The Scottish Consolidated Fund

2015/16 Annual audit report

October 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 the Scottish Consolidated Fund for the period 2011/12 to 2015/16.

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

Contents

Key messages

Audit of financial statements	• Independent auditor's report on the 2015/16 Scottish Consolidated Fund (SCF) account is unqualified.
Financial management and sustainability	• Receipts from the Scotland Office were £28,025 million, £558 million (1.95%) within the cash drawdown limit of £28,583 million set by the UK Parliament. • Surplus for the year of £53 million, increasing the overall cash balance in the account to £273 million. The balance does not necessarily represent amounts available to spend under budget acts. • First year of operation of the devolved taxes (Land and Buildings Transaction Tax and Scottish Landfill Tax); cash receipts from the devolved taxes of £510 million were paid over to the SCF by Revenue Scotland.
Governance and transparency	• The Scottish Government Audit and Risk Committee agreed to review its terms of reference to reflect its role in relation to the SCF; this arrangement will need to be carried through into the Scottish Government's revised, over-arching governance arrangements.
Outlook	• Scope to provide further information in the accounts to explain the significant role of the SCF in the wider system of budget management and financial reporting. • Additional Dwelling Supplement element of Land and Buildings Transaction Tax will be paid into the SCF from 2016/17. • Enhanced borrowing powers in the Scotland Act 2012 to be applied in 2016/17, with loan transactions (receipts and repayments of principal and interest) flowing through the SCF.

Introduction

1. This report is a summary of our findings arising from the 2015/16 audit of the Scottish Consolidated Fund (SCF).

2. Scottish Government officials are 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, 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 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. Appendix III is an action plan setting out our recommendations to address the high level risks we have identified from the audit. Officers will consider the issues and agree 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 the Scottish Government understands its risks and has arrangements in place to manage these risks. The Scottish Government Audit and Risk Committee, and the successor committee under the revised governance structure, should ensure that it is satisfied with proposed action and have mechanisms 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 2015/16 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 2016 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 Scottish Consolidated Fund.

Submission of financial statements for audit

8. We received the unaudited financial statements on 7 July 2016, in accordance with the agreed timetable. The working papers were of a good standard and staff provided support to the audit team which enabled us to complete our on-site fieldwork on 2 September 2016.

9. Late changes were made to the introductory narrative at the start of the accounts to set out the SCF's role and changes affecting its operations flowing from the new devolved financial powers.

Overview of the scope of the audit of the financial statements

10. 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 Scottish Government Audit and Risk committee on 17 March 2016.

11. 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 notional fee for the audit was £20,200 and, as we did not carry out any work additional to our planned audit activity, the fee remains unchanged.

12. 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.

13. 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.

14. 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

15. 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.

16. We summarised our approach to materiality in our Annual Audit Plan. We have not revised our planning materiality on receipt of the unaudited accounts which remains at £250,000. We used expenditure on judicial salaries, one of the key elements within the accounts, to set materiality (1% of prior year judicial salaries expenditure). Due to the nature of the account we have tested all receipts and payments into and out of the fund, recognising that any payment that is not in accordance with applicable legislation would require us to report as part of our opinion on the financial statements of the SCF.

17. No unadjusted misstatements were identified during the course of the audit.

18. 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

19. 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.

20. There are no matters that we wish to draw your attention in accordance with ISA 260.

Financial management and sustainability

Receipts
last year £32,872 million

£33,345m

Payments
last year £32,858 million

£33,292m

Surplus For The Period
last year £14 million

£53m

General Scottish Consolidated Fund Reserve

31 March 2016
£273m

31 March 2015
£220m

21. The Scottish Consolidated Fund (SCF) was established by Section 64 (1) of the Scotland Act 1998. The fund operates as a single receipts and payments 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.

22. The cash received from the Scotland Office reflects the Block Grant calculated using the Barnett formula. The SCF also 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.

23. Non-Domestic Rates (NDR) income collected by councils 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, which is audited separately.

24. 2015/16 was the first year of operation of the devolved taxes (Land and Buildings Transaction Tax and Scottish Landfill Tax) under sections 28 to 31 the Scotland Act 2012. The devolved taxes are collected and managed by Revenue Scotland. Receipts are paid to the SCF and then paid over to the Scottish Government.

Financial management

25. The SCF 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.

26. In 2015/16 the SCF received funding from this source of £28,025 million, £558 million less than the £28,583 million limit stated in the 2015/16 UK Supplementary Estimate. The limit is set by forecasting the cash requirement for the 2015/16 Scottish budget, drawing down less than this limit has no effect on the overall spending power of the Scottish Government and the wider Scottish Administration.

27. From 1 April 2015, the implementation of financial provisions in the Scotland Act 2012 for devolved taxes and enhanced borrowing powers affect the amounts and disclosures in the Scottish Consolidated Fund accounts.

28. Tax receipts from Land and Buildings Transaction Tax and Scottish Landfill Tax in 2015/16 were paid into the SCF and then paid over to the Scottish Government as part of payments from the fund authorised under the Budget Act. The total amount of devolved tax receipts paid into the SCF in 2015/16 was £510 million. The enhanced borrowing powers were not used on a cash basis in 2015/16. If the borrowing powers are used in future years, cash generated from borrowing and repayments of principal and interest will be reflected in the SCF.

29. Consolidated Fund Extra Receipts (CFER) of £39.1 million were paid into the SCF in 2015/16. This constitutes income that cannot be applied by Scottish public bodies, in line with applicable legislation. £29 million is classed as designated receipts and was paid over to the UK Consolidated Fund in line with the Designation of Receipts Order 2009.

30. The Queen's and Lord Treasurer's Remembrancer collects the unclaimed sums arising from personal estates and sequestrated companies and after a set period pays them over to the SCF. In 2015/16, receipts of £9 million are reflected in the SCF.

31. While receipts classed as Proceeds of Crime are paid over to the Scottish Government, there is no clear guidance or statutory regulations covering the use of non-designated CFERs and QLTR receipts. They cannot be used to fund additional expenditure without the agreement of Her Majesty's Treasury (HMT).

32. During 2015/16, discussions between the Scottish Government and HMT focused on developing and agreeing the Fiscal Framework to support the application of the provisions of the Scotland Act 2016. 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.

Refer Action Plan No.1

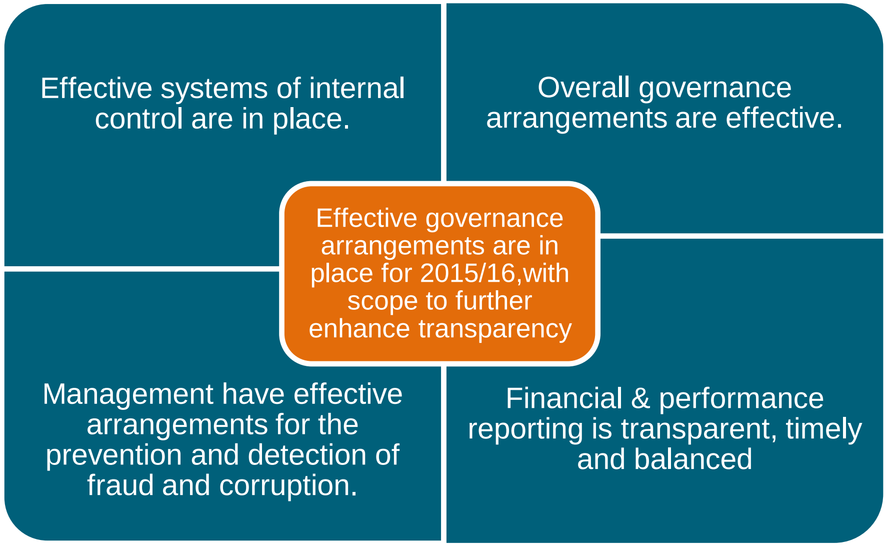
33. Payments out of the fund are made to the Scottish Administration and direct-funded bodies in line with the cash authorisation limits set out in the Scottish Budget. Payments totalling of £33,166 million in 2015/16 were within the overall limit of £33,585 million set by the Budget (Scotland) Act 2015.

34. In 2015/16 there was a surplus of receipts over payments of £53 million. This increased the general reserve balance of the Scottish Consolidated Fund to £273 million. The balance does not necessarily represent amounts available to spend under budget acts.

2016/17 outlook

35. In 2016/17, receipts from the Additional Dwelling Supplement of Land and Buildings Transaction Tax will be paid into the SCF. The SCF will also reflect the government's plans to use its enhanced borrowing powers in 2016/17. All loan transactions (receipts and repayments of interest and principle) will flow to the SCF. We will review the accounting treatment and financial reporting disclosures of devolved taxes receipts and borrowing as part of our 2016/17 audit.

Governance and Transparency



Corporate governance

36. 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 2015/16 Scottish Government's Consolidated Accounts concluded that the Scottish Government has adequate governance arrangements in place.

37. During the year, the Scottish Government Audit and Risk Committee (SGARC) agreed to review its terms of reference to reflect its role in relation to the SCF. In our view this is a helpful development, enhancing the oversight of the SCF's operations, accounts and audit.

38. The Scottish Government has brought forward proposals to amend its over-arching governance arrangements. As part of the implementation of the new arrangements and in determining the role of the new assurance and audit committee, the Scottish Government should ensure that SGARC's decisions in relation to the SCF are carried forward into the new arrangements.

Refer Action Plan No.2

Transparency

39. As indicated, with the implementation of new financial powers the SCF takes on greater significance in the wider system of budget management and financial reporting. We acknowledge the changes to the introductory narrative at the start of the accounts to set out the SCF's role and changes affecting its operations flowing from the new devolved financial powers. In our view, there is scope to provide further information in the accounts to explain the role of the SCF in that developing context.

40. For example, the SCF accounts could explain how amounts paid into the fund relate to the funding anticipated in the Scottish Budget, together with a link to how the receipts drawn down from the

Scotland Office tie back to the Block Grant provided by the UK government. While it is important to observe the differences in accountability between the Scotland Office and Scottish Government, there is scope to provide more narrative to explain how the SCF fits into the wider system of public finances in Scotland.

Internal control

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

42. No material weaknesses in the accounting and banking 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 SCF accounts.

43. 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 for 2015/16 was held by a division within the Scottish Government's Learning and Justice Directorate, with TBB performing monthly reconciliation and accounting controls.

44. 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.

45. In August 2015 the third party payroll contract was awarded to a new payroll provider, and from April 2016 administration responsibility has passed to the Scottish Courts & Tribunal Service.

46. We examined the new arrangements as part of our 2015/16 audit. It was identified that the same desk instructions and procedures are used by Scottish Courts & Tribunal Service. Prior to this change, training was also provided to Scottish Courts & Tribunal Service by the Scottish Government's Learning and Justice Directorate division. We concluded that the new arrangements are operating as planned.

Arrangements for the prevention and detection of fraud

47. We assessed the arrangements for the prevention and detection of fraud during the planning phase of our audit of the 2015/16 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

48. 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

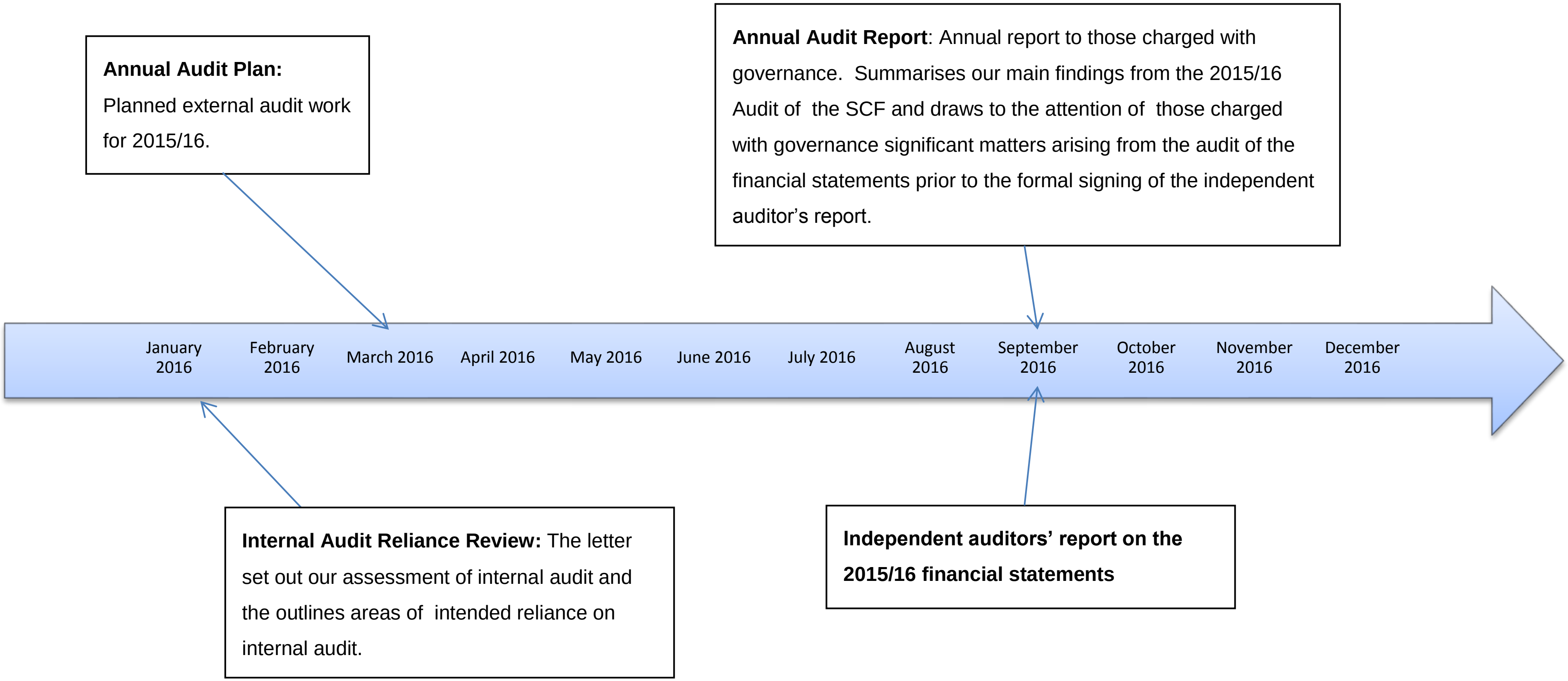
The table below sets out the audit risks we identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

Audit Risk	Assurance procedure	Results and conclusions
Risk of material misstatement		
Fiscal devolution The Scotland Act 2012 implementation will result in changes to the SCF accounts for 15/16, the collection of devolved taxes through Revenue Scotland and the new capital borrowing will flow through the SCF from 1 April 2015. There is a risk that these may not be disclosed and/or accounted for transparently or consistently in line with other published accounts.	• We will review the disclosures in the draft financial statements and consider the appropriateness of the accounting applied • We will consider the level of transparency applied in relation to other accounts prepared by the Scottish Government and Revenue Scotland.	The devolved taxes disclosures in the SCF accounts are appropriate. Receipts reflected in the SCF agree to disclosures in the Devolved Taxes Account produced by Revenue Scotland. Disclosures in the accounts reflect the fact that borrowing is covered in the scope of the SCF accounts, although the enhanced borrowing powers were not applied in 2015/16. We note the enhanced information on new financial powers in the 2015/16 accounts and will continue to review accounting and financial reporting disclosures of borrowing and devolved taxes receipts as part of our 2016/17 audit.

Audit Risk	Assurance procedure	Results and conclusions
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 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.	• Our audit approach includes 100% substantive testing of payments/receipts into and out of the SCF • Evaluation of significant transactions that are outside the normal course of business.	We tested all transactions into and out of the SCF found no evidence of management override of controls.
Risks identified from the auditor's wider responsibility under the Code of Audit Practice		
Governance arrangements for the SCF At present there is no formal role in the scrutiny of the SCF for any of the Scottish Government's audit and risk committees. Annual audit reports on the fund accounts are not regularly considered by the Financial Strategy Board. 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. It was recommended that given the increasing significance of the SCF, the Scottish Government should consider reviewing and enhancing the governance arrangements for the fund.	• Review the papers/minutes of the March SG ARC to identify whether there have been any changes to their terms of reference.	We recognise that the Scottish Government has taken steps to develop governance arrangements for the SCF. As a result the annual accounts and ISA 260 annual audit report for 2015/16 will be presented to the SG Audit and Risk Committee. SGARC agreed to include oversight of the SCF in its terms of reference. This will be carried forward and considered as part of changes to overarching governance arrangements proposed by the Scottish Government. Refer to action point 2 for recommendation.

Audit Risk	Assurance procedure	Results and conclusions
Treatment of QLTR and other miscellaneous receipts There remains no clear guidance or statutory regulations in place covering the treatment of QLTR and other miscellaneous receipts within the fund. There is a risk that the overall cash balance in the fund continues to accumulate with no clear, agreed processes for how it will be applied.	• Review of QLTR and other miscellaneous receipts in 2015/16 • Analysis of SCF balance at the year end • Regular meetings with Treasury & Banking staff • Discussions with other Scottish Government senior finance officials • Review Fiscal Framework agreement and consider impact on future operation of the SCF	While we acknowledge that the fiscal framework has been the main focus of discussions between the Scottish Government and HM Treasury, there has been no discussion as yet on the QLTR and miscellaneous receipts within the SCF. Refer to action point 1 for recommendation.

Appendix II: Summary of local audit reports 2015/16



Appendix III: Action plan

No.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
1.	32	**QLTR and other miscellaneous receipts** There remains no clear guidance or statutory regulations in place covering the treatment of QLTR and other miscellaneous receipts within the SCF. **Risk** These balances continue to accumulate with no clear, agreed processes for how they will be applied. **Recommendation** The Scottish Government should develop, in agreement with HMT, clear and comprehensive guidelines covering all relevant receipts within the SCF.	These minor receipts have accumulated in the SCF because any such receipts are required to be paid into the SCF. The ongoing process to implement the Fiscal Framework should provide an opportunity to address how these funds may be applied in Scotland.	Deputy Director, Finance March 2017
2.	38	**Governance arrangements for the SCF** The Scottish Government has brought forward proposals to amend its over-arching governance arrangements. As part of the implementation of the new arrangements and in determining the role of the new assurance and audit committee, agreement should be reached on its remit in relation to the SCF.	The new Scottish Government governance arrangements are now in operation and the Scottish Government Audit and Assurance Committee will consider this at its first meeting in December. *[The SG Finance view is that the Scottish Consolidated Fund account is a stand-alone*	

No.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
		Risk Without scrutiny of annual accounts by an audit committee or equivalent, the Scottish Government is not meeting recognised good governance practice. **Recommendation** The Scottish Government should review and confirm the governance arrangements of the SCF in the context of its revised over-arching governance arrangements.	*statutory account, quite separate from the annual accounts of the Scottish Government. The Public Finance and Accountability (Scotland) Act fully prescribes the details of the account, which is a cash account of the amounts paid into and out of the Fund. The statute also embeds procedures governing the paying out of Funds. SG Finance does recognise that there may be increasing interest in the SCF account, because receipts from the devolved taxes are paid into the Fund.]*	