiality, when defining our audit procedures. This is determined to ensure that uncorrected and undetected audit differences do not exceed our materiality level. Performance materiality was set as follows:

Account	Balance and %	Performance Materiality Level
Devolved Taxes	20% of £5.72m	£1.144m
Resource	20% of £0.046m	£0.01m (rounded)

Evaluation of misstatements

23. We report all misstatements greater than £1,000 for the Resource Accounts and £10,000 for the Devolved Taxes Account.

24. For the Resource Accounts there was one adjusted misstatement and one non-adjusted misstatement over our reporting threshold. An adjustment was required for expenditure on the tax collection system (SETS), firstly to account for it as an operating lease in accordance with accounting standards, and secondly to accrue for costs still to be invoiced by the supplier. Revenue Scotland identified an amount due and although it relates to 2014/15 it has agreed to meet the cost. The overall effect of this was to increase expenditure in the Statement of Comprehensive Net Expenditure by £1,000, and to create a new amount receivable for £138,000 (relating to accounting for the SETS lease) and a new amount payable for £139,000 (relating to amounts due under the SETS lease) in the Statement of Financial Position.

25. The gross amounts receivable and the payable were individually above our planning materiality level for the Resource Accounts. As the misstatement related to the specific circumstances of the SETS lease and the resulting correction provides a true and fair view of the accounting for this item, there was no requirement for us to extend our audit work.

26. The non-adjusted misstatement on the Resource Accounts was in relation to the accrued short-term employee benefit figure in note 5 of the accounts. This was over-accrued by £4,748 which, if adjusted, would reduce staff costs in the Statement of Comprehensive Net Expenditure and accruals in the Statement of Financial Position by £5,000. Revenue Scotland decided not to adjust for this amount, which is below our performance materiality level.

27. For the Devolved Taxes Account there was one adjusted misstatement and no non-adjusted misstatements over our reporting threshold. The adjustment was made to more accurately capture tax revenue for the year by extending the account closedown period. The estimate made for SLfT revenue for the fourth quarter of 2015/16 was revised to reflect the actual amount, following receipt of tax returns for that quarter. This resulted in a decrease in revenue and receivables of £955,000. The availability of more up-to-date figures for LBTT resulted in revenue and receivables increasing by £831,000. The net effect of these adjustments was to decrease tax revenue and receivables by £124,000. This figure is below our performance materiality level for the Devolved Taxes Account.

Significant findings from the audit

28. International Standard on Auditing 260 (ISA 260) requires us to communicate to you significant findings from the audit as detailed below:

- 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.

29. The following table details those issues or audit judgements that, in our view, require to be communicated to those charged with governance in accordance with ISA 260.

Table 1: Significant findings from the audit

Significant findings from the audit in accordance with ISA260

Accounts preparation and timetable

30. Revenue Scotland set an ambitious timetable for producing financial statements for its first year of account. Although the deadline of producing accounts for audit was achieved (9 May), between that date and the completion of the audit we received five versions of the Resource Accounts and the Devolved Taxes Account. These drafts contained errors, omissions and other matters requiring attention. There were also delays in finalising performance information, staff cost information and pension figures.

On consideration of the initial drafts, we found considerable work was required by Revenue Scotland to achieve compliance with the FReM, particularly in relation to the format of and disclosures in the annual report sections of both sets of accounts. Our Annual Audit Plan identified that the preparation of first-time accounts, the small finance team and the proposed timetable combined to present a significant challenge for Revenue Scotland. We conclude that Revenue Scotland under-estimated the challenges faced in producing the Resource Accounts and Devolved Taxes Account. This was compounded by the late provision of Accounts Directions by the Scottish Government, which were finalised in April 2016.

Resolution: The final drafts of the Resource Accounts and the Devolved Taxes Account meet the requirements of the FReM. We recommend that Revenue Scotland considers carefully its timetable for producing its 2016/17 financial statements, including a suitable closedown date for recognising tax revenue, and allows sufficient time and resources for drafting FReM-compliant annual reports and accounts. The timings of Audit and Risk Committee and Board meetings is an important consideration in this process.

Appendix IV – Action Plan No. 1

Significant findings from the audit in accordance with ISA260

Inconsistencies between the Resource Accounts and the Devolved Taxes Account

31. Throughout the audit we highlighted inconsistencies between Revenue Scotland's Resource Accounts and the Devolved Taxes Account and made recommendations for better sign-posting between the two sets of accounts. While each set of accounts has its own purpose, the nature of the content requires close read-across. Due to the difficulties set out in paragraph 30 and the way in which the component parts of the accounts were produced, we highlighted examples of inconsistencies from draft to draft which required further consideration by Revenue Scotland.

Resolution: Revenue Scotland amended the more significant inconsistencies to more closely align the two sets of accounts. We recommend that Revenue Scotland reviews its accounts preparation process and gives further consideration to what information is provided in each set of accounts.

Appendix IV – Action Plan No. 2

SETS contract

32. Revenue Scotland has a contract with an external supplier to provide its core tax collection and administration system, SETS (Scottish Electronic Tax System). The Scottish Government signed the contract on behalf of Scottish Ministers in August 2014, before Revenue Scotland was established.

During the audit we noted that the contract remained in the name of Scottish Ministers and management agreed that the contract should be 'novated' to Revenue Scotland. Novation took place after the financial year-end, in June 2016, when Revenue Scotland's Board also approved extending the contract from its initial 24 month term for a further 36 months, to the end of August 2019. The uncertainty around the ownership of the contract delayed resolution of how the contract should be accounted for in the Resource Accounts. We examined the contract and informed management that we were of the view that it is an operating lease, as defined in accounting standards. Management considered the matter, satisfied itself as to the proper accounting treatment and amended the accounts to reflect the relevant accounting entries.

Management alerted us in July 2016 to the fact that costs for the first five months of the contract prior to Revenue Scotland's establishment, from September 2014 to January 2015 (total £116,000), had not in fact been paid because the supplier had not invoiced. Revenue Scotland has agreed to meet the amount due and has reflected the associated accounting entries in its accounts.

Resolution: The SETS contract is now in Revenue Scotland's name. Management amended the Resource Accounts to reflect the accounting requirements for operating leases and the position it identified in relation to outstanding amounts due under the contract. The SETS contract is fundamental to Revenue Scotland's core business activities and we recommend that it keeps the SETS contract under close scrutiny.

Appendix IV – Action Plan No. 3

Non-Current Assets

33. Revenue Scotland determined it held no non-current assets. As part of our audit we examined expenditure incurred by the Scottish Government in 2014/15 in establishing Revenue Scotland to determine whether there were any items of a capital nature and identified computer hardware costing £14,000 and software costing £27,000. These amounts had been met by the Scottish Government as part of the implementation costs of setting up the new tax body and we are content with the position. In addition, we satisfied ourselves that Revenue Scotland's expenditure on items of a potential capital nature in 2015/16 was below its capitalisation threshold of £10,000.

Resolution: The Resource Accounts include an accounting policy for non-current assets to assist understanding. We recommend that Revenue Scotland establishes a non-current asset register to record capital items purchased, to improve its accounting records and internal controls and to support future decisions on assets and asset management.

Appendix IV – Action Plan No. 4

Purchase invoices

34. We experienced delays and difficulties in obtaining copies of purchase invoices to support figures in the Resource Accounts Statement of Comprehensive Net Expenditure. Revenue Scotland does not hold copies of invoices which are scanned and retained by the Scottish Government's Accounts Payable Team on its electronic records document management system.

Resolution: We obtained copies of all invoices required for our testing, either via Revenue Scotland's finance staff or by contacting the Scottish Government's accounts payable team directly. We recommend that Revenue Scotland reviews its processes to ensure an audit trail is readily available, to support day-to-day financial management and to facilitate audit processes.

Appendix IV – Action Plan No. 5

Financial management and sustainability

Resource Departmental Expenditure Limit (DEL) underspend £142,000

Initial Budget
£4.3 million

Final Budget
£4.819 million

Actual Outturn
£4.677 million

Underspend
£0.142 million

35. The main financial objective for Revenue Scotland is to ensure that the financial outturn for the year is within the budget allocated by Scottish Ministers.

2015/16 financial position

36. Revenue Scotland is a Non Ministerial Department, is funded from the Scottish Consolidated Fund. Its budget is set out in the annual Budget Bill following consultation with the Scottish Government to determine its resource requirements. Its original budget for 2015/16 was set at £4.3 million but this was increased by £0.3 million in the Autumn Budget Revision due to a savings transfer from HMRC following the introduction of LBTT. A further increase of £0.2 million was made in the Spring Budget Revision to cover implementation costs arising from the introduction of the LBTT additional dwelling supplement from 2016/17, external audit fees and annual leave accruals. This resulted in a final budget figure of £4.8 million.

37. Net operating costs for the year totalled £4.7 million of which staff costs accounted for 62% and the purchase of goods and services 38%. Costs are analysed in the Statement of Comprehensive Net Expenditure between administration (day to day running costs of the entity) and programme (costs incurred in establishing the infrastructure necessary to implement new devolved taxes).

38. The Statement of Financial Position at 31 March 2016 shows net liabilities of £376,000. This position is largely attributable to the fact that Revenue Scotland has no non-current assets and accruals of £379,000 (mainly sums owing for the SETS contract, to Scottish Environment Protection Agency (SEPA) for delegated duties on SLfT and secondment costs to HMRC for staff) at the end of the year.

39. The financial position of Revenue Scotland at the end of its first year of operations is satisfactory with the organisation operating within its available funding.

Financial planning

40. As Revenue Scotland's funding is set by the Scottish Government, there is a greater degree of certainty over future funding streams than for some other public sector organisations who are involved in income generating activities. Therefore, the main focus for Revenue Scotland is achieving a balanced financial plan to remain within its annual allocation.

41. Revenue Scotland’s corporate plan covers the first three years of operations. It does not contain any financial planning information but notes that budget predictions for 2016/17 and 2017/18 are dependent on the outcomes of the Scottish and UK Spending Reviews. Revenue Scotland’s future budgets will depend on the extent to which its operations widen as the collection of further devolved taxes comes within its remit. From April 2016, Revenue Scotland has commenced collection of the LBTT Additional Dwelling Supplement (ADS) and it is preparing to collect Air Passenger Duty

which is likely to be the next devolved tax to come on-stream, from April 2018.

42. Revenue Scotland should develop longer-term financial planning to support future business strategy and demonstrate financial sustainability beyond its first year of operations. Corporate decision making would be strengthened by a long-term financial plan which would assist management's understanding the financial implications of its decisions. Financial planning should be linked to the Corporate Plan’s strategic objectives and annual business plans and include all key areas of the business, including staffing, IT and procurement. **Appendix IV – Action Plan No 6**

Financial management

43. As auditors we need to consider whether bodies have established adequate financial management arrangements. We do this by considering a number of factors, including whether:

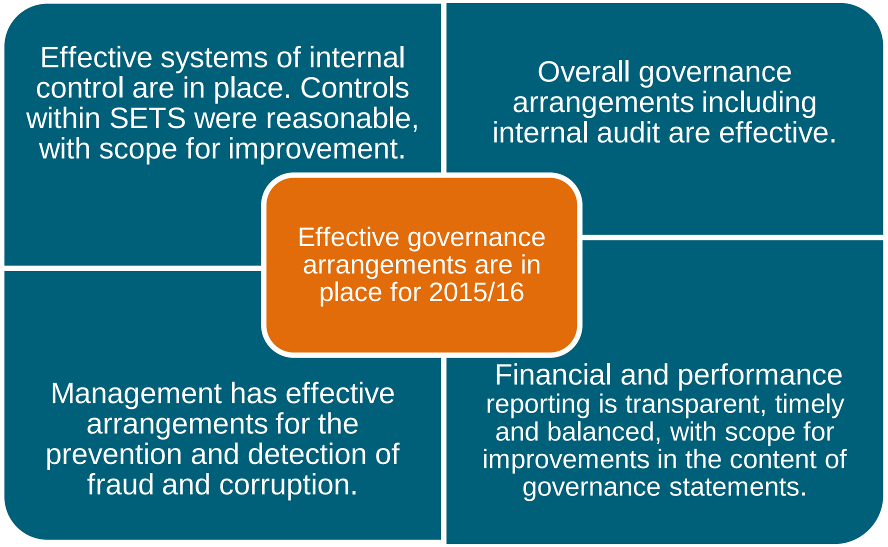
- the chief accountant has sufficient status to be able to deliver good financial management
- standing financial instructions and standing orders are comprehensive, current and promoted within the body
- reports monitoring performance against budgets are accurate and provided regularly to budget holders
- monitoring reports do not just contain financial data but are linked to information about performance
- audit and risk committee members provide a good level of challenge and question significant variances.

44. Based on our accumulated knowledge, our review of Board meeting papers and through our attendance at the Audit and Risk Committee, we concluded that Revenue Scotland has effective financial management arrangements in place. Regular finance reports have been submitted by the Chief Accountant to the Revenue Scotland Board and finances are managed well. We highlight a number of conclusions and recommendations in relation to the annual accounts preparation process at paragraph 30 above.

2016/17 budget

45. Revenue Scotland has an allocated Scottish Government Departmental Expenditure Limit (DEL) budget of £5.2 million for 2016/17. This represents a £0.4 million increase on the final 2015/16 budget of £4.8 million.

Governance and transparency



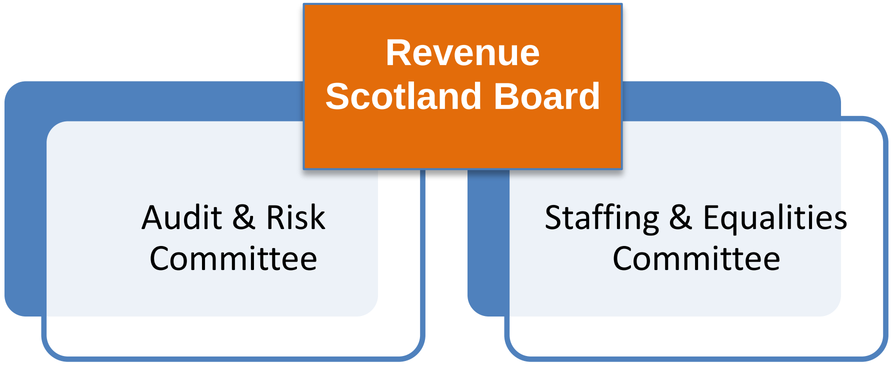
Corporate governance

46. As a Non-Ministerial Department, Revenue Scotland is part of the Scottish Administration but is independent from the Scottish Government and Scottish Ministers. It is accountable to the Scottish Parliament and is led by a Board consisting of five members, appointed by Scottish Ministers, who are collectively responsible for the leadership and management of the entity and for ensuring that it carries out its statutory functions effectively and efficiently. The Board met on three occasions in 2015 prior to the entity starting operations on 1 April 2016, and then met nine times during 2015/16. It is supported by an Audit and Risk Committee and a Staffing and Equalities Committee (exhibit 1 below).

47. The Chief Executive is the Accountable Officer, personally responsible for ensuring propriety and regularity in the handling of the public funds allocated to Revenue Scotland. She is accountable to the Board for day-to-day operational matters and is supported by a senior management team spanning tax policy, tax operation and compliance, legal, change management, finance and corporate services functions. In March 2016 Eleanor Emberson, the first Chief Executive of Revenue Scotland, left the organisation and Elaine Lorimer was appointed to replace her.

48. We concluded that Revenue Scotland has established effective overarching and supporting governance arrangements in its first year which provide an appropriate framework for organisational decision-making.

Exhibit 1: Revenue Scotland Governance Structure 2015/16



Transparency

49. The Scottish Government's *On Board* guidance (http://www.gov.scot/Publications/2015/04/9736/0) for board members of public bodies was updated and reissued in April 2015. *On Board* states that boards should demonstrate high standards of corporate governance at all times including openness and transparency in decision making. It recommends boards should consider:

- holding an annual open meeting
- holding board meetings in public unless there is a good reason not to
- publishing summary reports and/or minutes of meetings
- inviting evidence from members of the public in relation to matters of public concern
- consulting stakeholders and users on a wide range of issues
- making corporate plans and the annual report widely available.

50. Audit Scotland also believes in transparency of financial reporting within annual reports and accounts; through the accounts preparation process the audit team has encouraged Revenue Scotland to disclose information openly and clearly and the organisation has generally demonstrated a willingness to do so.

51. During the audit we recommended changes to improve the governance statements and to bring them into line with the requirements of the Scottish Public Finance Manual (SPFM). The 2015/16 governance statements meet the minimum requirements but we recommend further review next year to enhance the information and disclosures provided in the governance statements for the Resource Accounts and Devolved Taxes Account e.g. in relation to the risk profiles and related risk management arrangements.

Appendix IV – Action Plan No 7

52. Overall we concluded that Revenue Scotland's Board has implemented good levels of transparency around its activities: it publishes Board minutes, information on Board members and their interests and corporate publications on Revenue Scotland's website and has overseen consultation with key stakeholders and taxpayers and their agents during the year. Although it has not held any open

meetings, it has established open forums through which interested parties can participate in discussions on tax matters.

Internal control

53. No material weaknesses in the accounting and internal control systems were identified during the 2015/16 audit 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 Resource Accounts or in the Devolved Taxes Account.

54. We issued an interim report in June 2016 which concluded that internal controls for Revenue Scotland's business systems, operated on its behalf by the Scottish Government, operated effectively during 2015/16. We found that controls were reasonable in the tax collection system SETS, with scope for further development which senior management has accepted. For the purposes of our audit of the Devolved Taxes Account we took limited assurance and supplemented our approach with additional year-end testing which was satisfactory.

55. In our annual audit plan we noted our intention to consider Revenue Scotland's procedures for securing an effective check on the quantification, collection and proper allocation of tax revenue as part of our planned work in 2015/16. Our audit work in this area was satisfactory.

Internal audit

56. Internal audit is provided by the Scottish Government's Internal Audit Directorate (IAD); its work provides the Audit and Risk Committee and Accountable Officer with independent assurance on the overall risk management, internal control and corporate governance processes. We are required by international auditing standards to assess internal audit to determine the extent to which we can place reliance on its work. To avoid duplication, we place reliance on internal audit work where possible.

57. As part of our risk assessment and planning process for the Scottish Government audit we assessed the IAD and concluded that it operates in accordance with the Public Sector Internal Audit Standards (PSIAS). This enabled us to place reliance on internal audit, in terms of our wider Code of Audit Practice responsibilities.

58. IAD carried out an early review of corporate governance and provided substantial assurance on the governance arrangements established in Revenue Scotland's first year. It also reviewed debt collection for the devolved taxes and concluded that reasonable assurance could be provided but that there were areas for improvement. IAD noted the difficulty in a small Finance team, which consists of two permanent members of staff, in securing segregation of duties. Since then, Revenue Scotland has added to its Finance team by appointing a third, temporary member of staff. It has plans to appoint a Finance Manager in due course.

59. In addition to the two reviews set out in paragraph 58, IAD's plan included a review of budget management. This was deferred in agreement with Revenue Scotland and an assurance mapping review was planned instead; however, as Revenue Scotland commenced a restructuring exercise towards the end of the year, this was also deferred.

60. In its annual assurance report to the Audit and Risk Committee, IAD provided reasonable assurance in respect of Revenue Scotland's risk management, control and governance arrangements in its first year.

Arrangements for the prevention and detection of fraud

61. Revenue Scotland is responsible for establishing arrangements to prevent and detect fraud and other irregularity. We reviewed these arrangements and found that a counter-fraud policy, whistleblowing policy and fraud response plan were approved by the Board in March 2016.

62. We concluded that effective arrangements for the prevention and detection of fraud are in place, and disseminated to staff, albeit towards the end of the first year. The risk of fraud (internal and external) has featured on the corporate risk register throughout the year and has been monitored by the Audit and Risk Committee and staff have undergone training on handling taxpayer information and data protection.

National Fraud Initiative in Scotland

63. The National Fraud Initiative (NFI) uses electronic data analysis techniques to compare information held on individuals by different public sector bodies and different financial systems, to identify data matches that might indicate the existence of fraud or error.

64. Revenue Scotland was not operational in time to participate in the 2014/15 NFI exercise but will participate in 2016/17 through the Scottish Government Payroll and Accounts Payable Divisions. Audit Scotland published its biennial NFI report on the 2014/15 exercise in June 2016 and reported almost £17 million of fraud and error across services in Scotland.

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

65. Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and have proper arrangements in place for implementing and monitoring compliance with standards and codes of conduct, standing orders and financial instructions.

66. We considered whether Revenue Scotland has adequate arrangements in place and concluded that appropriate arrangements exist in the form of a Code of Conduct, Standing Orders and Conflict of Interest Policy.

Value for money

Arrangements for securing value for money

67. Accountable officers have a specific responsibility to ensure that arrangements have been made to secure value for money. The Auditor General may require the audit team to consider whether accountable officers have put in place appropriate arrangements to satisfy their corresponding duty of achieving value for money. Where such requirements are not specified we may, in conjunction with Revenue Scotland, agree to undertake local work in this area.

Shared services

68. During 2015/16 Revenue Scotland has embedded shared service arrangements in its activities in the interests of efficiency and economy. It makes use of Scottish Government corporate services for human resource and financial management, estates and facilities, procurement, legal and information technology functions.

69. In accordance with the Revenue Scotland and Tax Powers Act 2014, some of Revenue Scotland's tax functions are delegated to Registers of Scotland and the Scottish Environment Protection Agency. These partner bodies have worked closely with Revenue Scotland and supported it in implementing its tax collection and administration systems.

Performance management

70. Revenue Scotland has developed a suite of performance indicators for its operational and tax collection activities, based on the strategic objectives set out in its Corporate Plan. In this first year of operation it has reported on these in its annual report but it is likely to be next year before any targets are set and once appropriate baselines are determined and operations are more firmly embedded.

National performance audit reports

71. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2015/16, a number of reports were issued as outlined in Appendix III.

72. It is important that Revenue Scotland considers the key messages and recommendations in these reports. We have kept the Audit and Risk Committee informed during the year about our performance reporting activities. Where appropriate, the Board should take action to improve in the areas highlighted in each report.

73. During 2015/16 auditors were asked to undertake work reviewing workforce planning arrangements in place in all public bodies in Scotland. This work was following up on our 2013 report *Scotland's Public Sector Workforce*. The report recommended that bodies should develop organisation-wide workforce plans to help them to

plan strategically and ensure that workforce changes in one area do not have unintended consequences on another.

74. We carried out a baseline review of workforce planning at Revenue Scotland in May 2016 and found that there is currently no workforce plan in place. Most of Revenue Scotland's relatively small workforce was recruited by the Scottish Government under the Tax Administration Programme, the project that set up the new tax collection and administration body in 2014/15. Since then the workforce has increased from approximately 40 to 50, and a mixture of permanent, fixed term, agency and seconded staff make up the team.

75. The new Chief Executive has launched a structural review which is on-going and this is likely to lead to a reorganisation of roles. We recommend that in conjunction with this review, Revenue Scotland develops its workforce planning to assist future decision-making about resources and staff costs. This should facilitate forecasting of staff numbers, skill needs and costs and identify shared workforce opportunities. **Appendix IV – Action Plan No 8**

Appendix I: Significant audit risks

The table below sets out the audit risks we identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

	Audit Risk	Audit assurance procedure	Results and conclusions
Financial statement issues and risks			
1	ISA (UK&I) 240 requires that we plan our audit work to consider the risk of fraud, which is presumed to be a significant risk in any audit. There is a in any organisation a risk that management may override internal controls in order to manipulate the financial statements.	• Review management's arrangements and policies for preventing and detecting fraud • Review accounting estimates for bias • Review accounting adjustments at the year-end • Review any unusual and/or significant transactions • Test a sample of journals to ensure they are valid • Consider the results of controls testing	• Fraud policies were finalised by the end of the year and arrangements were found to be satisfactory • No estimation other than tax revenue recognition; an extension to the closedown period resulted in adjustments which the audit team checked and agreed as appropriate • There were accounting adjustments at the year-end, some of which were requested by the audit team; these were all considered satisfactory • We tested unusual and significant transactions and samples of journals for both the resource and devolved taxes account and found no matters of concern • Our interim report concluded that controls on SG systems operated effectively and those on the SETS system were reasonable. We carried out further audit work in relation to SETS transactions and found no evidence of any control override. We had some concerns that staff in the finance function have access to both SETS and SEAS (the ledger), and, as there are just two finance staff there is limited scope for segregation of duties. However, we concluded that the involvement of tax staff in SEAS transactions mitigated this risk. **Conclusion: our audit work found no evidence of management override of internal controls**

	Audit Risk	Audit assurance procedure	Results and conclusions
2	Under ISA (UK&I) 240 there is a (rebuttable) presumption that there are risks of fraud in revenue recognition. There is a risk that the entity could adopt accounting policies or treat income transactions in such a way as to lead to material misstatement in the reported revenue position. There is therefore a risk of fraud in revenue recognition for the Devolved Taxes account	• Review accounting policy for revenue recognition • Monitor budgetary process and reporting • Consider the regularity of transactions Test for cut-off to address the risk of misstatement	• We reviewed the accounting policy for revenue recognition and its application to tax revenues and confirmed FReM compliance • We reviewed the finance reports provided to the Board during the year and were satisfied with the quality of reporting against budget • We tested the regularity of transactions in both sets of accounts and found no matters of concern • We found minor cut-off errors in both sets of accounts but our testing was satisfactory overall **Conclusion: our audit work found no evidence of fraud in revenue recognition**

	Audit Risk	Audit assurance procedure	Results and conclusions
3	There is a risk that access to IT systems or the integrity of taxpayer data could be compromised as a result of a cyber attack.	• Review security controls against cyber attack including disaster recovery • Review management assurances over IT service contracts	• No disaster recovery testing has taken place on the SETS system. The supplier has provided disaster recovery testing plans and Revenue Scotland is looking to test business continuity in the event that SETS was unavailable for tax collection. We are content that arrangements with external IT suppliers cover the risk of cyber attack. Revenue Scotland's IT Manager reports on IT security matters to the Board and there is good awareness of the threat from cyber attack as reflected in risk management processes. • Revenue Scotland is addressing the need to obtain clearer and firmer assurances over its IT contracts. **Conclusion: we are content that Revenue Scotland is managing this risk through its arrangements with IT suppliers and we will continue to monitor this.**

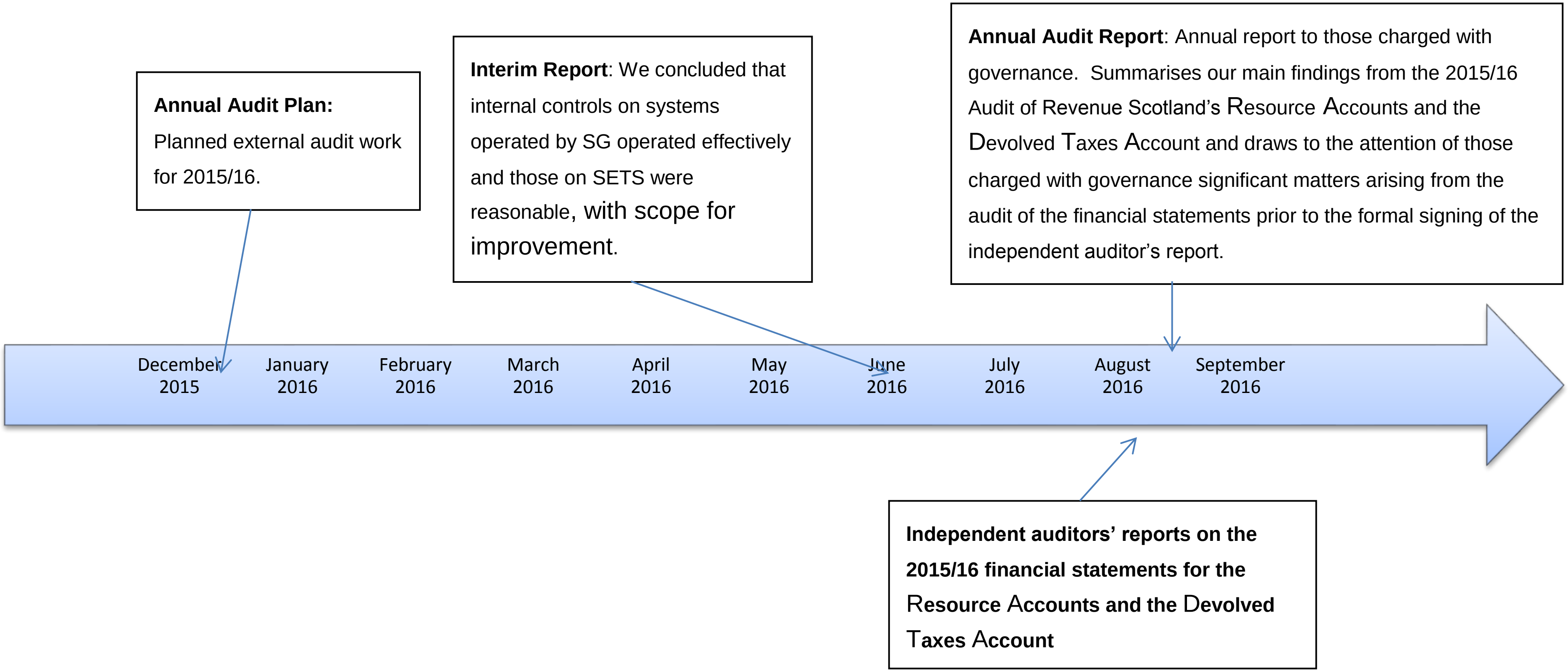
	Audit Risk	Audit assurance procedure	Results and conclusions
4	There is a risk that the financial statements may not be prepared appropriately and timeously; this risk is heightened by the following factors: • 2015/16 is the first year of accounts preparation for the body • The Accounts Direction from Scottish Ministers is outstanding • The format of the tax accounts is uncertain • The finance team consists of two members of staff The time lag in tax receipts at the financial year-end will delay outturn figures.	• Monitor progress in adhering to timetable • Monitor receipt of the Accounts Direction • Review pro-forma accounts for compliance with the FReM and the Accounts Direction	• The first draft accounts were provided to the audit team on 9 May. The ARC considered the draft accounts on 29 June as planned. • The Accounts Directions were not finalised until after the year-end, on 20 April. • Audit review of the first draft accounts found that they had not been prepared in accordance with the FReM, requiring redrafting to meet the standard required. Revenue Scotland underestimated the complexity and challenge of preparing first time accounts, compounded by the late delivery of the accounts directions, and limited awareness and experience of the FReM requirements. **Conclusion: the accounts preparation process has been challenging for Revenue Scotland with the result that audit fieldwork was not completed until the end of July, almost a month later than planned. The risks which we identified in our audit plan in December 2015 crystallised. We highlight this as a significant issue in our annual report, with recommendations to improve the process in 2016/17.**

	Audit Risk	Audit assurance procedure	Results and conclusions
5	There is a risk associated with the application of the legislation which established Revenue Scotland and the current devolved taxes; legislative complexity creates a risk that the body may apply aspects of its powers inappropriately.	• Review founding legislation and its application during the year • Review working relationships with SEPA and RoS • Review customer feedback and complaints management	• We reviewed the legislation and were satisfied that tax was being collected in compliance with the legislation. We explored the Board decision not to charge penalties and interest for the first 6 months of the year and concurred with management assurances that this was compatible with Revenue Scotland powers under the Revenue Scotland and Tax Powers Act 2014 • We found no concerns in the working relationships between Revenue Scotland and its partner bodies • There were a very small number of customer complaints about Revenue Scotland's operational processes, none of which indicated significant concerns about Revenue Scotland's processes. On the tax side, there are five disputes open at the year-end but no involvement with Tax Tribunals to date. We reviewed three tax appeal cases and agreed there was too much uncertainty at this early stage in proceedings to warrant any disclosures or provisions in the accounts. We will continue to monitor these. **Conclusion: our audit work suggests that Revenue Scotland has appropriately applied relevant legislation.**

	Audit Risk	Audit assurance procedure	Results and conclusions
6	Revenue Scotland's key IT systems are provided and maintained by external suppliers; this creates risks around contract management and service continuity, in particular the need to obtain satisfactory assurance on the quality, performance and security arrangements of these services and to put in place strategies for contract renewal or termination.	• Review IT service contracts • Review IT strategy for contract management including obtaining assurance and planning for contract renewal or termination.	• We reviewed the SETS contract and found significant issues as reported in the body of this report. These issues were resolved by the time the accounts were finalised. We have discussed IT contract management with Revenue Scotland staff and reported in our interim report that this risk needed to be addressed, as evidenced by the problems around the SETS contract. • An ICT strategy paper has been recently presented to the Board which covers the key IT contracts currently in place, and SG Procurement staff are to support Revenue Scotland to strengthen contract management. The SETS contract term was extended by the Board in June 2016. **Conclusion: Revenue Scotland is starting to address risks relating to contract management and service continuity. We will monitor this as processes develop into 2016/17.**

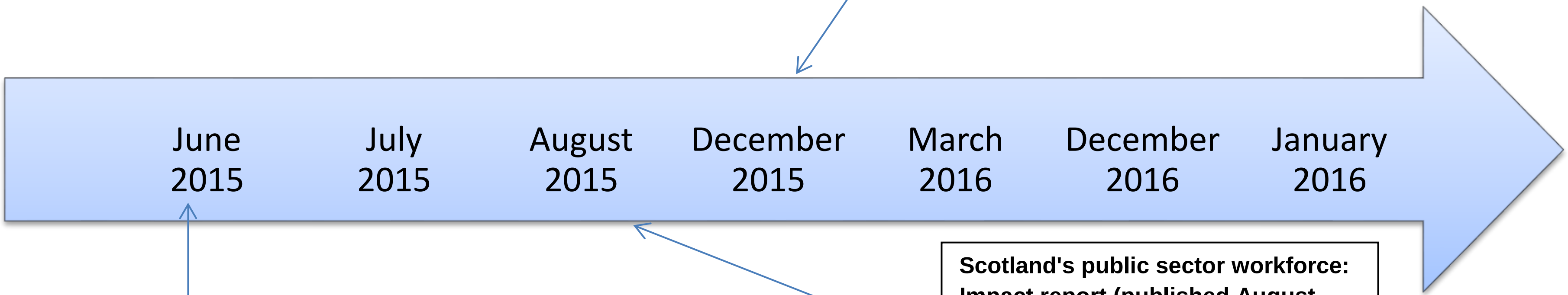
	Audit Risk	Audit assurance procedure	Results and conclusions
7	In this first year of audit we will gain an understanding of the systems that support the assessment, collection and allocation of taxes and consider the risks associated with these processes as they are undertaken for the first time.	• Gain and understanding of the systems • Consider the results of controls testing • Review working relationships with SEPA and RoS	• As reported in our Interim Report a significant amount of work was done by the audit team in understanding the processes and associated controls over the collection of tax. We documented the full process using a flow- chart to identify where particular controls would be expected. Producing the flowchart was an iterative process involving Revenue Scotland in order to gain an accurate picture of the processes and controls in the SETS system. • We designed audit tests to interrogate the system and processes to ensure the controls were operating effectively and tax returns had been completed in accordance with legislation. We examined a sample of returns that had been amended or corrected to ensure that Revenue Scotland was carrying out sufficient checks on the reasonableness of the returns. We specifically tested the quantification, collection and allocation of taxes. • A number of recommendations were made in our Interim Report to strengthen controls in the SETS system **Conclusion: the audit team has gained a good understanding of SETS and our testing has been satisfactory overall, providing assurance that SETS is working well and providing valid data for the accounts.**

Appendix II: Summary of local audit reports 2015/16



Appendix III: Summary of Audit Scotland national reports 2015/16

Implementing the Scotland Act 2012 – an update (published December 2015) - This report assessed how effectively Revenue Scotland implemented, and is collecting, the two devolved taxes introduced in April 2015. It also examined how the Scottish Government is working with HM Revenue and Customs to prepare to introduce the Scottish rate of income tax in April 2016, and looked at how the Scottish Government is developing its financial management and reporting.



Managing ICT contracts in central government: an update (published June 2015) - This report reviewed the progress that the Scottish Government and central government bodies had made against the recommendations in our previous report on managing ICT contracts.

Scotland's public sector workforce: Impact report (published August 2015) - This report summarised the impact of the Audit Scotland report on 'Scotland's public sector workforce', published on 28 November 2013 and the related good practice guide.

Appendix IV: Action plan

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
1.	30	**Accounts preparation and timetable** The accounts preparation process proved to be more complex and time-consuming than Revenue Scotland anticipated. Several sets of draft accounts were issued before the financial statements for the Resource Accounts and the Devolved Taxes Account complied with the FReM. **Risk:** There is a risk that the difficulties experienced in 2015/16 are repeated, with risks to the efficiency of the accounts preparation and audit processes. **Recommendation:** We recommend that Revenue Scotland considers carefully its arrangements for producing its 2016/17 financial statements, to allow sufficient time and resources for drafting FReM-compliant annual reports and accounts. The timings of Board and Audit and Risk Committee meetings is an important consideration in this process.	Accepted. We accept that there have been a number of drafts of the accounts. This was the first year for operations of Revenue Scotland and the first set of accounts to be produced. It was inevitable therefore that there would be a few versions. We are grateful to Audit Scotland for their assistance and guidance on the composition and wording to be included. We will welcome any recommendations for timing of the audit, ARC and Board meetings to assist with our planning for next year. The lease adjustment was identified by RS and advised to AS. The tax account accruals were always planned to be reviewed although we acknowledge a small adjustment was advised by AS due to a miscalculation. The requirement to review the tax account accruals may be avoided if we delay preparation of the accounts until after May.	Andrew Fleming Strategy and Change Director December 2016

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
2.	31	**Inconsistencies between the resource and devolved taxes accounts** During the accounts preparation process we noted inconsistencies between the Resource Accounts and Devolved Taxes Account, relating to the challenges in the accounts preparation process and the way in which the component parts of the financial statements were produced. **Risk:** There is a risk that inconsistencies between the two sets of accounts may affect the overall understanding of Revenue Scotland's activities and reduce the clarity of information reported. **Recommendation:** We recommend that Revenue Scotland reviews the accounts preparation process and gives further consideration to the alignment of information provided in each set of accounts.	See comments in response to 1 above.	Andrew Fleming Strategy and Change Director December 2016

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
3.	32	**SETS contract** The contract for Revenue Scotland's tax collection and administration system (SETS) remained in the name of Scottish Ministers until after the financial year-end when it was novated to Revenue Scotland. Following this and the Board's decision to extend it for a further 3 years, a material adjustment was made to the Resource Accounts to reflect the accounting requirements for leases. An accrual was also required to reflect payments due under the lease which were only recently identified by management. **Risk:** There is a risk to Revenue Scotland's activities if uncertainties emerge in relation to the management of the SETS contract. **Recommendation:** We recommend that Revenue Scotland strengthens controls over, and oversight of, the SETS contract.	Accepted - Work has already commenced to tighten controls around contract management generally and the SETS contract in particular.	Andrew Fleming Strategy and Change Director December 2016

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
4.	33	**Non-current assets** The Scottish Government purchased non-current assets for use by Revenue Scotland in its set-up phase and for when it became operational. No non-current assets were transferred to Revenue Scotland at the start of 2015/16. Revenue Scotland purchases of items of a capital nature in 2015/16 were below its capitalisation threshold. Revenue Scotland has yet to establish a fixed asset register to record capital items. **Risk:** There is a risk that purchases which are capital in nature may be expensed rather than capitalised in accordance with Revenue Scotland's accounting policy for non-current assets. This could lead to an under-recording of assets in the Statement of Financial Position. **Recommendation:** We recommend that Revenue Scotland establishes a non-current asset register to record all capital items purchased, to improve its accounting records and internal control and to support future decisions on assets and asset management.	Recommendation accepted.	Andrew Fleming Strategy and Change Director October 2016

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
5.	34	**Purchase invoices** Revenue Scotland does not retain copies of its purchase invoices; these are held by Scottish Government accounts payable system. **Risk**: There is a risk of gaps in the audit trail to support expenditure in the accounts. There is also a risk that delays in obtaining access to invoices may effect efficient day-to-day management of finances. **Recommendation:** We recommend that Revenue Scotland reviews its processes to ensure an audit trail is readily available, to support day-to-day financial management and to facilitate audit processes.	Accepted. This was outside our control as invoices are sent directly to SG Accounts payable. Once the Finance Manager is in post we will review our processes around this area with a view to ensuring all invoices are sent to us first.	Andrew Fleming Strategy and Change Director December 2016

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
6.	42	**Long-term financial planning** Revenue Scotland's focus in its first year has been to achieve a balanced budget and at present there is no long-term financial plan in place. **Risk:** There is a risk that business decisions may be taken without a clear understanding of the financial implications beyond the current financial year and how they affect the overall financial sustainability of Revenue Scotland. **Recommendation:** We recommend that Revenue Scotland develops a longer-term financial plan to demonstrate its financial sustainability over the longer term. The plan should link to Corporate Plan strategic objectives and annual business plans and incorporate key business areas such as staffing, IT and procurement.	Agreed. Work has commenced this year to understand better our financial planning requirements of our corporate and business planning processes, including key investment decisions on ICT and the likely impact on Revenue Scotland of collecting additional devolved taxes where a formal business case has been commissioned. In the course of this year, we will develop this work into a more structured planning document which better demonstrates our financial sustainability over the longer term.	Andrew Fleming Strategy and Change Director March 2017

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
7.	51	**Governance statements** During the audit we recommended changes to improve the governance statements and to bring them in to line with the requirements of the Scottish Public Finance Manual (SPFM). The 2015/16 governance statements meet the minimum requirements but there is scope for improvement in future in the content of the governance statements. **Risk:** there is a risk that the governance statements do not provide sufficient insight into key aspects of Revenue Scotland's governance arrangements. **Recommendation:** We recommend further review next year to enhance the information and disclosures provided in the governance statements for the Resource Accounts and Devolved Taxes Account e.g. in relation to the risk profiles and related risk management arrangements.	Noted and action completed.	Andrew Fleming Strategy and Change Director August 2016

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
8.	75	**Workforce Planning** Formal workforce planning is not yet in place at Revenue Scotland. **Risk:** Without effective workforce planning there is a risk that any decisions on staff matters may not be coordinated or not properly supported, leading to decisions in one area having unintended consequences in another. **Recommendation:** We recommend that in conjunction with the on-going internal structural review, Revenue Scotland develops its workforce planning to assist with future decision-making about resources and staff costs. This should facilitate forecasting of staff numbers, skill needs and costs and identify shared workforce opportunities.	Agreed. In the course of the year and as part of Revenue Scotland's first Organisational Development programme, work on aspects of workforce planning has already commenced. This work is feeding into the organisational review currently underway. In the course of the year, we plan to develop this into a more formal workforce planning approach which is better integrated into our corporate and business planning processes.	Andrew Fleming Strategy and Change Director March 2017