Scottish Consolidated Fund

2017/18 Annual Audit Report

AUDIT SCOTLAND

Prepared for the Scottish Government and the Auditor General for Scotland

December 2018

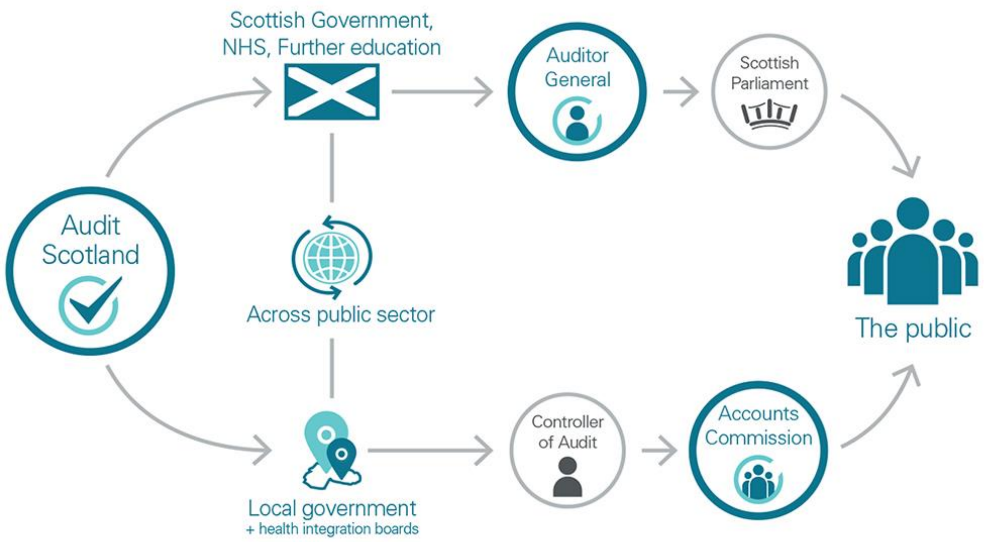
Who we are

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

2017/18 SCF accounts

1. **In our opinion the financial statements of the Scottish Consolidated Fund properly present the receipts into and payments out of the Fund for the year ended 31 March 2018.**
2. **The payments and receipts in the financial statements were incurred or applied in accordance with applicable enactments and guidance.**
3. **For 2017/18 only, the capital borrowing liability has been disclosed on the Statement of Balances. Going forward the Scottish Government will need to review their suite of financial reporting to ensure borrowing is clearly and transparently reported.**
4. **The other information provided was consistent with the financial statements and prepared in accordance with legal requirements.**
5. **The independent auditor's report on the 2017/18 Scottish Consolidated Fund account is unqualified.**

Financial sustainability and governance statement

6. **The Scottish Government had effective overall management of the SCF in 2017/18.**
7. **We concluded that the information in the governance statement is consistent with the financial statements and complies with the guidance issued by the Scottish Ministers.**

Introduction

1. This report summarises the findings from our 2017/18 audit of the Scottish Consolidated Fund (SCF). The scope of our audit was set out in our Annual Audit Plan. This report comprises the findings from:

- an audit of the annual accounts
- consideration of the financial sustainability and appropriateness of governance statement

2. Our standard audits are based on four audit dimensions that frame the wider scope of public sector audit requirements. These are:

- financial sustainability,
- financial management,
- governance and transparency, and
- value for money.

3. The *Code of Audit Practice 2016* (the Code) includes provisions relating to the audit of small bodies. Where the application of the full wider audit scope is judged by auditors not to be appropriate to an audited body then the annual audit work can focus on the appropriateness of the disclosures in the governance statement and the financial sustainability of the body and its services.

4. As highlighted in our 2017/18 Annual Audit Plan, due to the volume and lack of complexity of the financial transactions, we applied the small body provisions of the Code to the 2017/18 audit of the SCF. As such, our audit dimensions work focused on financial sustainability and governance and transparency.

5. Scottish Government officials have primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing annual accounts that are in accordance with the accounts direction from Scottish Ministers. Scottish Government officials are also responsible for compliance with legislation putting arrangements in place for governance, propriety and regularity that enable it to successfully deliver its objectives.

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

7. As public sector auditors we give independent opinions on the accounts and conclusions on securing financial sustainability and appropriateness of the governance statement disclosures. In doing this, we aim to support improvement and accountability.

8. The weaknesses or risks identified are only those which have come to our attention during our normal audit work and may not be all that exist. Communicating these does not absolve management from its responsibility to address the issues we raise and to maintain adequate systems of control.

9. Our annual audit report contains an agreed action plan at Appendix 1 setting out specific recommendations, responsible officers and dates for implementation. It also includes outstanding actions from last year and progress against these.

10. We confirm that we comply with the Financial Reporting Council's Ethical Standard. We have not undertaken any non-audit related services and therefore the 2017/18 audit fee of £22,290 as set out in our Annual Audit Plan, remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

Adding value through the audit

11. Our aim is to add value to the Scottish Government by providing insight and foresight on financial sustainability and by identifying areas of improvement and recommending / encouraging good practice. In so doing, we aim to help the Scottish Government promote improved standards of financial planning, better management and decision making.

12. This report is addressed to the Scottish Government's Corporate Board and the Auditor General for Scotland and will be published on Audit Scotland's website www.audit-scotland.gov.uk in due course.

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

Part 1

Audit of the 2017/18 accounts

Main judgements

In our opinion the financial statements of the Scottish Consolidated Fund properly present the receipts into and payments out of the Fund for the year ended 31 March 2018.

The payments and receipts in the financial statements were incurred or applied in accordance with applicable enactments and guidance.

For 2017/18 only, the capital borrowing liability has been disclosed on the Statement of Balances. Going forward the Scottish Government will need to review their suite of financial reporting to ensure borrowing is clearly and transparently reported.

Audit opinions on the accounts

14. The accounts for the year ended 31 March 2018 were presented to the Scottish Government Assurance and Audit Committee on 24 September 2018. We reported, within our independent auditor's report:

- an unqualified opinion on the financial statements
- an unqualified opinion on regularity of receipts and payments; and
- an unqualified audit opinion on the Governance Statement
- we have nothing to report in respect of those matters which we are required by the Auditor General to report by exception.

The accounts are the principal means of accounting for the stewardship of its resources and its performance in the use of those resources.

Submission of accounts for audit

15. We received the unaudited accounts on 29 June 2018 in line with our agreed audit timetable.

16. The unaudited annual accounts provided for audit were complete and of a good standard and finance staff provided good support to the audit team which helped ensure the final accounts audit process ran smoothly.

Whole of Government Accounts

17. The draft Whole of Government Accounts (WGA) pack was provided on 5 September 2018. In accordance with the WGA guidance we aim to complete the required assurance statement and submit it to the National Audit Office (NAO) by the 28 September 2018 deadline.

Risks of material misstatement

18. Appendix 2 provides a description of areas we assessed as being at risk of material misstatement at the planning stage, how we addressed them and our conclusions thereon. These risks influenced our overall audit strategy, the allocation of staff resources to the audit and how the efforts of the audit team were directed.

Materiality

19. Misstatements are material if they could reasonably be expected to influence the economic decisions of users taken based on the financial statements. When deciding on what is material we consider both the amount and nature of the misstatement.

20. We carried out our initial assessment of materiality for the accounts during the planning phase of the audit. Our planning materiality was based on 1% of judicial salaries. On receipt of the accounts we reviewed our planning materiality calculations and updated these to reflect the reported position at 31 March 2018, as summarised in Exhibit 1.

Exhibit 1

Materiality values

Materiality level	Amount
Overall materiality	£0.32 million
Performance materiality	£0.27 million
Reporting threshold - For this audit, we have determined that we are required to report to those charged with governance on all adjusted misstatements	

Source: Audit Scotland

How we evaluate misstatements

21. There were no material adjustments to the unaudited financial statements arising from our audit. One arithmetical error was identified and discussed with senior finance officers who agreed to amend the financial statements. There are no unadjusted misstatements and we did not identify any monetary errors.

Significant findings from the audit (ISA 260)

22. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance. These are summarised in Exhibit 2. Where a finding has resulted in a recommendation to management, a cross reference to the Action Plan in Appendix 1 has been included.

23. The findings include our views about significant qualitative aspects of the board's accounting practices including: significant financial statements disclosures, the impact of any uncertainties, misstatements in the accounts, accounting estimates and judgements and the effect of any unusual transactions on the financial statements.

Exhibit 2
Significant findings from the audit of the financial statements

Finding	Resolution
Capital borrowing In March 2018, the Scottish Government (SG) borrowed its full annual capital borrowing allowance of £450 million. This is the first year the borrowing powers under the Scotland Act 2016 have been used in full. The receipt for the borrowing flows through the SCF and repayments back to the national loans fund will be made from the SCF. The liability to repay this loan is not recognised on the SG Consolidated Accounts balance sheet nor in the SCF account which is primarily a receipts and payment account. The legislation framing the reporting requirements of the SCF did not foresee further devolution and the changes associated with it. The draft SCF accounts included disclosures in respect of the loan as a note. We agreed that payments from the SCF are classed as parliamentary funding and therefore recognise that the current accounting boundary of the SG consolidated accounts does not provide a suitable platform for the capital borrowing liability to be reflected in the Statement of Financial Position of the Consolidated Accounts. As a result, we agreed with the preparers of the accounts for the need to create a Statement of Balances in the SCF accounts showing all debt and cash held on the account.	We concluded that the current accounting structure is limited in fully recognising the assets and liabilities that arise from borrowing. For 2017/18 only, we requested additional disclosures within the SCF accounts in the form of a Statement of Balances showing debt and cash held. The issue highlights limitations in the current suite of financial reporting available and further highlights the need for the creation of a separate loan fund account and publication of a consolidated account for the whole public sector in Scotland to help provide better information in this area. Recommendation 1 (refer appendix 1, action plan)

Source: Audit Scotland

Follow up of prior year recommendations

24. We have followed up actions previously reported and assessed progress with implementation, these are reported in Appendix 1 and identified by the prefix b/f (brought forward).

25. One agreed action was raised in 2016/17 in relation to the Queen's and Lord Treasurer's Remembrancer receipts. This action is now complete and can be seen in Appendix 1.

Part 2

Financial sustainability and governance statement

Main judgements

The Scottish Government had effective overall management of the SCF in 2017/18.

We concluded that the information in the governance statement is consistent with the financial statements and complies with the guidance issued by the Scottish Ministers.

Financial performance in 2017/18

26. The receipts paid into the SCF during the year totalled £34,259 million with payments from the SCF of £34,251 million. This resulted in a surplus of £7.5 million to increase the cash reserve balance to £250 million.

27. 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.

28. In 2017/18 the SCF received funding from this source of £16,385 million, £431 million less than the £16,816 million stated in the 2017/18 UK Supplementary Estimate. The limit is set by forecasting the cash requirement for the 2017/18 Scottish Budget. Drawing down less than the limit has no effect on the overall spending power of the Scottish Government and the wider Scottish Administration.

29. The Scotland Act 2012 empowers the Scottish Parliament to set a Scottish Rate of Income Tax (SRIT) for Scottish taxpayers with effect from 6 April 2016. As such, income tax earned from Scottish taxpayers are assigned to the Scottish Administration and paid into the Scottish Consolidated Fund. Receipts from Scottish Rate of Income Tax (SRIT) of £11,858 million were paid into the SCF in 2017/18; this increased from £4,900 million in 2016/17 following the transition to the Scotland Act 2016 powers.

30. The total amount of devolved tax receipts (Land and Building Transaction Tax and Scottish Landfill tax) paid into the SCF in 2017/18 was £697 million (£636 million in 2016/17). Further detail is published in a separate Devolved Taxes account, which is produced by Revenue Scotland and audited separately.

31. 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. Receipts from NDR paid into the fund in 2017/18 were £2,665 million.

32. The Queen's and Lord Treasurer's Remembrancer (QLTR) collects the unclaimed sums arising from personal estates and sequestrated companies and after a set period pays them over to the SCF. Receipts of £6,750 million from the QLTR were included in the 2017/18 fund. QLTR accounts are also audited separately.

33. Funding is drawn down from the SCF to support the spending plans approved by the Scottish Parliament in the annual Budget Act.

Financial Sustainability

34. The annual budget setting process sets cash allocation limits for the authorities funded by drawdowns from the SCF and monthly drawdowns are monitored against these limits. Requests for cash allocation increases are processed through budget revisions generating a surplus or deficit for the year.

Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

35. At the end of 2017/18, the SCF presented a surplus of receipts over payments of £7,463 million.

36. The Statement of Balances shows cash held and debt held. A cash reserve is held in the SCF general reserve to manage surpluses or deficits. At 31 March 2018 the balance was £250 million (£242 million in 2016/17). The Statement of Balances also shows the liability for capital borrowing of £450 million along with the interest associated with it relating to 2017/18.

37. In May 2018, the Scottish Government published a five-year financial strategy, Scotland's Fiscal Outlook. The document provides information and scenarios about Scottish Government revenue expectations for the next five years and its effect on public spend. It outlines the Scottish Government's broad approach to various sources of funding, such as income tax, non-domestic rates, devolved taxes and borrowing. Further details on the financial strategy and financial sustainability can be found in our 2017/18 Scottish Government Annual Audit Report.

Internal Controls

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 there are systems of recording and processing transactions in place which provide a sound basis for the preparation of the financial statements.

39. The Scottish Consolidated Fund is subject to the same controls that apply to the Scottish Government therefore for this audit we could place reliance on our findings from the interim audit report presented to the Scottish Government Assurance and Audit Committee on 13 July 2018. We concluded that the controls were operating effectively. No significant internal control weaknesses were identified during the audit which could affect the ability to record, process, summarise and report financial and other relevant data to result in a material misstatement in the financial statements of the SCF.

Governance statement

40. Under the UK Government's Financial Reporting Manual (FReM), an annual governance statement must be included with the 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.

41. Although the Scottish Consolidated Fund itself sits outside the Scottish Government's internal governance arrangements, the operation of the Fund is carried out within Scottish Government Finance. The Fund is therefore subject to the same controls and assurance procedures that apply to the Scottish Government. Our review of the governance statement assessed the assurances which are provided to the Scottish Government Permanent Secretary as Principal Accountable Officer regarding the adequacy and effectiveness of the Fund's system of internal control which operated in the financial year.

42. The SPFM does not prescribe a format of the annual governance statement but sets out minimum requirements for central government bodies. The governance statement within the 2017/18 accounts of the SCF complies with the minimum SPFM requirements.

43. We concluded that the information in the governance statement is consistent with the financial statements and complies with the guidance issued by the Scottish Ministers. Based on our knowledge and work performed, we concluded that the statement presents an appropriate assessment of governance arrangements and matters.

Appendix 1

Action plan 2017/18

2017/18 recommendations for improvement

No.	Issue/risk	Recommendation	Agreed management action/timing
1	**Capital Borrowing** In March 2018, the Scottish Government (SG) borrowed its full annual capital borrowing allowance of £450 million. The liability to repay this loan was not recognised on the SCF account nor the Scottish Government Consolidated Accounts. Both draft accounts included disclosures in respect of the loan. **Risk** There is a risk that a significant liability is not recognised appropriately in line with the accounting standards, giving rise to a lack of transparency and potential material misstatement.	An interim measure has been agreed for 2017/18 whereby the SCF accounts include a Statement of Balances to record debt and cash held on the account. Going forward, the Scottish Government should consider creating a separate loans fund account to ensure the current reporting is fit for purpose and allows transparent financial reporting to support decisions.	The reporting of the capital borrowing liability in the Scottish Government Accounts and in the Scottish Consolidated Fund Accounts complies fully with all requirements. The liability in respect of borrowing will also be reported in the further consolidated accounts to be produced in respect of the 2017-18 financial year. The Scottish Government analysed the position with capital borrowing very carefully and shared that analysis during the audit, proposing the detailed disclosures in both sets of accounts. As set out in that analysis, the Scottish Government would be happy to consider the production of a separate loan account, associated with the SCF account. Audit Scotland has noted that it would need to be clear on the basis for such an account. Agreed action – discussion on this early in the new year as part of 2018-19 planning, to be agreed by end March 2019. Responsible officer – Deputy Director, Corporate Reporting
Follow up of prior year recommendations			
b/f	**Treatment of QLTR and CFERs** There remains no clear guidance or statutory regulations in place covering	The Scottish Government should develop, in agreement with HMT, clear and comprehensive guidelines covering all relevant receipts	Section 64 of the Scotland Act deals with amounts paid in to the SCF and states that a body in the Scottish Administration

No.	Issue/risk	Recommendation	Agreed management action/timing
	the treatment of QLTR and other miscellaneous receipts within the SCF The Scottish Government has indicated they plan to resolve the issue with HM in their ongoing discussion on the Fiscal Framework. **Risk** The balances continue to accumulate with no clear, agreed processes for how they will be applied.	within the SCF and how these apply to Scotland.	receiving money must pay it into the SCF. Section 65 deals with amounts that can be paid out of the SCF and states that amounts must be put into the account and will be paid out under the applicable legislative Act. In this case, the Act is the annual Budget Act which permits spending of all receipts, such as QLTR receipts. For 2018/19, the SG have included a note on QLTR receipts in the draft 2018/19 budget to clarify that these funds are to be utilised during the year. **Complete**

Appendix 2

Significant audit risks identified during planning

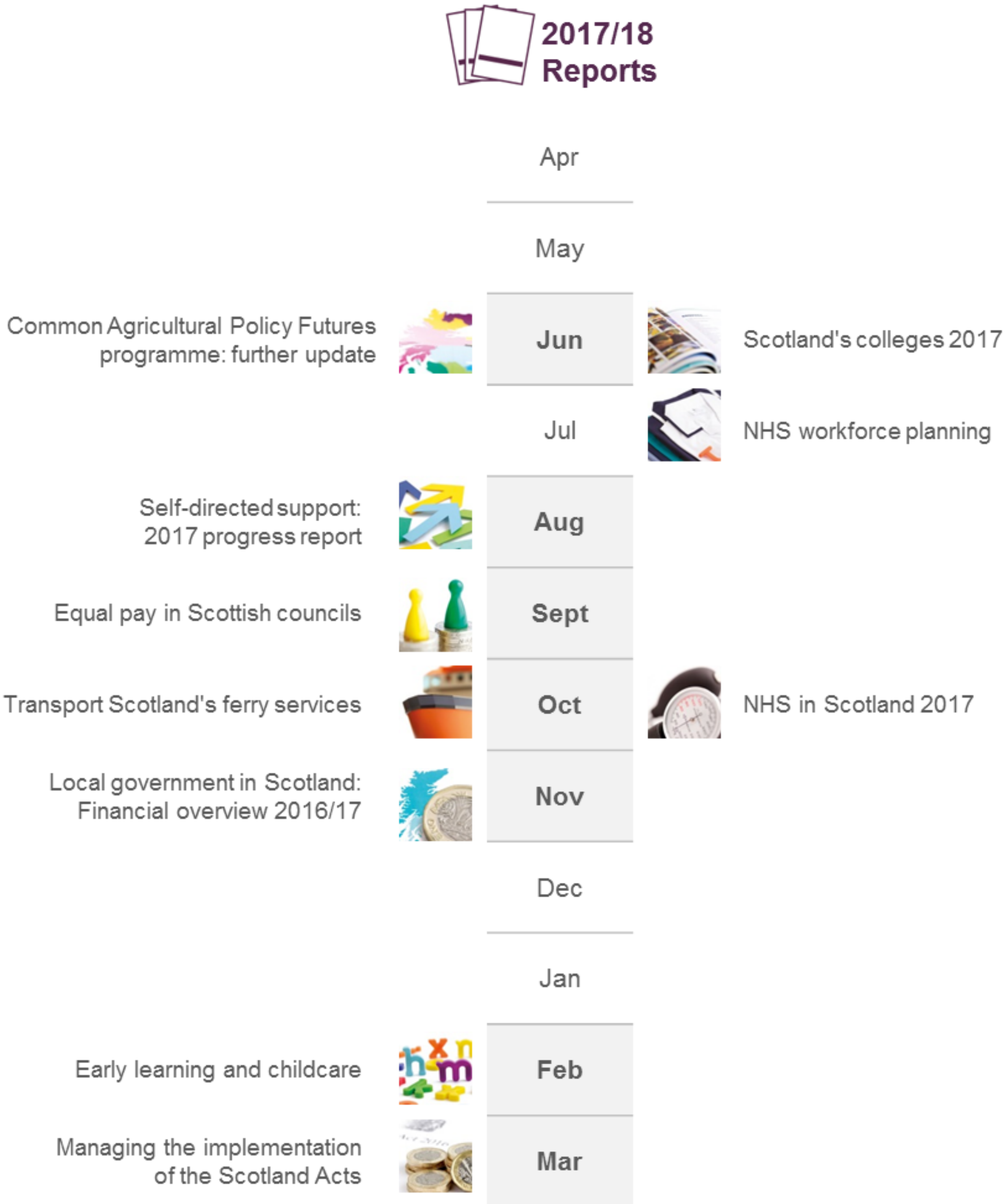
The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the accounts and those relating our wider responsibility under 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 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.	Detailed testing of journal entries. Testing of all transactions.	We tested all transactions into and out of the Scottish Consolidated Fund and found no evidence of management override of controls.
2 Risk of fraud over income and expenditure ISA 240 presumes a risk of fraud in regard to revenue recognition in the financial statements and Practice Note 10 (Audit of financial statements of public sector bodies in the UK) and the Code of Audit Practice expands the ISA assumption to aspects of expenditure.	Testing of all transactions.	We tested all transactions into and out of the Scottish Consolidated Fund and found no evidence of income or expenditure fraud.
Risks identified from the auditor's wider responsibility under the Code of Audit Practice		
3 Agreement to use QLTR and other receipts There remains no agreement in place with Her Majesty's Treasury (HM Treasury) covering the use of Queen's and Lord Treasurer's Remembrancer (QLTR) and other miscellaneous receipts within the SCF. As a result, there is an accumulated balance in the SCF.	Review the current plans the Scottish Government has in relation to this matter.	We discussed the matter with senior officers and our in-house technical team. Under section 65 of the Scotland Act, receipts received into the Fund are permitted to be spent if there is a legislative Act authorising this. In the case of the SCF and QLTR receipts, the Act permitting spending of these funds is the annual Budget Act.

Audit risk	Assurance procedure	Results and conclusions
The Scottish Government has previously indicated they plan to resolve this issue with HM Treasury in their ongoing discussions on the Fiscal Framework. Without an agreement with HM Treasury, there is a risk that there may be different interpretations for how any accumulated amounts may be applied.		We are satisfied that the Budget Act is sufficient authority to grant spending of QLTR receipts. We would encourage the Scottish Government to continue to reduce the accumulated QLTR receipts as it is not appropriate for the Fund to hold balances.

Appendix 3

Summary of national performance reports 2017/18



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