Revenue Scotland

Resource Accounts
Devolved Tax Account

2016/17 Annual Audit Report

AUDIT SCOTLAND

Prepared for Revenue Scotland and the Auditor General for Scotland

14 September 2017

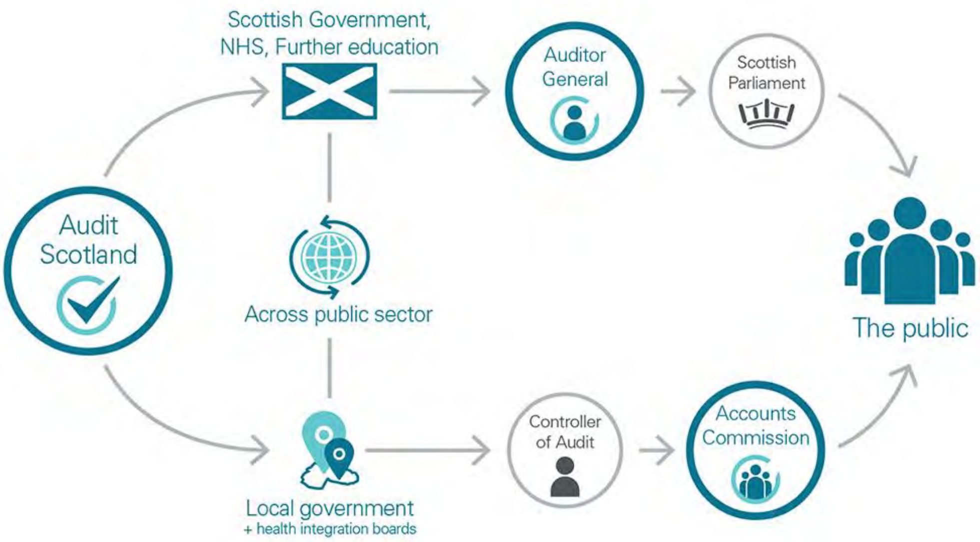
Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.

- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.

- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money

- reporting our findings and conclusions in public

- identifying risks, making clear and relevant recommendations.

Contents

Key messages

Audit of the 2016/17 financial statements

1 Our audit opinions on both the resource accounts and the devolved tax accounts were all unqualified. These covered the financial statements, regularity of transactions, remuneration and staff report, performance reports and governance statements.

2 The other information in the annual report and accounts was consistent with the financial statements and prepared in accordance with legal requirements.

Financial management

3 Revenue Scotland has arrangements in place for effective financial management and has remained within its overall resource budget for 2016/17.

4 In 2016/17 devolved tax revenues were £38 million lower than Scottish Ministers' forecast.

5 Systems of internal control operated effectively in 2016/17.

Financial sustainability

6 Revenue Scotland intends to build longer term financial planning into its 2018-2021 Corporate Plan which is currently being developed.

7 There are no significant concerns about the overall financial position of Revenue Scotland.

Governance and transparency

8 Revenue Scotland has effective governance arrangements in place.

9 Internal audit operates in accordance with the Public Sector Internal Audit Standards

Value for money

10 Revenue Scotland has overall arrangements in place which support effective performance management.

Introduction

1. This report is a summary of our findings arising from the 2016/17 audits of:

- Revenue Scotland's Resource Accounts. Revenue Scotland was established in January 2015 and 2016/17 was its second full year of operation.

- The Devolved Taxes Account. This account is prepared by Revenue Scotland to record 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). Additional Dwelling Supplement (ADS) was introduced on the purchase of additional residential properties with effect from 1 April 2016.

2. The scope of our audit was set out in our Annual Audit Plan presented to the March 2017 meeting of the Audit and Risk Committee. This report comprises:

- audits of the both the resource accounts and devolved tax account annual report and financial statements

- consideration of the wider dimensions set out in the *Code of Audit Practice 2016* as illustrated in Exhibit 1.

Exhibit 1
Audit dimensions

Source: Code of Audit Practice 2016

3. The main elements of our audit work in 2016/17 have been:

- an interim audit of Revenue Scotland's main financial systems and governance arrangements
- an audit of Revenue Scotland's 2016/17 annual report and accounts for the Resource Accounts and for the Devolved Taxes Account including the issue of an independent auditor's report setting out our opinions on each of these accounts
- a follow-up review of Audit Scotland's 2010 report on the Role of Boards.

4. Revenue Scotland is responsible for preparing financial statements that give a true and fair view, for the accuracy of the other information in the annual report and accounts, and for establishing effective arrangements for governance, propriety and regularity that enable the board to successfully deliver its objectives.

5. Our responsibilities as independent auditor are established by the Public Finance and Accountability (Scotland) Act 2000 and the *Code of Audit Practice 2016*, supplementary guidance and guided by the auditing profession's ethical guidance.

6. These responsibilities include giving independent opinions on the financial statements, regularity, the remuneration and staff report, the performance report and the governance statement. We also review and report on the arrangements within Revenue Scotland to manage its performance, regularity and use of resources. In doing this, we aim to support improvement and accountability.

7. Further details of the respective responsibilities of management and the auditor can be found in the *Code of Audit Practice 2016* and supplementary guidance.

8. The weaknesses or risks identified in this report are only those that have come to our attention during our normal audit work, and may not be all that exist. Also, our annual audit report contains an action plan at Appendix 1 (page 22). It sets out specific recommendations, responsible officers and dates for implementation.

9. Communication in this report of matters arising from the audit of the annual report and accounts or of risks or of weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

10. As part of the requirement to provide fair and full disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2016/17 audit fee for both the Resource Accounts and the Devolved Taxes Account were set out in our Annual Audit Plan and as we did not carry out any work additional to our planned audit activity, the total fee remains unchanged.

11. This report is addressed to both the board and the Auditor General for Scotland and will be published on Audit Scotland's website www.audit-scotland.gov.uk.

12. We would like to thank all management and staff who have been involved in our work for their cooperation and assistance during the audit.

Part 1

Audit of 2016/17 financial statements

Main judgements

Our audit opinions on both the resource accounts and the devolved tax accounts were all unqualified. These covered the financial statements, regularity of transactions, remuneration and staff report, performance reports and governance statements.

The other information in the annual report and accounts is consistent with the financial statements and prepared in accordance with legal requirements.

Unqualified audit opinions

13. The annual report and accounts for both the Resource Accounts and the Devolved Taxes Account for the year ended 31 March 2017 were approved by the board on 13 September 2017. We reported, in our independent auditor's reports on both accounts:

- an unqualified opinion on the financial statements;
- an unqualified opinion on regularity of expenditure and income; and
- an unqualified audit opinion on the remuneration and staff report, performance report and governance statement.

14. Additionally, we are satisfied that there are no matters which we are required by the Auditor General to report by exception.

Submission of annual report and accounts for audit

15. We received the unaudited financial statements on 12 June 2017, in line with our agreed audit timetable.

16. The working papers provided with the unaudited financial statements were of a good standard and finance staff provided effective support to the audit team which helped ensure the final accounts audit process ran smoothly.

17. In our 2015/16 annual audit report we recommended 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 suitably compliant annual reports and accounts. We are pleased to record that these issues were largely addressed in the preparation of the 2016/17 accounts.

18. Significant changes were made to the annual report section following submission of the accounts for audit. The revised version was much improved and addressed many of our initial concerns relating to the completeness of information.

We have discussed options with management to further improve the accounts preparation process.

19. We provided copies of the 2016/17 Government Financial Reporting Manual (FReM) disclosure checklists (covering both the annual report and the financial statements) to management to assist in their accounts preparation processes. These checklists help to ensure that the annual report and financial statements adopt the required format and include disclosures required by the Accounts Directions. We recommend that these checklists are used going forwards, to confirm that all detailed reporting requirements have been met. Action Plan (Appendix 1, point 1)

Risk of material misstatement

20. Appendix 2 (page 24) provides a description of those assessed risks of material misstatement that were identified during the planning process which had the greatest effect on the overall audit strategy, the allocation of resources to the audit and directing the efforts of the audit team.

Materiality

21. Materiality defines the maximum error that we are prepared to accept and still conclude that our audit objective has been achieved. The assessment of what is material is a matter of professional judgement. It involves considering both the amount and nature of the misstatement.

22. Our initial assessment of materiality for the annual reports and accounts was undertaken during the planning phase of the audit and was reported in our Annual Audit Plan. This was based on budget and forecast figures. On receipt of the annual reports and accounts we revised our original materiality calculations to reflect actual income and expenditure for the year and this is summarised in Exhibit 2. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

Exhibit 2

Materiality values

Materiality level: Resource Accounts (RA)	Amount
Overall materiality: This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It was set at 1% of gross expenditure for the year ended 31 March 2017.	£45,000
Performance materiality: This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality, this would indicate that further audit procedures should be considered. Using our professional judgement we have calculated performance materiality at 60% of overall materiality.	£27,000
Reporting threshold: We are required to report to those charged with governance on all unadjusted misstatements in excess of the ‘reporting threshold' amount. This has been calculated at 2% of overall materiality.	£1,000

Source: Audit Scotland

Materiality level: Devolved Taxes Account (DTA)	Amount
Overall materiality: This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It was set at 1% of gross tax revenue for the year ended 31 March 2017.	£6.330 million
Performance materiality: This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality, this would indicate that further audit procedures should be considered. Using our professional judgement we have calculated performance materiality at 20% of overall materiality.	£1.266 million
Reporting threshold: We are required to report to those charged with governance on all unadjusted misstatements in excess of the 'reporting threshold' amount. This has been calculated at 1% of overall materiality.	£63,000

Source: Audit Scotland

Evaluation of misstatements

23. There were no material adjustments to the unaudited financial statements arising from our audit. We identified one error (£3,600) in the Resource Accounts where a VAT re-charge on an invoice had not been processed and which was subsequently corrected.

24. It is our responsibility to request that all misstatements are corrected although the final decision on this lies with those charged with governance taking into account advice from senior officer and materiality levels. There are no unadjusted misstatements above our reporting threshold remaining in the financial statements.

Significant findings from the audit

25. International Standard on Auditing (UK and Ireland) 260 requires us to communicate significant findings from the audit to you. These are summarised in Exhibit 3. Where a finding has resulted in a recommendation to management, a cross reference to the Action Plan in Appendix 1 (page 22) has been included.

Exhibit 3
Significant findings from the audit of financial statements

Issue	Resolution
1. Potential ADS Repayments An Additional Dwelling Supplement (ADS) to LBTT was introduced in 2016/17. Property buyers who have included ADS in their LBTT tax return are entitled to seek a repayment of the supplement if they meet certain criteria, which include selling their previous main residence within 18 months of the purchase of their new property. We discussed the principles underpinning the accounting treatment for potential repayments of ADS within the Devolved Tax Accounts with the Accountable Officer. This included the question of	The Accountable Officer has concluded that, given the legal provisions for ADS repayment, the obligation to repay ADS arises at the point that the conditions for repayment are satisfied. In order to satisfy the conditions for repayment, the taxpayer needs to sell a previous main residence within 18 months and submit a valid claim for repayment. As a result, repayments totalling £14.265 million that meet these conditions have been recognised in 2016/17. Potential repayments that do not meet the conditions for repayment have been disclosed as a contingent liability, as set out in note 9 of the Devolved Tax Accounts. We are content that this

Issue	Resolution
whether potential future repayments of ADS should be provided for in 2016/17, making reference to *IAS 37: Provisions, Contingent Liabilities and Contingent Assets*.	approach is appropriate. We have sought and obtained written confirmation of the basis of the Accountable Officer's judgement.
2. Contingent liabilities Note 9 of the Devolved Taxes Account discloses contingent liabilities of £18.3 million that relate to the repayment of Additional Dwelling Supplement (as outlined above). At the time of submitting their LBTT tax return, taxpayers are invited to indicate their intention to sell their previous main residence and seek repayment of ADS. In these cases, where the taxpayers have not submitted a claim by the end of the financial year, the total potential refund has been disclosed as a contingent liability.	The amount disclosed reflects the information provided by the taxpayer at the time of submitting the original LBTT claim, and note 9 highlights that this is an indicative figure. We are content that this approach is reasonable.
3. Contingent assets Contingent assets are possible assets whose existence will be confirmed only by future events not within Revenue Scotland's control. Note 8 of the Devolved Tax Account highlights cases where a deferral of LBTT payable has been granted, where the relevant conditions have been met. Deferrals totalling £1.4 million have been identified. The note also refers to Revenue Scotland's power to open an enquiry in relation to a taxpayer's liability to pay tax and the amount of tax due. At 31 March 2017, a number of enquiries remained open. Management were unable to assess with any certainty the amount of tax potentially due, given the nature of the enquiries.	Contingent assets related to enquiries are disclosed without quantification. We are content that this approach is reasonable.

Source: Audit Scotland

Other findings

26. We have highlighted below a number of other matters identified during our audit.

Compliance yield

27. The annual reports refer to a range of compliance activity undertaken by Revenue Scotland to ensure that taxes are paid as intended. Revenue Scotland measures the revenue raised as a direct result of any non-compliance activity identified. It reported this has generated £1.9 million direct compliance yield (£1.5 million taxes and £0.4 million penalties and interest) and is one of Revenue Scotland's key performance indicators. This is a significant increase from 2015/16 when £589,000 was reported and is an indicator of the increased effectiveness of Revenue Scotland's compliance work.

28. Revenue Scotland also assesses the impact of this compliance activity on tax paid in subsequent tax returns following clarification of the liability. The annual report refers to £2 million in additional tax paid by taxpayers in a 12 month period following Revenue Scotland interventions. This total includes the £1.5 million additional tax paid mentioned above.

29. We reviewed the rationale behind the compliance disclosures in the annual report and examined the records maintained by Revenue Scotland to record the outcome and impact of its compliance work and concluded that the disclosures are consistent with the assessment undertaken.

Scottish Landfill Communities Fund

30. Revenue Scotland is responsible for regulating the Scottish Landfill Communities Fund which is a tax credit scheme designed to encourage landfill operators to make contributions to community projects. Revenue Scotland delegates its regulatory function to the Scottish Environment Protection Agency (SEPA). Contributions of £10 million were received from landfill operators in 2016/17 which were paid to Approved Bodies, authorised by SEPA to distribute the funds to eligible projects. Revenue Scotland receives assurances from SEPA on this work. We have reviewed the assurance statement received from SEPA for 2016/17 and have noted that no issues have been highlighted.

Exit costs

31. The Remuneration and Staff Report within the Resource Accounts record that early departure packages costing £295,000 were agreed with three members of staff. These posts were removed from the establishment as a consequence of the Chief Executive’s review of the staffing structure. We reviewed the evidence in support of these payments and confirmed these were paid in accordance with the Civil Service Compensation Scheme.

Part 2
Financial management

Main judgements

Revenue Scotland has arrangements in place for effective financial management and has remained within its overall resource budget for 2016/17.

In 2016/17 devolved tax revenues were £38 million lower than Scottish Ministers' forecast.

Systems of internal control operated effectively in 2016/17.

Financial performance in 2016/17

32. Revenue Scotland is a Non Ministerial Department and 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. The main financial objective for Revenue Scotland's Resource Accounts is to ensure that the financial outturn for the year is within the budget allocated by Scottish Ministers.

33. Revenue Scotland has reported an outturn of £4.5 million (2015/16: £4.7million), remaining within its overall budget of £5.2 million for 2016/17 (2015/16: £4.8 million) with an underspend of £0.7 million.

34. The increase in the budget reflected the impact on the business to collect, assess and repay ADS and the costs of preparing for the introduction of Air Departure Tax (ADT). The underspend against budget has arisen largely as a result of:

- implementation of the revised staff structure being later than anticipated
- external legal advice required being less than expected
- costs recharged by partners (Registers of Scotland [RoS] and the Scottish Environment Protection Agency [SEPA]) being significantly lower than estimated.

35. Revenue Scotland is responsible for the collection and administration of the devolved taxes. In 2016/17 tax revenues were £633 million (2015/16:£572 million) which was lower than Scottish Ministers' forecast by £38 million (2015/16: £74 million above forecast) as outlined in the Spring Budget Revision.

36. In addition to the taxes collected (LBTT £484 million) and SLfT (£149 million), penalties and interest totalling £0.3 million were levied for late or incorrect returns and payments.

37. Revenue Scotland is required to remit receipts from the devolved taxes to the Scottish Consolidated Fund (SCF). The Devolved Taxes Account shows that £636 million of cash generated during 2016/17 from the devolved taxes was remitted to the SCF during the year. Per note 7 of the financial statements, a further £59 million was due to be remitted to the SCF and reflected accrued income and amounts which were outstanding and/or uncleared at the year end.

Internal controls

Financial management is about financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

38. As part of our audit we identify and inspect the key internal controls in those accounting systems which we regard as significant for the production of the financial statements. Our objective is to gain assurance that Revenue Scotland has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

39. Our findings were included in an interim audit report presented to the Audit and Risk Committee in June 2017. We reported improvements had been made to the management of the contract for the tax collection system (Scottish Electronic Tax System [SETS]). Our review of tax compliance activity established that there remains scope for improvement as many areas continue to develop and capacity is increased. An action plan was developed and agreed with management.

40. In respect of our testing in relation to the Resource Accounts, no significant control weaknesses were identified which could affect Revenue Scotland's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

41. In respect of our audit of the Devolved Taxes Account, we took limited assurance from our interim work and supplemented our approach with additional year end testing. This further testing proved satisfactory.

42. 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 2016/17. Our audit work in this area was concluded satisfactorily.

Budgetary processes

43. We also reviewed Revenue Scotland's budgetary processes and budget monitoring arrangements. From our review of budget monitoring reports, review of committee papers and attendance at committees we confirmed that senior management and members receive regular, timely and up to date financial information on the financial position.

44. Budget reporting to members has continued to develop. We concluded that Revenue Scotland has effective budgetary monitoring and control arrangements that allow both board members and senior management to carry out effective scrutiny of its finances.

Prevention and detection of fraud and irregularity

45. We assessed Revenue Scotland's arrangements for the prevention and detection of fraud. Our audit work covered a number of areas such as whistleblowing and review of the counter fraud strategy.

46. We concluded that Revenue Scotland is proactive in promoting fraud awareness and had appropriate and adequate arrangements in place for fraud detection and prevention during 2016/17.

National Fraud Initiative

47. The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise coordinated by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify 'matches' that might suggest the existence of fraud or error.

48. Revenue Scotland has participated in the 2016/17 exercise. Through its use of the shared ledger system, the Scottish Government has provided the required payroll and accounts payable data for those entities which use its systems. The Scottish Government has taken the lead in investigating all matches but will refer to its users if further information is required. Revenue Scotland's involvement has therefore been indirect. We have been advised that there were no matches relating to Revenue Scotland data.

Standards of conduct and arrangements for the prevention and detection of bribery and corruption

49. We have reviewed the arrangements in place to maintain standards of conduct including the Staff Handbook and Civil Service and Members' Codes of Conduct. There are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.

50. Revenue Scotland has a conflict of interest policy in place in order to encourage staff to think and behave ethically. In addition, all members of staff are required to sign confidentially agreements due to the high level of sensitive personal data they are exposed to.

51. A Charter of Standards and Values is publically available which sets out the behaviour expected from taxpayers, agents and representatives in addition to Revenue Scotland's own staff and the staff of its partner bodies.

52. We are also aware that staff are expected to disclose to their line managers when they are personally involved in a dwelling house transaction. We discussed whether there was a need to formalise this arrangement and also whether there was scope for all staff to pro-actively disclose links with third party organisations given the nature of its business. Action Plan (Appendix 1, point 2)

53. Based on our review of the evidence we concluded that Revenue Scotland has appropriate arrangements in place for the prevention and detection of bribery and corruption.

Part 3

Financial sustainability

Main judgements

Revenue Scotland intends to build longer term financial planning into its 2018-2021 Corporate Plan which is currently being developed.

There are no significant concerns about the overall financial position of Revenue Scotland.

2016/17 financial position

54. The Statement of Financial Position in the Resource Accounts summarises what is owned and owed by Revenue Scotland. This shows taxpayers' equity – an accounting measurement of the amount invested that has continuing public benefit. It shows how much of this has arisen from the application of revenues and that which has resulted through changes over time in the value of physical assets.

55. The Statement of Financial Position at 31 March 2017 shows net liabilities of £33,000 (2015/16: net liabilities of £376,000). This change has arisen as a result of a decrease in trades payables (£225,000), an increase in trades receivables (£43,000) together with an increase in non current assets of £75,000.

56. This negative position has arisen as a result of the small asset base: Revenue Scotland owns no assets but recently capitalised £76,000 for the upgrade of its office accommodation. This excess of liabilities over assets is not considered an issue in relation to the going concern of the organisation as Revenue Scotland receives all its funding directly from the Scottish Government.

Financial planning

57. Revenue Scotland has an allocated Scottish Government Departmental Expenditure Limit (DEL) budget of £6.1 million for 2017/18. This represents a £0.9 million increase on the final 2016/17 budget of £5.2 million and takes account of the resource requirements to implement ADT and to prepare for the procurement of a new tax collection IT system.

58. The expenditure budget which was approved by the board in June 2017, estimates operational costs of £4 million; £1.2 million for the introduction of ADT and procurement of IT; and £0.8 million for delegated partner costs. The operational costs budget includes a contingency of £223,000 to allow for the impact of demand led costs such as legal costs.

59. The challenge going forwards will be to ensure that Revenue Scotland remains within its budget while delivering on the key projects of ADT and ICT system procurement.

60. The Scottish Government has set out its methodology and assumptions for its forecasts of devolved tax revenues over the next five years. It forecasts that tax revenue of £656 million (£507 million: LBTT and £149 million: SLfT) will be raised in 2017/18. This is £15 million less than estimated in 2016/17 and is £23 million greater when compared to 2016/17 outturn. The Scottish Fiscal Commission has reported that it considers these forecasts to be reasonable.

Medium to long term financial planning

61. We reviewed the financial planning systems and assessed how effective they are in identifying and addressing risks to financial sustainability across the medium and long term.

62. 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 2018, Revenue Scotland will be responsible for collecting Air Departure Tax.

63. Revenue Scotland is funded from the Scottish Government budget allocation on an annual basis. This should not preclude management from preparing medium to long term financial plans based on sensitivity analysis and scenario planning for possible budget changes.

64. We recommended in our 2015/16 annual audit report that Revenue Scotland should develop longer-term financial planning to support future business strategy and demonstrate financial sustainability. Management agreed to take this forward and intend to develop longer term financial planning as part of the development of the new corporate plan covering the period 2018-2021. Longer term financial planning will assist management understanding of 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. Action Plan (Appendix 1, point 3)

Part 4
Governance and transparency

Main judgements

Revenue Scotland has effective governance arrangements in place.

Internal audit operates in accordance with the Public Sector Internal Audit Standards.

Governance arrangements

65. 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 seven occasions in 2016/17. It is supported by an Audit and Risk Committee and a Staffing and Equalities Committee.

66. 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 leadership team who are responsible for legal services, strategy and corporate functions and tax.

67. As part of the wider review of governance arrangements across the public sector, we completed a follow-up of our 'Role of Boards' national report, published in September 2010. This involved review of documentation, discussions with key officers and attendance at audit committee meetings.

68. The Revenue Scotland board continues to bed in and mature as the organisation moves into its third year of operation. Members demonstrate strong commitment to their roles and responsibilities and the board demonstrates commitment to continuous improvement and personal development. The arrangements in place also support effective working relationships between the board and the Senior Leadership Team.

69. The Audit and Risk Committee (ARC) has three members, all of whom are also board members. The ARC assesses its effectiveness annually in accordance with good practice. In September 2017 it concluded that it is satisfied that it meets the standards expected of a public audit committee. We are content that the ARC operated effectively during 2016/17, providing an appropriate level of challenge.

70. As members of the board, ARC members have a good understanding of board business which assists their role on the ARC. It is important that they can separate their involvement in board decisions from their collective scrutiny and challenge role. As the organisation further develops and grows, it is important that the composition of the ARC continues to be kept under review.

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision-making and transparent reporting of financial and performance information.

71. We concluded that, overall, Revenue Scotland has appropriate arrangements in place that support good governance and accountability.

The annual governance statement

72. Under the Treasury's Financial Reporting Manual (FReM), Revenue Scotland must prepare an annual governance statement within the Annual Report and Accounts. Guidance is set out within the Scottish Public Finance Manual (SPFM) for the content of the statement and provides assurances around the achievement of the organisation’s strategic objectives.

73. The SPFM does not prescribe a format for the annual governance statement, but sets out minimum requirements for central government bodies. The process undertaken by management included an assurance mapping exercise: defining the sources of assurance across a range of processes helps senior management to better understand how each contributes to the overall level of assurance.

74. In addition, the members of the senior leadership team are required to provide the Accountable Officer with certificates of assurance together with completion of a detailed internal control checklist.

75. We concluded that the 2016/17 annual governance statement complies with the guidance issued by the Scottish Ministers and based on our knowledge and work performed presents a comprehensive picture of governance arrangements and matters.

Internal audit

76. Internal audit provides Revenue Scotland and the Accountable Officer with independent assurance on the organisation’s overall risk management, internal control and corporate governance processes.

77. The internal audit function is carried out by Scottish Government’s Internal Audit Directorate (IAD). We carried out a review of the adequacy of the internal audit function and concluded that it operates in accordance with the Public Sector Internal Audit Standards (PSIAS) and has sound documentation standards and reporting procedures in place.

78. To avoid duplication effort we place reliance on the work of internal audit wherever possible. In 2016/17 we placed formal reliance on internal audit’s work on Budget Management, Business Continuity Planning and Debt Collection Arrangements (follow-up). We were unable to place reliance on the Tax Governance and Compliance Review due to the timing of the work. Also, we considered internal audit report findings as part of our wider dimension work.

79. In its annual assurance report to the Audit and Risk Committee, IAD provided reasonable assurance and noted that while were some weaknesses in risk, governance and/or control procedures, none were of a significant nature.

ICT risks

80. We reviewed and updated our understanding of the tax collection and administration system, the Scottish Electronic Tax System (SETS) and followed up on the matters raised in our 2015/16 interim audit report.

81. We were pleased to record that in relation to the matters raised in our 2015/16 interim report:

- good progress has been made around the management of the SETS contract: the contract has been renewed and regular reports are being provided by the supplier on system performance

- arrangements have been introduced to ensure the continuing provision of IT services in the event of a failure in the tax collection system (SETS). A verified ESCROW arrangement has been established which will permit the independent re-building of the system in the event of failure or the supplier going out of business and not being able to support the system any longer.

82. The current SETS contract is due to expire in 2019. We note that action is being taken by management to address the re-procurement of SETS. Phase 1 (procurement activities leading to contract award) is underway with a completion date of February 2018. Phase 2 (mobilisation and service transition) will then commence, with completion planned in 2019. This is a business critical system and it is essential that the re-procurement progresses as planned. Management and members have recognised this and are working closely with all interested parties with the aim of ensuring a smooth transition. Action Plan (Appendix 1, point 4)

Risk management

83. As part of our planning work, we reviewed Revenue Scotland's risk management arrangements, including a review of the risk management policy and procedure. The Audit and Risk Committee are provided with regular updates outlining the changes to the status of risks. During the year the board assessed how well risk management processes were being embedded across the organisation using the risk maturity model set out in their framework. It concluded that while risk governance arrangements were in place, there was not consistent application across the whole organisation. In our view Revenue Scotland has good arrangements in place for the management of risk but would note that for risk management to be fully effective, it needs to be embraced as part of the day to day job of all staff.

Transparency

84. Transparency means that stakeholders, including the public, have access to understandable, relevant and timely information about how the board is taking decisions and how it is using public resources. Revenue Scotland's board meetings are not open to the public. Edited board minutes are published on the website but no other papers or minutes are published. Management have stated on the website that that, in terms of the Freedom of Information (Scotland) Act 2002, some information originally minuted is considered to be exempt.

85. A range of other information is available. Revenue Scotland has published information on Board members and their interests, corporate publications and consultations with key stakeholders and taxpayers and their agents during the year. In addition, open forums have been established through which interested parties can participate in discussions on tax matters. Revenue Scotland has demonstrated a willingness to disclose information openly and clearly.

86. With increasing public expectations for more openness in the conduct of public business, Revenue Scotland needs to keep this area under review and consider whether there is scope to enhance transparency. This could include, for example, reviewing the availability of board and committee papers and committee minutes.

Part 5

Value for money

Main judgements

Revenue Scotland has overall arrangements in place which support effective performance management

Performance management

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

Value for money is concerned with using resources effectively and continually improving services.

88. 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 first Corporate Plan. The annual report in both the Resource and Devolved Taxes Accounts provide information on the performance across the year against the key performance indicators (KPIs). Management have acknowledged that the indicators will be further refined in light of operational experience and feedback from taxpayers and other stakeholders. In addition targets for improvement will be developed once appropriate baselines are determined and operations are more firmly embedded. Revenue Scotland intends to revise its KPIs and associated targets as part of the development of its 2018-2021 corporate plan.

89. The performance of Revenue Scotland is monitored by the Board on a quarterly basis through the provision of performance dashboard reports which highlights progress made against the 2016-17 Business Plan. Information is provided on:

- key projects covering the 10 business critical projects
- the remainder of tasks and sub tasks reported on an exceptions basis
- key performance indicators.

90. Revenue Scotland's purpose and ambition are aligned with the Scottish Government's Purpose and the National Outcomes as set out in the National Performance Framework. In addition, the collection and management of the devolved taxes is an important contributor to the successful delivery of Scotland's Economic Strategy.

91. We concluded that Revenue Scotland has overall arrangements in place which support effective performance management.

Shared services

92. Revenue Scotland has continued to embed 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.

93. 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.

Workforce planning

94. We recommended in our 2015/16 annual audit report that Revenue Scotland should develop its workforce planning to assist future decision-making about resources and staff costs. Management agreed to develop their approach and to integrate it more into the corporate and business planning processes.

95. A People Strategy has now been developed and discussed with staff. The various strands of the strategy are being taken forward as a key project for 2017/18. One of the key elements of this is the production of a workforce plan. Management have advised that this is in development and good progress is being made. It is important that that a clear workforce plan is in place to assist future decision making about resources and staff costs, when Revenue Scotland takes on responsibility for the ADT and moves to a new tax administration system. Action Plan (Appendix 1, point 5)

National performance audit reports

96. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2016/17, we published a number of reports which are of direct interest to the board. These are outlined in Appendix 3 accompanying this report.

97. We have kept the Audit and Risk Committee informed during the year about our performance reporting activities. Where appropriate, Revenue Scotland should take action to improve in the areas highlighted in each report.

98. Our report *Managing New Financial Powers: an update* was published in March 2017. It examined how the Scottish Government, Revenue Scotland and the Scottish Fiscal Commission (SFC) were implementing or preparing to introduce these new powers. We highlighted that Revenue Scotland was collecting two devolved taxes and was making good progress preparing for further devolved taxes. We also concluded that Revenue Scotland successfully made the adjustments necessary to collect ADS from April 2016.

Appendix 1

Action plan 2016/17

2016/17 recommendations for improvement

Page no.	Issue/risk	Recommendation	Agreed management action/timing
8	**1. Preparation of Financial Statements** To assist management in their preparation of the financial statements, the FReM disclosures checklists should be completed and applied. **Risk** There is a risk to the efficiency of the accounts preparation and audit processes if FReM compliant accounts are not delivered.	Copies of the disclosure checklists were provided to management. These checklists should be applied going forwards to ensure the production of FReM compliant accounts.	Accepted. The checklist will be used in relation to 2017-18 and made available to auditors. Responsible officer: Chief Accountant Agreed date: June 2018
14	**2. Staff disclosure of interests** Staff are required to advise their line manager if they are personally involved in a tax transaction. This is done informally by email. In addition, there is no requirement for staff to complete an annual register of interests' declaration. **Risk** There is a risk that staff could have links to third party organisations and their tax information.	Management should consider formalising the approach in relation to staff disclosing an interest in a house sale / purchase. Management should consider whether there would be benefit if extending the register of interests to cover all staff, given the nature of the business.	Staff are bound by the Civil Service Code which highlights standards of integrity, honesty, objectivity and impartiality. Management will however review this recommendation and discuss with the Staffing and Equalities Committee. Responsible officer: Governance Team Leader Agreed date: March 2018
16	**3. Longer-term financial planning** Revenue Scotland is developing its approach to longer term financial planning. **Risk** There is a risk that business decisions may be taken	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	Work on the longer term financial plan is being developed as part of the Corporate Plan 2018-21 Responsible officer: Head of Strategy and Corporate Functions Agreed date: March 2018

Page no.	Issue/risk	Recommendation	Agreed management action/timing
	without a clear understanding of the financial implications beyond the current financial year and how they affect the overall financial sustainability of Revenue Scotland.	areas such as staffing, IT and procurement.	
19	**4. ICT re-procurement** The current SETS contract is due to expire in 2019. This is a business critical system and it is essential that the re-procurement is successful. **Risk** There is a risk that if the timetable is not achieved, continuity of service is affected or additional unexpected costs are incurred.	Management should continue to vigorously pursue the achievement of the re-procurement timetable to ensure continuity of service.	This work is constituted as a key project and as such has formal project management architecture and reports on a regular basis to the CEO and the Board. Independent reviews have been established to provide further assurance as part of this reporting arrangement. Responsible officer: Head of Strategy and Corporate Functions Agreed date: ongoing
21	**5. Workforce Planning** Formal workforce planning is currently being developed. **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.	Revenue Scotland should continue to develop 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.	Our approach to workforce planning has been refined and is a key strand of our People Strategy. Quarterly strategic reviews of workforce planning are in place taking into account known and anticipated organisational need. This analysis will be incorporated into longer-term financial planning as part of the suite of documents supporting the corporate plan. Responsible officer: Head of Organisational Development Agreed date: March 2018

Appendix 2

Significant audit risks identified during planning

The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the annual report and accounts and those relating our wider responsibility under the *Code of Audit Practice 2016*.

Audit Risk	Assurance procedure	Results and conclusions
Risks of material misstatement in the financial statements		
1 Risk of management override of controls (RA/DTA) 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.	• Review arrangements and policies for preventing and detecting fraud. • Detailed testing of journal entries. • Review of accounting estimates. • Focused testing of accruals and prepayments. • Focused testing of accounting adjustments at the year-end. • Evaluation of significant transactions that are outside the normal course of business.	We did not identify any issues as a result of our audit work that would indicate management override of controls affecting the year end position.
2 Risk of fraud over revenue (DTA) ISA 240 requires auditors to presume a risk of fraud where income streams, other than Scottish Government funding, are significant. Revenue Scotland's role is to collect and administer devolved taxes on behalf of the Scottish Government. The value and complexity of tax revenue means that, in accordance with ISA240, there is an inherent risk of fraud.	• Detailed testing of tax revenue transactions focusing on the areas of greatest risk. • Review accounting policy for revenue recognition. • Monitor early intervention and compliance checks. • Cut-off testing	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 did not identify any evidence of fraud in revenue recognition
3 Risk of tax revenue being misstated (DTA) Processes and procedures continue to bed in for both Revenue Scotland staff and users and these are becoming more 'business as usual'.	• Liaise with Internal Audit in regard to its review of tax compliance work. • Review compliance activity and case progress. • Continue to understand and update our knowledge	We were unable to rely on Internal Audit's work on tax compliance due to the timing of the audit work. We updated our knowledge of the key processes in place and reviewed a sample of compliance

Audit Risk	Assurance procedure	Results and conclusions
Internal controls over processes and procedures are still being developed and refined. As a consequence of this better understanding, the volume of tax compliance activity has increased and there has been an increase in the number of challenging, complex and time consuming cases identified particularly where the legislation is unclear. There is a risk that the tax revenue reported in the financial statements is misstated due to • The incorrect assessment of tax due • The non- or delayed collection of taxes due • The incorrect allocation of taxes received.	on the key processes in place. • Substantive testing to ensure that: – the tax due has been properly assessed – the legislation has been applied appropriately – timely payment has been received – income has been correctly allocated. • Review stakeholder feedback and complaints management. • Review Board papers. • Review working relationships with SEPA and RoS and other stakeholders.	work undertaken by Revenue Scotland. Substantive testing was undertaken. We reviewed Board papers and assurance statements provided by partner organisations. Our audit testing did not identify any instances of tax revenue being misstated.
Risks identified from the auditor's wider responsibility under the Code of Audit Practice		
4 Financial sustainability(RA) Revenue Scotland intends to develop longer-term financial planning with clear links to the Corporate Plan strategic objectives and the annual business plan. Longer term planning should ensure that the financial implications of business decisions are taken into consideration.	• Review progress on preparing longer term financial plans which link into corporate, business and workforce plans. • Review of action taken to progress prior year audit findings. • Monitor progress on implementation of new taxes (APD).	See part 2 and 3 of this report
5 Financial management (RA) Budget management processes continue to develop as the organisation matures. The budget has to be reassessed to reflect the administration of the further devolving of taxes and subsequent collection by Revenue Scotland. There remains a risk that actual expenditure exceeds annual and longer term budgets and that the organisation does not meet its objectives.	• Early review of Internal Audit's work on budget management. • Review of action taken to progress prior year audit findings. • Review of key financial controls. • Monitor progress on reassessing budget as tax collection responsibilities increase.	See parts 2 and 3 of this report

Audit Risk	Assurance procedure	Results and conclusions
6 **Financial Management (DTA)** Systems and processes to assess, collect and allocate tax revenues are continuing to develop. This development will be crucial as further taxes are devolved to Scotland. As a consequence, the assessment, collection and allocation of these taxes will become more challenging. There is a risk that the control environment and related internal controls do not operate effectively, resulting in the: • incorrect assessment of tax due • non- or delayed collection of taxes due • incorrect allocation of taxes received.	• Focused testing of assessment, collection and allocation of tax revenues. • Continue to understand and update our knowledge on the key processes in place throughout our audit appointment. • Review Board papers. • Review working relationships with SEPA and RoS and other stakeholders. • Monitor work done by the Change & Strategy team to prepare for increased workloads. • Review Internal Audit work where appropriate.	Substantive testing was undertaken on the assessment, collection and allocation of tax revenues We updated our knowledge of the key processes. We reviewed Board papers and assurance statements provided by partner organisations. Arrangements are progressing for the delivery of ADT We were unable to rely on Internal Audit's work on tax compliance due to the timing of the audit work. Our audit testing did not identify any instances of the control environment not operating as intended.
7 **Governance and transparency: (RA/DTA)** There has been a staff restructuring which resulted in a number of staff changes including the departure of 3 senior staff. A small number of some senior posts remain to be filled. There is a risk that the ongoing restructuring: • could impact on staff capacity and morale • new roles and reporting lines may take some time to bed down. • There could be a loss of key staff together with knowledge and skills due to the uncertainty. In addition, there is a risk that internal controls may not be as effective in a period of change. There is a further risk that due to the pace and level of organisational change together with policy changes may impact adversely on senior management capacity to manage the day to day operation and achieve the	• Review exit payments and ensure compliance with appropriate guidance. • Monitor progress on finalising staff restructure. • Follow up on any outstanding matters raised in relation to prior year audit reports. • Follow up the Audit Scotland national report 'Role of Boards' published in 2010. • Early review of Internal Audit work and early discussion on any material issues arising. • Review progress on workforce planning.	See parts 2, 3, 4 and 5 of this report

Audit Risk	Assurance procedure	Results and conclusions
business objectives.		
8 **Governance and transparency: (DTA)** The key business critical system, Scottish Electronic Tax System (SETS) which manages, records and processes all tax transactions, is provided and managed by an external supplier. There are a number of risks related to this relationship including: • The quality of the service being provided • General contract management • Business continuity and disaster recovery arrangements • Impact of cyber attacks • Contract renewal and/or termination.	• Review IT strategy for contract management (including contract renewal and termination planning). • Review security controls in place to protect against cyber attack. • Review Internal Audit review of disaster recovery testing. • Review management assurances over IT service contracts. • Monitor progress on testing plans for business continuity.	See section 4 of this report

Appendix 3

Summary of national performance reports 2016/17

2016/17 Reports

Apr			
May	Common Agricultural Policy Futures programme: an update		
Jun	South Ayrshire Council: Best Value audit report	The National Fraud Initiative in Scotland	
Jul	Audit of higher education in Scottish universities	Supporting Scotland's economic growth	
Aug	Maintaining Scotland's roads: a follow-up report	Superfast broadband for Scotland: a progress update	Scotland's colleges 2016
Sept	Social work in Scotland	Scotland's new financial powers	
Oct	Angus Council: Best Value audit report	NHS in Scotland 2016	
Nov	How councils work – Roles and working relationships in councils	Local government in Scotland: Financial overview 2015/16	
Dec	Falkirk Council: Best Value audit report	East Dunbartonshire Council: Best Value audit report	
Jan			
Feb	Scotland's NHS workforce		
Mar	Local government in Scotland: Performance and challenges 2017	i6: a review	Managing new financial powers: an update

The following reports may be of particular interest:

The National Fraud Initiative in Scotland – June 2016

Supporting Scotland's economic growth – July 2016

Scotland's new financial powers – September 2016

i6: a review – March 2017

Managing new financial powers: an update – March 2017

Revenue Scotland

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