

# Non-Domestic Rating Account

2018/19 Annual Audit Report



 AUDIT SCOTLAND

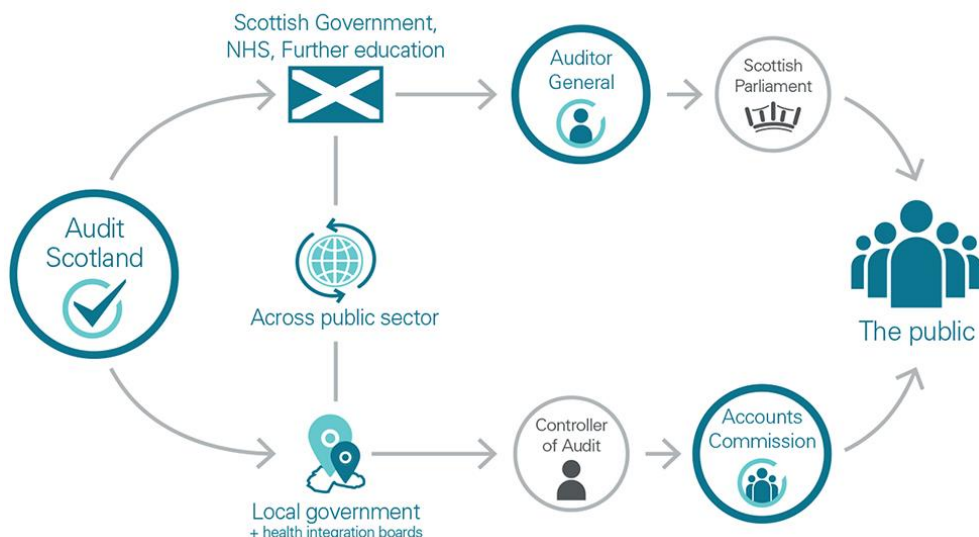
Prepared for the Scottish Government and the Auditor General for Scotland

November 2019

## 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.

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# Key messages

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## Audit of the 2018/19 Non-Domestic Rating account

- 1 The independent auditor's report for the 2018/19 Non-Domestic Rating Account is unqualified.
- 2 The receipts and payments in the NDR account were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

## Financial management, governance and transparency

- 3 The 2018/19 account shows Scottish Ministers received £2,898 million of non-domestic rates in the year and paid £2,733 million back to local authorities. This means the overall deficit on the account decreased by £165 million, from £141 million in 2017/18 to a surplus of £24 million in 2018/19. This is in line with plans outlined in the 2018/19 draft Scottish budget.
- 4 The Scottish Government's medium-term financial strategy, Scotland's Fiscal Outlook, no longer includes details of how NDR operates or its impact on the Scottish budget. This has reduced transparency. Overall there is a need for the Scottish Government to improve the transparency of financial information and reporting on NDR.

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# Introduction

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1. This report summarises the findings from our 2018/19 audit of the Scottish Government's Non-Domestic Rating Account (NDR Account).
2. The scope of our audit was set out in our Annual Audit Plan presented to the Scottish Government's Audit and Assurance Committee (SGAAC) on 11 March 2019. This report comprises the findings from:
  - an audit of the 2018/19 NDR account
  - consideration of the audit dimensions that frame the wider scope of public audit set out in the [Code of Audit Practice 2016](#).
3. 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 2018/19 Annual Audit Plan, we applied the small body provisions of the Code to the 2018/19 audit of the NDR account. As such, our audit dimensions work focused on financial sustainability and governance and transparency.

## Responsibilities and Reporting

5. The Scottish Government has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing the NDR account in accordance with the accounts direction from the Scottish Ministers and for the accuracy of other information disclosed alongside the account. The Scottish Government is also responsible for establishing appropriate and effective arrangements for governance, propriety and regularity to successfully deliver its objectives.
6. Our responsibilities as independent auditor are established by the Public Finance and Accountability (Scotland) Act 2000 and the [Code of Audit Practice 2016](#), and supplementary guidance and International Standards on Auditing in the UK.
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 the Scottish Government promote improved standards of governance and accountability. 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. This report raises matters from the audit of the NDR account. 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.

**10.** We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and therefore the 2018/19 audit fee of £11,130 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 identifying areas of improvement and recommending and encouraging good practice. In so doing, we aim to help the Scottish Government promote improved standards of financial reporting and governance.

**12.** This report is addressed to the Scottish Government's Corporate Board and the Auditor General for Scotland and will be made available on Audit Scotland's website <http://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 2018/19 Non-Domestic Rating Account



### Main judgements

The independent auditor's report for the 2018/19 Non-Domestic Rating Account is unqualified.

The receipts and payments in the NDR account were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

### Audit opinions on the accounts

14. The accounts for the year ended 31 March 2019 were presented to the Scottish Government's Audit and Assurance Committee on 23 September 2019. We reported within the independent auditor's report that:

- The financial statements properly present in accordance with Schedule 12 of the Local Government Finance Act 1992 as amended by Schedule 13 of the Local Government etc. (Scotland) Act 1994 and directions made thereunder by the Scottish Ministers the receipts and payments of the NDR account for the year ended 31 March 2019 and the balances held at that date.
- In all material respects, the sums paid out of the NDR account for the purpose of meeting the payments 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.
- 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 NDR account. Additionally, we are satisfied that there are no matters which we are required by the Auditor General to report by exception.

### Submission of accounts for audit

15. We received the unaudited NDR account in May 2019 in line with our agreed audit timetable. The working papers provided were of a good standard and finance staff provided support to the audit team which helped ensure the audit process ran smoothly.

### Risk of material misstatement

16. [Appendix 2](#) provides a description of those assessed risks of material misstatement in the NDR account and any wider audit dimension risks that were identified during the audit planning process. It also summarises the work we have done to gain assurance over the outcome of these risks.

## Materiality

**17.** Misstatements are material if they could reasonably be expected to influence the economic decisions of users taken based on the financial statements. The assessment of what is material is a matter of professional judgement and involves considering both the amount and nature of the misstatement.

**18.** Our initial assessment of materiality for the NDR account was carried out during the planning phase of the audit and is summarised in [Exhibit 1](#). With regards to the annual account, we assess the materiality of uncorrected misstatements both individually and collectively.

**19.** On receipt of the unaudited NDR account we reviewed our materiality calculations and concluded that they remained appropriate.

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## Exhibit 2

### Materiality values

Materiality level	Amount
Overall materiality	£26.4 million
Performance materiality	£19.8 million
Reporting threshold	£0.25 million

Source: Non-Domestic Rating Account: Annual Audit Plan 2018/19

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## Evaluation of misstatements

**20.** There were no material adjustments to the unaudited NDR accounts arising from our audit.

**21.** International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the accounting practices covering accounting policies, accounting estimates and financial statements disclosures. Our audit identified a number of presentational and disclosure issues which were discussed with management. These were adjusted and reflected in the audited NDR account.



# Part 2

## Financial management, governance and transparency



### Main judgements

The 2018/19 account shows Scottish Ministers received £2,898 million of non-domestic rates in the year and paid £2,733 million back to local authorities. This means the overall deficit on the account decreased by £165 million, from £141 million in 2017/18 to a surplus of £24 million in 2018/19. This is in line with plans outlined in the 2018/19 draft Scottish budget.

Looking ahead, the Scottish Government plans to allocate £100 million more than forecast NDR receipts in 2019/20 to support local government funding, which will return the NDR pool back into a deficit position.

The Scottish Government's revised medium term financial strategy, Scotland's Fiscal Outlook, no longer includes any details of how NDR operates or its impact on the Scottish budget. This has reduced transparency. Overall there is a need for the Scottish Government to improve the transparency of financial information and reporting on NDR.

### Financial performance in 2018/19

**22.** The NDR account operates on a receipts basis and is managed by the Scottish Government. All NDR income collected by local authorities in Scotland is placed in a national "pool" and distributed to the local authorities as part of the Scottish Government's funding arrangements.

**23.** The Scottish Government guarantees the combined amount of revenue grant funding and non-domestic rates distributions provided to councils each year and manages the financial risk of variances within its budget. Where variances in non-domestic rates occur, the Scottish Government adjusts the council's general revenue grant to ensure funding levels to local government align to the levels agreed in the local government finance settlement for that year. Weekly payments are made to local authorities. These payments represent total revenue funding less NDR income, and any specific revenue grants that local authorities expect to receive.

**24.** Total non-domestic rates collected in 2018/19 was £2,898.4 million of which £15.7 million related to prior years. The total amount distributed for 2018/19 was £2,733.5 million which includes £97.5 million relating to prior years. The net position for 2018/19 was therefore a surplus of £165 million (2017/18: surplus of £155.5 million) resulting in a cumulative surplus balance on the account of £24 million carried forward into 2019/20.

### Financial sustainability and transparency

**25.** In May 2019, the Scottish Government published its revised medium-term financial strategy, Scotland's Fiscal Outlook. The document provides information and scenarios about the Scottish Government's revenue expectations for the next five years and its effect on public spending. This latest version does not include any details about its approach to NDR as a main source of funding. This has

reduced transparency about the impact of NDR funding on the Scottish Budget and local government finance.

**26.** The Scottish Fiscal Commission is responsible for providing independent five-year forecasts of non-domestic rates income. Details of both the Commission's forecast of NDR income to 2023/24 and the Scottish Government's planned distributable amount up to 2022/23 are set out in the 2019/20 Scottish Budget. The Budget shows that the Scottish Government plans to allocate £100 million more than is forecast in NDR receipts for 2019/20 leaving the account in deficit in both 2019/20 and 2020/21. The Scottish Government plans to return the NDR account to a zero balance at the end of 2021/22.

**27.** Last year, we recommended that there is scope for the Scottish Government to improve further the transparency of financial information and reporting on NDR. This remains the case. The Scottish Government should provide the Parliament and the wider public with a fuller understanding of how NDR funding operates. They could do this by:

- including details of NDR forecasts and funding within its medium-term financial strategy
- publish details of how the distributable amount is calculated including details of any assumptions used
- undertaking, and publishing, scenario planning and sensitivity analysis to provide decision makers with greater information of how any fluctuations in NDR contributions or distributions may impact on decisions about how local government is funded.

## Systems of internal control

**28.** 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.

**29.** The NDR Account is subject to the same controls that apply to the Scottish Government therefore for this audit we could place reliance on our findings from our Management (interim) Report presented to the Scottish Government Assurance and Audit Committee on 24 June 2019. 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 NDR Account.

## Governance arrangements

**30.** The governance arrangements for the NDR account operate within the context of the Scottish Government's overall system of corporate governance. Our judgements on the adequacy of the governance arrangements form part of our reporting on the 2018/19 Scottish Government's Consolidated Accounts.

**31.** The Scottish Government Audit and Assurance Committee is responsible for oversight of the NDR account on an exceptions basis. Any issues relating to reporting or the administration of the NDR account are escalated to the Committee.

**32.** The arrangements, within which the NDR account operates, are assessed by the Scottish Government who confirmed that these arrangements comply with generally accepted best practices and relevant guidelines. Assurance is also provided by the work of internal and external audit and can be supported by SGAAC if required.

**33.** A separate governance statement is not prepared for the NDR account as it is not an entity but an extract of the Scottish Consolidated Fund. Although the Scottish Consolidated Fund sits outside the Scottish Government's internal governance arrangements, the Fund, like the NDR account, is subject to the same controls and assurance procedures that apply to the Scottish Government.

# Appendix 1

## Action plan 2018/19



No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p><b>Transparency of financial reporting</b></p> <p>In previous years, we have recommended that there is scope for the Scottish Government to improve further the transparency of financial information and reporting on NDR. This remains the case. The Scottish Government should provide the Parliament and the wider public with a fuller understanding of how NDR funding operates. They could do this by:</p> <ul style="list-style-type: none"> <li>• including details of NDR forecasts and funding within its medium-term financial strategy</li> <li>• publish details of how the distributable amount is calculated including details of any assumptions used</li> <li>• undertaking, and publishing, scenario planning and sensitivity analysis to provide decision makers with greater information of how any fluctuations in NDR contributions or distributions may impact on decisions about how local government is funded.</li> </ul> <p><b>Risk</b></p> <p>There is a risk that transparency over NDR is reduced.</p>	<p>The Scottish Government should use the annual account as an opportunity to enhance reporting on NDR.</p>	<p>Firstly, we do not accept this should be a criticism of the NDRI Account. For information, the first MTFS set out factual detail on how the NDR operates however the structure of the second MTFS changed and the information on the NDR operation was not repeated however neither MTFS publication included NDR in its funding outlook. The first MTFS states that ‘a statement of the NDR account is published annually in accordance with legislative requirements’.</p> <p>Secondly on the point about the need for greater transparency, again we are not convinced that this should be a criticism on the Annual Account as it already fully explains how the account operates. In addition we have provided further information within the Scottish Budget: 2019-20 about the NDR Pool including a time series of the Scottish Fiscal Commission’s NDRI Forecasts (Table 6.12) as well as a table explaining the Calculation of the NDR Distributable Amount for 2019-20 (Table 6.13).</p>

# 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
<b>Risks of material misstatement in the financial statements</b>		
<p><b>1 Risk of management override of controls</b></p> <p>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 to change the position disclosed in the financial statements.</p>	<p>Detailed testing of journal entries.</p> <p>Review of accounting estimates.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p>	<p>The balances making up the 2018/19 NDR account were substantively tested and the results were satisfactory.</p>
<p><b>2 Openness and transparency</b></p> <p>In 2017/18 we reported that the Scottish Government had made progress in increasing the transparency of its financial information and reporting on NDR. However there remains scope to enhance disclosures in the NDR Account such as explaining how the distributable amount is calculated and set. In doing so, this would help provide the Parliament and the wider public with a fuller understanding of how NDR funding operates.</p>	<p>Consider disclosures in the NDR Account for 2018/19</p> <p>Review the Scottish Government's updated medium-term financial strategy due to be published in 2019.</p>	<p>There remains scope for the Scottish Government to increase transparency over the NDR account. See Appendix 1.</p>

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