


Mr Kenneth Gibson MSP  
Convener  
Finance Committee  
The Scottish Parliament  
Edinburgh  
EH99 1SP

4 March 2016

Dear 

The proposals for further devolution contained in the Scotland Bill 2015 and the accompanying fiscal framework represent a substantial increase in the financial powers of the Scottish Parliament. The Smith Commission agreed that the Scottish Parliament should seek to expand and strengthen the independent scrutiny of Scotland's public finances in recognition of the additional variability and uncertainty that further tax and spending devolution will introduce into the budgeting process. As Auditor General, I am committed to supporting the Parliament in developing world class arrangements for holding government to account and improving the use of public money.

I recognise the timetable for Parliamentary scrutiny of the fiscal framework is necessarily compressed. I offer a number of observations below that I hope that the Committee finds helpful in concluding its current enquiries and in the related considerations of the new Parliament. I have also written in similar terms to the Devolution (Further Powers) Committee. Both letters have been copied to the Public Audit Committee.

### **Fiscal framework and wider Scottish public finance system**

In 2015 Audit Scotland provided written evidence<sup>1</sup> to the Committee for its inquiry into Scotland's Fiscal Framework. This highlighted a number of key elements of such a framework including:

- Fiscal rules
- Medium term budgetary framework
- Budgetary procedures including effective scrutiny
- Sound fiscal reporting
- Fiscal institutions.

I recognise that some key elements are present in the agreement between the UK and Scottish Governments. In particular it provides for specific rules on capital and resource borrowing, and for the new Scottish Reserve. It also sets out the respective roles of the Office of Budget Responsibility and the Scottish Fiscal Commission (SFC) as fiscal institutions, including the role the SFC will have in preparing forecasts.

The fiscal framework agreed between the governments is critical. It is also underpinned by the wider system for the Scottish public finances. In my assessment it is essential this is further developed to reflect increased fiscal responsibility. I look forward to sharing my views on this with the new Parliament in due course. In the meantime I would also highlight my continuing interest in two important and related issues:

- the financial sustainability and management of the Scottish public finances and the important role of audit in reporting independently on this. This supports Parliament's own responsibilities for the oversight of the public finances.
- as set out in my reports on *Developing Financial Reporting*<sup>2,3</sup> my strong view is that the case for comprehensive, transparent, reliable and timely reporting of Scotland's public finances, as part of

<sup>1</sup> [http://www.scottish.parliament.uk/S4\\_FinanceCommittee/General%20Documents/Audit\\_Scotland\(1\).pdf](http://www.scottish.parliament.uk/S4_FinanceCommittee/General%20Documents/Audit_Scotland(1).pdf)

a strong fiscal framework, has never been stronger. A key element of this is an overall account of the revenues, expenditure, assets and liabilities of the Scottish public sector as a whole.

Underpinning all of this is a need for transparency to enable Parliament, Government and the wider public to see the basis on which decisions are being made and to be able to understand the assumptions underlying changes in revenues and expenditures from one year to another. The agreement on the fiscal framework sets out how areas such as the block grant adjustments will work, and further technical detail is anticipated in due course. The continuing role of the Barnett formula is also highlighted.

In my view it is critical that the details of how these mechanisms operate in practice each year is clearly and objectively reported by the Scottish Government, covering all material elements of the Scottish budget including:

- movements in the Scottish block grant arising from the application of the Barnett formula, baseline adjustments to the block grant for each relevant component set out in the fiscal framework agreement, indexation of block grant adjustments
- any adjustments in relation to policy spillover effects
- movements and balances in the Scottish Reserve
- relevant revenue and expenditure forecasts including income tax, assigned VAT, devolved taxation and social security spending
- the impact of capital and resource borrowing.

In relation to the principle of no detriment for policy spillover effects, Audit Scotland highlighted that the UK and Scottish Governments should be clear on the direct effects that can be readily measured but should only consider behavioural or other indirect effects if there is evidence of these being significant. This approach appears to be embodied in the fiscal framework and I welcome this.

Finally, I note that there is no specific provision for the review/ uprating of borrowing and reserve limits in the agreement on the fiscal framework in the transition period to 2021/22. The equivalent powers in the Scotland Act 2012 were subject to provisions for such a review. I anticipate that both Governments would wish to keep this under review.

## **Public audit in Scotland**

Public audit provides independent assurance that public money is spent properly and provides value for money. It helps create a strong and effective system of financial accountability and transparency, which improves the use of public money in the public interest. The principles of public audit ensure that auditors can carry out their work free of interference and raise issues of concern in the public domain. Taken together with effective public and parliamentary scrutiny, this contributes to strong and transparent oversight of public funds.

I work closely with the Accounts Commission (which audits local government) and Audit Scotland. Our recent joint paper *Public audit in Scotland*<sup>2</sup> sets out the shape, principles and themes of public audit. It reflects the changing context for public audit in Scotland, including the new devolved financial powers in place and proposed. I believe we have a strong platform for successful delivery of the additional audit responsibilities that flow to us from the further devolution of financial powers and any other responsibilities that may become necessary.

We have established arrangements to ensure that public audit plays a full part in the success of the new financial powers coming to Scotland. We will continue to support the Parliament by contributing our views on the arrangements as they are developed and through our audit work. We will also make sure that the organisation of Audit Scotland continues to be fully effective in this new environment.

---

<sup>2</sup> [http://www.audit-scotland.gov.uk/uploads/docs/report/2015/nr\\_150317\\_developing\\_financial\\_reporting.pdf](http://www.audit-scotland.gov.uk/uploads/docs/report/2015/nr_150317_developing_financial_reporting.pdf)

<sup>3</sup> [http://www.audit-scotland.gov.uk/uploads/docs/report/2013/nr\\_130704\\_financial\\_reporting.pdf](http://www.audit-scotland.gov.uk/uploads/docs/report/2013/nr_130704_financial_reporting.pdf)

<sup>4</sup> [http://www.audit-scotland.gov.uk/uploads/docs/report/2015/as\\_150511\\_public\\_audit\\_scotland.pdf](http://www.audit-scotland.gov.uk/uploads/docs/report/2015/as_150511_public_audit_scotland.pdf)

We have significant experience of the implementation of devolved powers, arising from the initial devolution arrangements and, more recently, the implementation of the new powers in the Scotland Act 2012. I look forward to continuing to work with the Committees of the new Parliament to strengthen the Parliament's oversight of Government in line with the recommendation of the Smith Commission and to support scrutiny of the implementation of the new financial powers.

Yours sincerely

Caroline

**Caroline Gardner**  
**Auditor General for Scotland**