

# Non-Domestic Rating Account

2020/21 Annual Audit Report



 AUDIT SCOTLAND

Prepared for the Scottish Government and the Auditor General for Scotland

December 2021

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# Key messages

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## 2020/21 Non-Domestic Rating account

The Independent Auditor's Report on the 2020/21 Non-Domestic Rating (NDR) Account is qualified.

The Non-Domestic Rating Contributions (Scotland) Regulations 1996 permit mid-year adjustments to councils' funding only where revised NDR income estimates by councils are below 97 per cent of their initial estimates. During 2020/21, the Scottish Government adjusted NDR receipts and payments based on councils' mid-year estimates to support councils' cashflows during the Covid-19 pandemic. These adjustments included £60.3 million where the mid-year estimates were more than 97 per cent of the initial estimates. As a result, the NDR account includes £40.4 million of receipts and £19.9 million of payments which were not in accordance with the regulations.

All other audit opinions are unmodified.

## Financial sustainability, governance and transparency

The 2020/21 account shows Scottish Ministers received £1,969 million of non-domestic rates in the year and paid £2,054 million back to local authorities. This means the overall surplus on the account decreased by £85 million to a deficit balance of £60 million in 2020/21.

A deficit balance of £100 million was estimated which is £40 million more than the actual outturn position. The intention is to bring the account back into balance by the end of 2022/23. The ongoing impact of Covid-19 on the business community and non-domestic rates income over the medium to longer term remains uncertain.

The Scottish Government took the decision to account for the impact of 2020/21 mid-year estimates provided by local authorities as a one-off measure in response to the Covid-19 pandemic. This resulted in additional receipts from local authorities of £40.4 million and additional payments of £44.8 million to local authorities.

There is scope for the Scottish Government to further improve the transparency of financial information and reporting on NDR and this is particularly important given the uncertainty in public finances created by the Covid-19 pandemic.

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# Introduction

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- 1.** This report summarises the findings from our 2020/21 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 (AAP) presented to the Scottish Government's Audit and Assurance Committee (SGAAC) on 22 March 2021. This report comprises the findings from:
  - an audit of the 2020/21 NDR account
  - consideration of the appropriateness of the disclosures in the governance statement and the financial sustainability of the NDR Account.
- 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 2020/21 Annual Audit Plan, we applied the small body provisions of the Code to the 2020/21 audit of the NDR account. As such, our audit dimensions work focused on financial sustainability, governance and transparency.
- 5.** The Covid-19 pandemic continued to have a considerable impact on the Scottish public sector during 2020/21. This has had significant implications for the NDR account. Total contributions during 2020/21 decreased by £951 million and the non-domestic rates distributed reduced by £865 million compared to 2019/20 which reflects the impact of Covid-19 on the business community and the reliefs awarded. Risks related to the pandemic were considered when preparing our AAP, and our audit approach was considered and adapted as appropriate to respond to emerging risks during the audit process.

## Responsibilities and reporting

- 6.** 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.
- 7.** The Scottish Government is also responsible for establishing appropriate and effective arrangements for governance, propriety and regularity, that enable it to successfully deliver its objectives.
- 8.** 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. As public sector auditors we give independent opinions on the

accounts and conclusions on securing financial sustainability and appropriateness of the governance statement disclosures. Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.

**9.** This report raises matters from our 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.

**10.** Our annual audit report contains an agreed action plan at [Appendix 1](#). It sets out specific recommendations, the responsible officers and dates for implementation. It also includes any outstanding actions from last year and progress against these.

## Auditor Independence

**11.** Auditors appointed by the Accounts Commission or Auditor General must comply with the Code of Audit Practice and relevant supporting guidance. When auditing the financial statements auditors must comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies.

**12.** 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 2020/21 audit fee of £11,630 as set out in our Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

**13.** This report is addressed to both the Scottish Government and the Auditor General for Scotland and will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk) in due course.

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

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# 1. Audit of 2020/21 Non-Domestic Rating Account

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## Main judgements

The Independent Auditor's Report on the 2020/21 Non-Domestic Rating Account is qualified.

The Non-Domestic Rating Contributions (Scotland) Regulations 1996 permit mid-year adjustments to councils' funding only where revised NDRI estimates by councils are below 97 per cent of their initial estimates. During 2020/21, the Scottish Government adjusted NDR receipts and payments based on councils' mid-year estimates to support councils' cashflows during the Covid-19 pandemic. These adjustments included £60.3 million where the mid-year estimates were more than 97 per cent of the initial estimates. As a result, the NDR account includes £40.4 million of receipts and £19.9 million of payments which were not in accordance with the regulations.

All other audit opinions are unmodified.

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## The Independent Auditor's Report is qualified

**15.** The NDR account for the year ended 31 March 2021 was presented to the Scottish Government's Audit and Assurance Committee on 13 December 2021. As reported in the Independent Auditor's Report:

- 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 account for the year ended 31 March 2021 and the balances held at that date.
- The Non-Domestic Rating Contributions (Scotland) Regulations 1996 permit mid-year adjustments to councils' funding only where revised NDR income estimates by councils are below 97 per cent of their initial estimates. During 2020/21, the Scottish Government adjusted NDR receipts and payments based on councils' mid-year estimates. These adjustments included £60.3 million where the mid-year estimates were more than 97 per cent of the initial estimates. As a result, the NDR account includes £40.4 million of receipts and £19.9 million of payments which were not in accordance with the regulations. The audit opinion on regularity is therefore qualified in relation to this matter.

- All other expenditure and income was applied in accordance with applicable enactments and guidance issued by Scottish Ministers
- 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.

**16.** We recognise that the adjustment to reflect the mid-year estimates were made with the intention of supporting councils during an unprecedented and challenging time. The qualified regularity audit opinion is made on a technical basis and reflects that the legislation was not designed for these extraordinary circumstances.

**17.** We have assessed the impact of these irregular adjustments on the Scottish Consolidated Fund. We are content that there is no impact on this account as the total amount appropriated is for the purposes of meeting expenditure in the year as laid down in the Budget (Scotland) Act 2020 as amended.

### Working papers were of a good standard

**18.** The unaudited annual report and accounts were received on 15 June 2021 which was slightly later than our agreed audit timetable date of 31 May 2021. Due to the ongoing restrictions imposed in response to the pandemic, we were required to audit supporting documentation remotely. We did not encounter any difficulties in obtaining the evidence required.

**19.** 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.

### Overall materiality is £18.7 million

**20.** Our initial assessment of materiality was carried out during the planning phase of the audit and is summarised in [Exhibit 1](#). On receipt of the unaudited NDR account we reviewed our materiality calculations and concluded that they remained appropriate.

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## Exhibit 1

### Materiality values

Materiality level	Amount
<b>Overall materiality:</b> This is the figure we calculate to assess the overall impact of audit adjustments on the financial statements. It has been set at 1% of the Distributable Amount.	£18.7 million
<b>Performance materiality:</b> 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	£14 million

Materiality level	Amount
should be considered. Using our professional judgement, we have calculated performance materiality at 75% of planning materiality.	
<b>Reporting threshold:</b> We are required to report to those charged with governance on all unadjusted misstatements more than the 'reporting threshold' amount. This has been calculated at 1% of planning materiality.	£0.19 million

Source: Non-Domestic Rating Account: Annual Audit Plan 2020/21

## **Appendix 1 identifies the main risks of material misstatement and our audit work to address these**

**21.** [Appendix 1](#) identifies the main risks of material misstatement and our audit work to address these. These risks influence our overall audit strategy, the allocation of staff resources to the audit and indicate how the efforts of the audit team were directed. [Appendix 1](#) also identifies the work we undertook to address these risks and our conclusions from this work.

## **We have one significant finding to report on the audit of the NDR Account**

**22.** 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 body's accounting practices. 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.

**23.** Details of our significant finding are provided in [Exhibit 2](#).



## Exhibit 2

### Significant finding from the audit of financial statements

Issue	Resolution
<p><b>Mid-year adjustments were not in accordance with legislation</b></p> <p>Note 4 of the NDR Account refers to a net additional payment of £4.4 million paid to local authorities. This net payment was as a result of gross additional receipts of £40.4 million and gross payments made of £44.8 million.</p> <p>The Non-Domestic Rating Contributions (Scotland) Regulations 1996 were made under Schedule 12 to the Local Government Finance Act 1992 to govern the operation of the NDR Account. The regulations permit mid-year adjustments to councils' funding only where revised NDR income estimates by councils are below 97 per cent of their initial estimates. During the 2020/21 financial year, to support councils' cashflows during the Covid-19 pandemic, the Scottish Government adjusted NDR receipts and payments based on councils' mid-year estimates. The adjustments included £60.3 million where the mid-year estimates were more than 97 per cent of the initial estimates. As a result, the NDR account includes £40.4 million of receipts and £19.9 million of payments which were not in accordance with the regulations.</p> <p>These receipts and payments are therefore irregular.</p>	<p>The independent auditor's report for the 2020/21 Non-Domestic Rating Account (NDR account) has been qualified in respect of the regularity of the additional receipts and payments made, which were not in accordance with the legislation.</p>

Source: Audit Scotland

### Identified misstatements of £85.2 million were adjusted in the accounts

**24.** As noted above, the unaudited NDR account included an amount of £4.4 million in respect of additional sums paid as a result of interim recalculations (mid-year estimates adjustments) for 2020/21. Our audit work identified that the £4.4 million reflected the net impact of additional receipts of £40.4 million and additional payments of £44.8 million. The accounts have been restated to disclose the gross additional receipts and payments separately on the Receipts and Payments account. The restatement did not impact on the net deficit for the year which was unchanged from the unaudited account and there was no impact on the Statement of Balances.

**25.** We have reviewed the nature and causes of the above misstatement and have concluded that it arose from an isolated issue and do not indicate further systemic error. We did not consider any change to our audit approach to be necessary.

**26.** It is our responsibility to request that all misstatements, other than those below the reporting threshold, are corrected, although the final decision on making the correction lies with those charged with governance considering advice from senior officers and materiality. Management have adjusted all identified misstatements above our reporting threshold; there are no unadjusted errors to report.

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## 2. Financial sustainability, governance and transparency

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### Main judgements

The 2020/21 account shows Scottish Ministers received £1,969 million of non-domestic rates in the year and paid £2,054 million back to local authorities. This means the overall surplus on the account decreased by £85 million to a deficit balance of £60 million in 2020/21.

A deficit balance of £100 million was estimated which is £40 million more than the actual outturn position. The intention is to bring the account back into balance by the end of 2022/23. The ongoing impact of Covid-19 on the business community and non-domestic rates income over the medium to longer term remains uncertain.

The Scottish Government took the decision to account for the impact of 2020/21 mid-year estimates provided by local authorities as a one-off measure in response to the Covid-19 pandemic. This resulted in additional receipts from local authorities of £40.4 million and additional payments of £44.8 million to local authorities.

There is scope for the Scottish Government to further improve the transparency of financial information and reporting on NDR and this is particularly important given the uncertainty in public finances created by the Covid-19 pandemic.

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### Financial performance in 2020/21

**27.** 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.

**28.** 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.

**29.** Total non-domestic rates collected in 2020/21 was £1,969.3 million of which £12.5 million related to prior years. The total amount distributed for 2020/21 was £2,054.1 million which includes £141.2 million relating to prior years.

**30.** The net position for 2020/21 was therefore an excess of distributions over contributions resulting in a negative balance of £85 million (2019/20: surplus of £1 million). The cumulative deficit balance on the account of £60 million will be carried forward into 2021/22.

**31.** In the Scottish Budget for 2020/21, published in February 2020, the Scottish Government made a policy decision to set the distributable amount at a level which led to a forecast £100 million deficit balance in the account at 31 March 2021, with plans set out in the same budget document to bring the account back into balance by the end of 2022/23.

**32.** Significant amendments to the 2020/21 budget were made in the Summer and Autumn Budget revisions, (published in May and September 2020 respectively), reducing the distributable amount by £922 million. This reflected the reduction in NDR income as a result of reliefs introduced by Ministers in response to the Covid-19 emergency. As NDR income and expenditure were both reduced, these changes did not impact on the planned cumulative negative balance.

**33.** Actual receipts and payments (including mid-year and prior year adjustments) were both higher than forecast but receipts exceeded forecast by £40 million more than the additional payments, and therefore the actual deficit balance was £40 million lower than the forecast deficit balance.

**34.** The Covid-19 outbreak has had a significant impact on the short-term finances of the NDR account and the impact of this in medium/longer-term planning is still to be evaluated.

### Financial sustainability and transparency

**35.** The Scottish Budget for 2021/22 shows that the Scottish Government plans to allocate £19 million more (including prior year adjustments) than it receives, increasing the overall balance on the account from a deficit of £60 million to a deficit of £79 million. The Scottish Government plans to bring the account back into balance by the end of the following year, 2022/23.

**36.** In recognition of the impact of the Covid-19 pandemic on the economy, the Scottish Government has taken the decision to reduce the Basic Property Rate ('poundage') to the 2019/20 level, a reduction of £120 million compared with previously published plans. The 100% relief introduced for the Retail, Hospitality, Leisure and Aviation sectors ('RHL relief') introduced in 2020/21 will be extended into 2021/22 for at least three months. The Scottish Government has also undertaken to match any further extensions to the UK Government's equivalent RHL relief that generates consequential funding.

**37.** During 2020/21 the Scottish Consolidated Fund received income of £125.1 million from some businesses who voluntarily repaid some or all of their non-domestic rates relief provided by Scottish local authorities as part of the Covid-19 response. The Scottish Government intends to apply this income to fund the 100% relief for the Retail, Hospitality, Leisure and Aviation sectors.

**38.** The Scottish Government has improved transparency around NDR, with information provided on the calculation of the distributable amount in the 2020/21 Non-Domestic Rating account.

**39.** In previous years, we have recommended there is scope for the Scottish Government to further improve 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. This is particularly important where the public finances are adapting to a series of uncertainties from Covid-19 and withdrawal from the EU. They could do this by:

- including details of NDR forecasts and funding within its medium-term financial strategy
- 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
- including more information in the Foreword to the annual accounts about reasons for the annual deficit and future plans to reduce the overall deficit on the account
- including further information in the annual accounts about the ongoing impacts of the Covid-19 pandemic e.g. delay to NDR revaluation exercise, amount of reliefs being repaid

**40.** It remains the responsibility of the Scottish Government to take action to address these action points and therefore we have not repeated our recommendation within this year's report. Increasing users' understanding of the NDR account and how it links with the Scottish budget is particularly important given the uncertainty in public finances created by the Covid-19 pandemic.

**41.** The financial impact of the pandemic on the Scottish economy is likely to extend across several years and there continues to be uncertainty over the long-term implications on NDR receipts and payments. Increasing users understanding of the NDR account and how it links with the Scottish budget is particularly important given the uncertainty in public finances created by the pandemic.

### **Financial systems of internal control are operating effectively**

**42.** As part of our audit, we identify and inspect the key internal controls in those accounting systems which we regard as significant to produce 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.

**43.** 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 in June 2021. 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**

**44.** 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 2020/21 Scottish Government's Consolidated Accounts.

**45.** 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.

**46.** 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.

**47.** 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. Significant audit risks

The table below sets out the audit risks we identified on the 2020/21 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 financial statements and those relating to our wider responsibility under the [Code of Audit Practice 2016](#).

## Risks of material misstatement in the financial statements

Audit risk	Assurance procedure	Results and conclusions
<p><b>1. Management override of controls</b></p> <p>International Auditing Standards require that audits are planned to consider the risk of material misstatement in the financial statements caused by fraud, which is presumed to be a significant risk in any audit. This includes the risk of fraud due to the management override of controls.</p>	<p>Detailed testing of journal entries.</p> <p>Reviewed accounting estimates.</p>	<p>Testing of journal entries and review of accounting estimates were completed with no issues identified.</p>

# Non-Domestic Rating Account

## 2020/21 Annual Audit Report

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[www.audit-scotland.gov.uk/accessibility](http://www.audit-scotland.gov.uk/accessibility)



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