

The 2018/19 audit of the Scottish Government Consolidated Accounts



AUDITOR GENERAL 

Prepared for the Public Audit and Post-Legislative Scrutiny Committee by the Auditor General for Scotland
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Contents

Introduction	4
Financial management	6
Financial reporting.....	12
Performance reporting.....	14
Governance.....	15
Conclusion	18

Introduction

1. The Consolidated Accounts are a key component of the Scottish Government's accountability to the Scottish Parliament and the public. The boundary for the Consolidated Accounts is determined by the Scottish Government and reflects the areas for which it has direct responsibility and accountability, including the core portfolios and supporting administration, the executive agencies and NHS bodies. It does not include bodies where the Scottish Government holds significant shareholdings such as Caledonian Maritime Assets Limited (CMAL), Scottish Futures Trust or Prestwick Airport. The Consolidated Accounts:

 - cover around 84 per cent of the spending approved by the Scottish Parliament
 - report the amounts the Scottish Government spent against each main budget heading, and the reasons for any significant differences
 - show the amounts distributed to other public bodies including local government
 - report the assets, liabilities and other financial commitments of the core Scottish Government, and bodies within the consolidated boundary, carried forward to future years
 - contain a performance report, in which the government gives a limited account of its performance during the year.
2. The Scottish budget is now more complex and subject to greater uncertainty and volatility as a result of tax and borrowing powers arising from the Scotland Acts in 2012 and 2016. Comprehensive, transparent and timely reporting of the Scottish Government's budget and financial performance, and what it achieves, has never been more important. The ongoing uncertainty and significant risks emerging from EU withdrawal is providing unprecedented challenges for the Scottish Government's management of public finances. This comes at the same time as ongoing pressures in available public finances, the implementation of significant new powers for social security benefits and increasing public demands for improved public services.
3. In December 2017, the Scottish Government published its draft 2018/19 Scottish Budget which set out its spending priorities and plans for the year. The Scottish Government's Consolidated Accounts for 2018/19 provides information on how this budget was managed and where money was spent.
4. My independent audit opinion on the 2018/19 Consolidated Accounts is unqualified. This means I am content they show a true and fair view, following accounting standards, and that the income and expenditure for the year is lawful. My audit opinion is set out at pages 59 to 63 of the accounts.
5. This report highlights key information in the Consolidated Accounts. It explains what they show about the Scottish Government's management of its budget. It also provides information on governance, financial and performance management and highlights significant audit findings where action is required by the Scottish Government.

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6. I provide this report on the 2018/19 Consolidated Accounts to support the Scottish Parliament in its important scrutiny role of public finances in Scotland.
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Key messages

- **The Scottish Government's Consolidated Account for 2018/19 meets the requirements of the Government Financial Reporting Manual (FReM) and my opinion on them is unqualified. The accounts show that the total net expenditure during 2018/19 was £36,137 million, £778 million less than budget.**
- **In recent years, the Scottish Government has taken a direct role in providing financial support to private companies. In 2018/19, the Scottish Government provided a further loan of £30 million to Ferguson Marine Engineering Limited (FMEL) in addition to a loan of £15 million in 2017/18. The Scottish Government impaired the value of the loans to nil at the end of the financial year due to the challenging financial position of FMEL. The valuation of loans and guarantees to other private companies, such as Burntisland Fabrications Ltd and Prestwick Airport, also declined significantly during 2018/19. The Scottish Government has recently published guidance to support accountable officers but has not developed a clear framework to outline its overall approach to financial interventions in private companies.**
- **The Scottish Government needs to improve the quality of financial reporting to better support Parliament. In May 2019, the Scottish Government published its second medium-term financial strategy, but it does not reflect all the basic components of a medium-term financial plan. It does not include indicative spending plans or priorities, or links to outcomes. There is no detail on how the Scottish Government would address a possible £1 billion shortfall due to forecast errors. In addition, the government has still not fulfilled its commitment to publish a consolidated account covering the whole devolved public sector in Scotland. This would fill an important gap and improve strategic public financial management, support Parliamentary scrutiny and enable better decision-making.**
- **The Scottish Government made some improvements to its governance arrangements during 2018/19 including the appointment of new non-executive directors. They have also taken some initial steps to improve the effectiveness of their role in sponsoring public bodies. The government's Audit and Assurance Committee needs to provide greater scrutiny and challenge to support the advice and assurances given to the Permanent Secretary as the Principal Accountable Officer. This is particularly important given the scale of challenges facing the Scottish Government including the implementation of new powers, continued pressures on public finances and the uncertainty and risks associated with the UK's withdrawal from the European Union.**

Financial management

Scottish budget performance 2018/19

7. The Consolidated Accounts show that total net expenditure during 2018/19 was £36,137 million, £778 million less than budget ([Exhibit 1](#)). The resource budget was underspent by £508 million (1.4 per cent) against a budget of £35,109 million and capital by £270 million (15 per cent) against a budget of £1,806 million. Budget management during the year was effective in managing total spending within the limit set although the total underspend is significantly more than in 2017/18 (2017/18: £84 million).

Exhibit 1

Total expenditure (resource and capital) against the Scottish Budget approved by the Scottish Parliament

The Scottish Government consolidated total was £778 million under budget in 2018/19.

Portfolio	Actual (£m)	Budget (£m)	Over/(under) spend (£m)
Finance, Economy and Fair Work	501	525	(24)
Health and Sport	13,855	13,895	(40)
Education and Skills	4,174	4,471	(297)
Justice	2,622	2,638	(16)
Communities and Local Government	11,116	11,147	(31)
Environment, Climate Change and Land Reform	392	452	(60)
Culture, Tourism and External Affairs	286	297	(11)
Rural Economy	220	135	85
Transport, Infrastructure and Connectivity	2,370	2,736	(366)
Social Security and Older People	281	289	(8)
Government Business and Constitutional Relations	11	11	-
Crown Office and Procurator Fiscal Office	121	122	(1)
Administration	188	197	(9)
Scottish Government consolidated total	36,137	36,915	(778)

Source: *Scottish Government Consolidated Accounts 2018/19 (page 64)*. Further information of individual portfolio spending performance can be found in pages 65 to 77 in the Consolidated Accounts.

8. Variations in each portfolio are managed by the Scottish Government to ensure overall spending remains within budget. Almost half of the underspend relates to the transport, infrastructure and connectivity portfolio, including spending on projects deferred to future years and lower than anticipated unitary payments for revenue-financed projects. High-level reasons for significant variances between actual and budgeted spend are included in the Consolidated Accounts (pages 65 to 77). Further information is given in the accounts of other bodies.

Social Security and Older People portfolio

9. The 2018/19 financial year is the first year that Social Security Scotland, an executive agency, is consolidated into the Scottish Government's accounts as a separate component audited body. The relevant expenditure is disclosed within the new Social Security and Older People portfolio outturn statement (page 74). This shows £191 million expenditure relating to Social Security Assistance. This covers demand-led benefits expenditure for Carer's Allowance, Carer's Allowance Supplement and Best Start Grant.
10. The 2018/19 Social Security Scotland accounts were qualified by the auditor. The qualification relates specifically to Carer's Allowance expenditure. The auditor confirmed in his independent auditor's report that the other transactions in the accounts, including Carers Allowance Supplement, Best Start Grant and administration expenditure comply with all relevant legislation, regulations and guidance.
11. The 2018/19 accounts include Carer's Allowance expenditure of £152 million. The auditor qualified his regularity opinion in relation to this because available estimates of error and fraud levels from DWP do not provide enough evidence to determine whether this spending was in line with the relevant legislation. Carer's Allowance is being delivered by the Department for Work and Pensions on behalf of the Scottish Government through an agency agreement, meaning there is operational reliance on the DWP. Further details can be found in my separate report on the 2018/19 audit of Social Security Scotland.
12. As a component audit, the qualified audit opinion on the Social Security Scotland accounts requires me to assess the potential impact of its inclusion within the Scottish Government's Consolidated Accounts. This includes consideration of the qualitative and quantitative impact of the auditor's opinion on Carer's Allowance expenditure as it applies to the Consolidated Accounts. I concluded that, for 2018/19, the likely amount of maximum error incurred in Carer's Allowance is unlikely to be significant enough to influence the economic decisions of the users of the accounts. Looking ahead, as the level of benefits expenditure is expected to increase significantly in the next few years, the consolidation of Social Security Scotland's accounts will have a considerable and increasing influence on the Consolidated Accounts and on my successor's audit opinion.

Capital borrowing

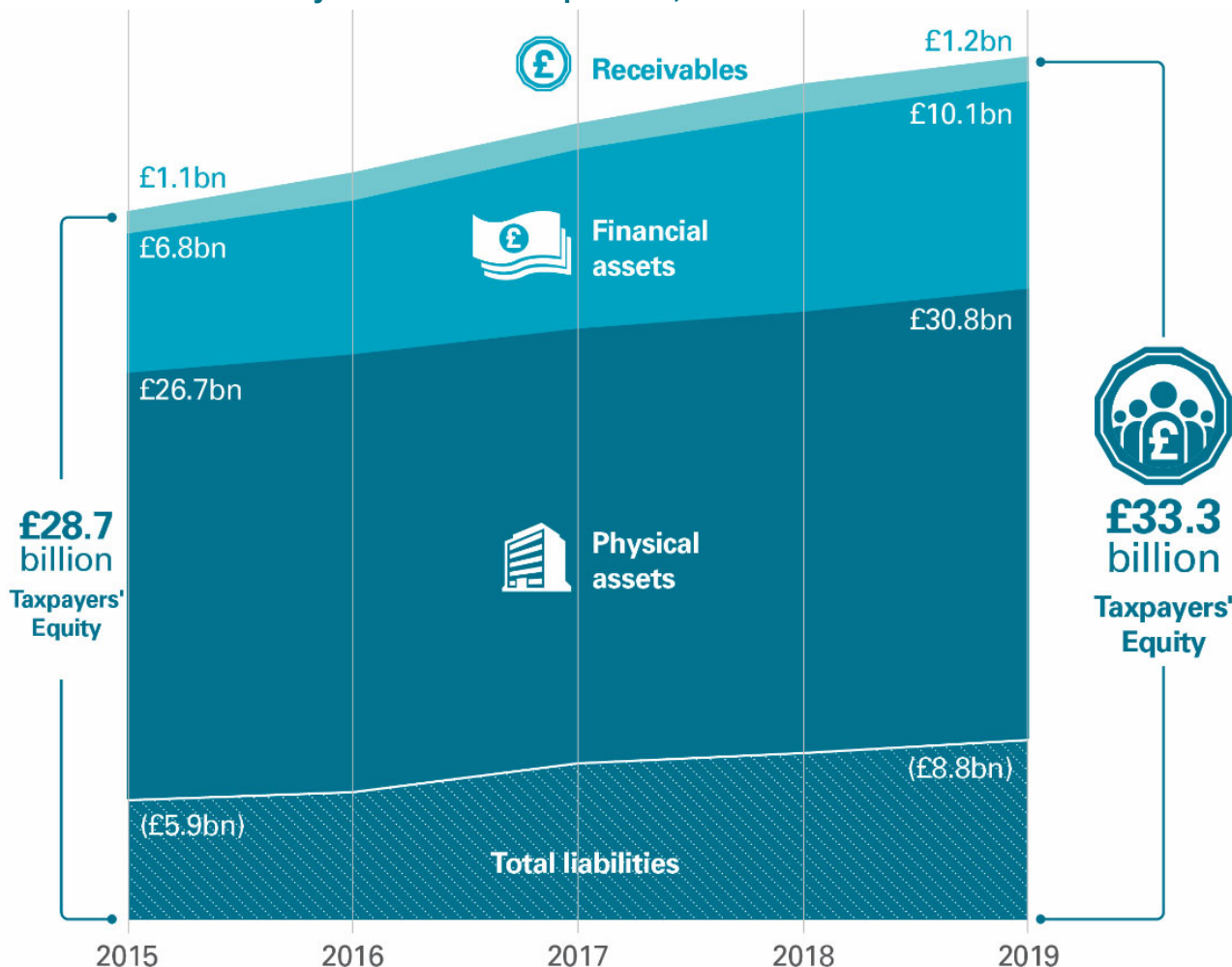
13. Under the terms of the Scotland Act 2016, Scottish ministers' can borrow up to £3 billion for capital purposes, with an annual borrowing limit of 15 per cent (£450 million) of the overall borrowing cap. In 2018/19, the Scottish Government borrowed £250 million. This was less than the £450 million outlined by Scottish ministers as part of the 2018/19 Scottish budget. Repayments of the loan, from the National Loans Fund, are to be made over the next ten years in line with timescales outlined in the Fiscal Framework.
14. The Scottish Government reported that 2018/19 borrowing was used to support its overall capital programme including major projects such as the completion of the Forth Replacement Crossing, trunk road programmes, NHS hospital building programmes and Forth Valley College. This is the fourth year that the Scottish Government has used its capital borrowing powers and, as at 31 March 2019, the total principal level of capital borrowing outstanding was £692.9 million, with interest of £126.7 million applying over its remaining life.
15. Details of the overall loan, repayments and interest payments are outlined on page 25 of the Consolidated Accounts. The Scottish Government's borrowing and associated repayments are made via the Scottish Consolidated Fund (SCF). Borrowed amounts and repayments are made between the SCF and HM Treasury with the corresponding adjustments made to funding received by the Scottish Government from the SCF. This means there is no associated liability disclosed in the Statement of Financial Position within the Scottish Government's Consolidated Accounts. Details of the amount of capital borrowing and the associated liability are set out within a separate account prepared for the SCF.

Overall financial position

16. The Consolidated Statement of Financial Position (page 78) is one of the primary financial statements in the Consolidated Accounts. It summarises what is owned and owed by the core Scottish Government and those public bodies within the consolidated boundary. This shows taxpayers' equity – an accounting measurement of the amount of taxpayers' money applied that has continuing public benefit. It shows how much of this has arisen from the application of parliamentary funding (arising from the Scottish Block Grant, capital borrowing and devolved taxes) and how much resulted from changes in the value of physical assets over time.
17. The key items in the Statement of Financial Position over the last five financial years are summarised in [Exhibit 2](#). Taxpayers' equity has increased in each of the last five years, largely due to an increase in physical assets (such as property and roads) and financial assets (such as loans and investments). Total liabilities (such as payments for private-financed projects) have also increased from £5.9 billion to £8.8 billion. It is important to note that the position does not reflect all the assets and liabilities of the Scottish public sector. Key liabilities are excluded such as capital borrowing, local government borrowing, and all public sector pension liabilities funded from the Scottish budget.

Exhibit 2

Scottish Government's year-end financial position, 2015 to 2019



Source: Consolidated Accounts 2014/15 to 2018/19.

Financial support to private companies

18. In recent years, the Scottish Government has taken a direct role in providing financial support to private companies in addition to support provided through its enterprise agencies; Scottish Enterprise and Highlands and Islands Enterprise. This includes:

- the purchase of Prestwick Airport together with loans of £39.9 million
- loan facilities of £45 million to Ferguson Marine Engineering Limited (FMEL)
- loan facilities of £51 million to Burntisland Fabrications Limited (BiFab) including a conversion to equity stake.
- a financial guarantee for power purchase obligations at the hydro plant and aluminium smelter at Lochaber with a value of £21.4 million at the time of agreement.

Prestwick Airport

19. In November 2013, the Scottish Government purchased Prestwick Airport for a nominal price of £1 with the stated aim of protecting jobs and safeguarding what it considered to be a strategic infrastructure asset. As at 31 March 2019, the Scottish Government's level of loan support to the Airport totalled £39.9 million. In its 2018/19 annual accounts, Transport Scotland impaired the value of this loan by £33 million to reflect expected losses in line with new accounting requirements. In June 2019, the Scottish Government announced that the sale of Prestwick Airport was being progressed, in keeping with its long-term objective that the airport should be returned to the private sector. Prestwick Airport is currently assessing expressions of interest in purchasing the airport. No date has been set to complete the sale, but Transport Scotland anticipates that a sale may be achievable by the end of 2019/20.

Ferguson Marine Engineering Limited

20. In September 2017, the Scottish Government provided a commercial loan facility of £15 million to FMEL, a ship-building and engineering company based in Port Glasgow. The purpose of the loan was to support FMEL's completion of a contract to build two 'dual-fuel' ferry vessels for Caledonian Maritime Assets Limited (CMAL) valued at around £97 million. In June 2018, the Scottish Government provided FMEL with an additional £30 million loan to improve their cash flow position to help support the delivery of the CMAL vessels and improve the prospects of the company and shipbuilding on the Clyde. CMAL is a company wholly owned by the Scottish Government in which Scottish ministers are the sole shareholders. It does not fall within the consolidated boundary of the Scottish Government Consolidated Accounts and appoints its own external auditors.
21. By April 2019, FMEL had drawn down the full loan facility of £45 million and no extended facilities were provided. The Scottish Government impaired the value of its loans to zero in the Consolidated Accounts reflecting its view that the loans were unlikely to be repaid given FMEL's challenging financial position.
22. In August 2019, FMEL entered administration which led to the Scottish Government outlining plans to bring the company into public ownership if a private sale is not achieved. The Scottish Government reported that completing the two ferry vessels and securing jobs and the long-term future of the yard was their main priority in acquiring the company. An arrangement was reached with the Administrator to allow the Scottish Government to oversee operations while the sale process for the business takes place. The Scottish Government appointed a turnaround director to manage the company and both the government and Scottish Enterprise will be represented on a new oversight Board. The board is expected to produce an operational plan including timescales and estimated costs of completing the ferries by the end of October 2019. I have asked the auditors of the Scottish Government and Transport Scotland to monitor developments at FMEL and I will report to Parliament during 2020 on the value for money.

Burntisland Fabrications Limited

23. In November 2017, the Scottish Government entered into an agreement to offer a commercial loan facility of £15 million to Burntisland Fabrications Limited (BiFab), a fabricator of oil, gas and offshore wind structures, to support the completion of two key contracts. Between January and April 2018, the Scottish Government extended the loan facility up to £41 million as a result of increasing costs associated with the completion of contracts for the Beatrice Offshore Wind Farm. Included in the agreement with BiFab is a provision for the loan to be converted to an equity stake, not exceeding a 38 per cent shareholding in BiFab. A further £10 million loan was made available to BiFab in April 2018 to support business restructuring following the completion of the contracts, taking the total loan support available to BiFab up to £51 million.
24. At the end of March 2019, BiFab had drawn down £37.4 million of the £41 million loan facility. This was subsequently converted to equity by the Scottish Government representing a total equity stake of 32 per cent. In the 2018/19 Consolidated Accounts, the Scottish Government impaired the value of its equity stake from £37.4 million to £2 million to reflect expected losses in line with new accounting requirements. This followed an assessment of the valuation of the Scottish Government's equity stake by external professional advisors. The Scottish Government plans to monitor options for when it will sell its shareholding, but no decision has yet been made.

Lochaber Aluminium Smelter - Liberty Group

25. In December 2016, the Scottish Government entered into a 25-year financial guarantee relating to the hydro plant and aluminium smelter at Lochaber. This involved the government guaranteeing the power purchase obligations of the smelter if the business does not fulfil its obligations to pay for contracted power. The guaranteed annual amounts vary between £14 million and £32 million over the lifetime of the contract. The Scottish Government receives an annual fee in return for the guarantee which was classed as a financial asset in the Consolidated Accounts. The asset was valued at £21.4 million at the time of agreement in 2016/17. In 2018/19, the value of asset was impaired to nil as a result of a review of expected credit losses in line with new accounting standards. Similarly, the calculation of the government's potential exposure to default payments was also updated, resulting in the creation of a new provision of £33 million.
26. In August 2019, the Scottish Government published guidance to support accountable officers on the steps to consider when investing in private companies. However, the Scottish Government has not yet developed a clear framework to outline its approach to financial interventions in private companies. Last year, I highlighted the need for the Scottish Government to be more transparent about its overall approach in providing significant public funds to support private companies. This included a recommendation that the Scottish Government should develop a framework that clearly outlines its role in financial interventions in private companies to support decision making over where, when and at what level to invest. Such a framework should provide clear information on financial capacity, risk tolerance and expected outcomes. In doing so, the Scottish Government will provide the Parliament with greater assurance and better information over its strategic objectives in entering these

agreements and allow for greater scrutiny of the risks and opportunities that exist, including the opportunity costs involved.

European Social Fund

27. The Scottish Government is responsible for managing two European Structural and Investment Funds for the period 2014 to 2020. One of the programmes, the European Social Fund, aims to help people improve their lives by learning new skills and finding better jobs. In February 2019, the European Commission (EC) notified the Scottish Government that the ESF had been placed in 'pre-suspension' as a result of serious deficiencies in the management and control system following issues identified by their auditors. The issues mirror similar difficulties with the 2007-13 ESF programme.
28. The EC aims to avoid making payments where there is a risk that the Scottish Government and lead partners (32 councils and other public bodies) have not followed the rules on how funds are spent. EC payments are stopped until it considers such risks have been removed. Pre-suspension means that the EC stop making payments, and the Scottish Government cannot make claims, until the issues identified are resolved.
29. The Scottish Government has until November 2019 to resolve the issues to enable the pre-suspension to be lifted and payments made. Lead partners are continuing to make payments to beneficiaries from their own budgets during this time. The Scottish Government will not reimburse lead partners on related issues until they have confirmation that the pre-suspension will be lifted. The Scottish Government is currently working with lead partners to resolve the issues that led to pre-suspension. The Scottish Government would face a financial penalty if the EC place the programme in full suspension. The EC can impose a maximum penalty of up to 25 per cent of the whole programme, which would be in the region of £190 million although the possibility of such a significant amount is remote. Any penalty would be subject to negotiation between the Scottish Government and the Commission.
30. A contingent liability of £10.4 million is included in the Consolidated Accounts to reflect the amounts paid by the Scottish Government to lead partners but subsequently withdrawn from declarations to the EC as a result of the pre-suspension.

Financial reporting

31. In May 2019, the Scottish Government published its second medium-term financial strategy, Scotland's Fiscal Outlook. The strategy, to be updated annually, aims to provide an assessment of the medium-term outlook for Scotland's public finances as the new financial powers from the Scotland Acts 2012 and 2016 come into effect. The production of a financial strategy followed a recommendation from the Parliament's Budget Process Review Group (BPRG) in 2017. The BPRG said that such a strategy should set out expectations and broad financial plans for at least five years ahead, including clear policies and principles for using, managing and controlling the new financial powers.
32. The strategy provides an explanation of the fiscal framework and outlines potential funding scenarios for the Scottish budget over the next five financial years to 2023/24 based on

independent forecasts carried out by the Scottish Fiscal Commission. The strategy includes the Scottish Fiscal Commission's income forecasts, which show a potential £1 billion cumulative reduction to the Scottish budget over the next three years. The Scottish Government project that available funding for resource spending will grow annually by 1.1 per cent in real terms over the next five years.

33. The 2019 strategy now includes principles and policies on reserves and borrowing powers. This is a positive step and will help to improve the transparency of decision-making on the capital programme such as the level, type and timing of borrowing, and will support a more transparent approach in managing the Scotland Reserve.
34. The strategy does not reflect some basic components of a medium-term financial plan. It does not include indicative spending plans or priorities, or links to outcomes and there is no detail on how the Scottish Government would address the possible £1 billion shortfall if this materialises. There is also little evidence to demonstrate that the strategy is a key component of the government's financial decision-making. The 2018 strategy included spending scenarios for the Scottish Government's priority areas. The 2019 strategy does not include such scenarios, instead focusing on the key financial challenges and opportunities and setting out a framework for a future Spending Review.
35. Overall, the 2019 strategy represents a missed opportunity and a step backwards for the Scottish Government's financial reporting. The absence of high-level financial plans, priorities and scenarios will make the Parliament's scrutiny of the forthcoming 2020/21 budget more difficult. This is particularly challenging when considering the impact of changes in spending patterns on outcomes set out in the National Performance Framework.
36. In 2016, the Scottish Government committed to producing a consolidated account to cover the devolved public sector in Scotland including total assets, investments and liabilities such as local government borrowing and public sector pension liabilities. The Scottish Government had designated 2016/17 as a 'shadow year' with a view to producing the account for audit during 2018 but this did not happen, and progress slowed. In November 2018, the Scottish Government confirmed to the Public Audit and Post-Legislative Scrutiny Committee that an account would be published using 2017/18 data by the end of March 2019. Although work was undertaken to develop the new account, the planned publication did not happen. In July 2019, the Scottish Government issued a draft account to its Audit and Assurance Committee for consultation. Audit Scotland will contribute to that process.
37. The use of the new borrowing powers increases the need for a public consolidated account to provide a comprehensive and transparent assessment of the state of Scotland's public finances. This is important for decision making over the longer term as it will provide important information about the impact of past decisions on future budgets, the scale of liabilities, and potential risks to financial sustainability. The Scottish Government needs to quicken the pace of its development and should aim to finalise the account for audit by the end of the 2019/20 financial year.

Non-Domestic Rates 2018/19

38. Non-domestic rates form a key part of the Scottish budget and are a significant source of funding for local government. The Non-Domestic Rating (NDR) account prepared annually by the Scottish Government shows the amount of non-domestic rates collected by councils and redistributed back to them by the Scottish Government during the year. Due to forecasting and timing differences between collection and distribution, the balance on the Non-Domestic Rating account shows either a surplus or deficit balance.
39. 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 to a deficit position ([Exhibit 3](#)).

Exhibit 3

Non-domestic rates contributions and distributions, 2012/13 to 2018/19

Any surplus or deficit on the NDR account is carried forward to the following financial year.

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Contributions (from councils to Scottish Government)	2,442	2,501	2,554	2,628	2,799	2,869	2,898
Distributions (from Scottish Government to councils)	2,311	2,513	2,781	2,843	2,807	2,713	2,733
Surplus/(deficit)	131	(12)	(227)	(215)	(8)	156	165
Cumulative surplus/(deficit)	165	153	(74)	(289)	(297)	(141)	24

Source: Scottish Government

Performance reporting

40. The 2018/19 Consolidated Accounts include a performance report and an accountability report in line with the requirements of the Government Financial Reporting Manual (FRM). The performance report (pages 5 to 27) summarises financial performance for the year, with emphasis on performance against budget. It also contains some specific performance information which is required by current guidance on supplier payment performance, and signposts where more information is available on sustainability and environmental

performance. The report provides only very limited performance information on the Scottish Government's own progress towards its overall aims and objectives, with users of the accounts directed to the National Performance Framework (NPF).

41. This means that the Consolidated Accounts focus on the government's finances. They do not report on the performance of individual portfolios or the Scottish Government as a whole, limiting the reader's ability to see the government's own contribution to national outcomes. This means that the reader is unable to see the links between the money spent by the Scottish Government, what it has achieved, and progress made towards achieving national outcomes.
42. As Scotland's fiscal responsibilities grow, it is increasingly important for the Scottish Government to produce more detailed and transparent performance reporting, that better links spending with outcomes. The Parliament's new budget process places a greater emphasis on the need for better performance reporting to provide a clearer focus on the delivery of outcomes. This includes better information about what activity public spending will support, its aims, and the contribution it expects to make to national outcomes. The revised National Performance Framework provided the opportunity for the Scottish Government to better improve the links between Government spending and what it delivers, but the performance report does not provide this detail. The Scottish Government should prepare a performance report that clearly links to the financial resources outlined in the Consolidated Accounts. Greater transparency around the Scottish Government's own performance towards meeting its strategic objectives would provide greater accountability for its use of financial resources. This would provide a more rounded account of the Scottish Government's overall performance, enhance reporting to the Scottish Parliament and the public, and help strengthen accountability and scrutiny.

Governance

43. A Governance Statement (pages 29 to 43) prepared by the Permanent Secretary is a key feature of the Consolidated Accounts. It forms part of a wider accountability report and summarises how the core Scottish Government organisation is controlled and directed. The statement confirms that it complies with relevant guidance on corporate governance. It also highlights some of the main risks and opportunities for the organisation and any significant internal control issues in 2018/19. I am content that the Governance Statement is consistent with the financial statements and has been prepared in accordance with guidance issued by the Scottish ministers.
44. The Scottish Government has improved aspects of its governance arrangements during 2018/19, such as greater consistency in approach to Directors General assurance meetings, a greater focus on corporate and directorate risks, and more detailed reports on corporate performance. In addition, the Scottish Exchequer, created in 2017, now has an organisational structure in place and appointments have been made to all key posts. The Exchequer has set its objectives and a transformation programme is in place to direct its activities. It will be

important for the Exchequer to continue to develop its arrangements through its transformation programme to ensure that both fiscal risks and opportunities are managed effectively.

45. The Scottish Government's Audit and Assurance Committee is responsible for advising and supporting the Permanent Secretary in her responsibilities for issues relating to risk, control and governance. The Committee is made up of non-executive directors. The Committee receives regular reports from both internal and external audit, but the Committee's consideration of their findings and recommendations remains limited. There is a need for the Committee to provide greater scrutiny and challenge to support the advice and assurances given to the Permanent Secretary as the Principal Accountable Officer. The Committee does not produce an annual report to summarise its work from the past year, nor does it undertake a review of its own effectiveness as required by its own terms of reference. The Committee should address this to ensure it operates in line with the Scottish Government's own good practice guidance on audit and assurance committees.
46. The Scottish Government has taken initial steps to improve the effectiveness of its role in sponsoring public bodies. The Scottish Government has an important leadership role in supporting public bodies to better understand the risks and challenges facing them. In June and July 2019, the Scottish Government held workshops, supported by Audit Scotland, to discuss common themes and issues among sponsors. These covered governance and accountability, risk management and relationships. They highlighted the need for greater engagement on shared issues and risks between the Scottish Government and its public bodies. This is an area that requires ongoing attention and I welcome these initial developments.
47. In March 2019, the Scottish Government appointed four new non-executive directors and two deputy non-executive directors to strengthen its capacity in this area. The new appointees have a wide-range of knowledge and experience from across both private and public sectors. It will be important for the Scottish Government to take advantage of the non-executive directors' expertise to strengthen support and challenge to their decision-making and assurance processes. This is particularly important given the scale of challenges facing the Scottish Government including the implementation of new powers, continued pressures in public finances and the uncertainty and risks associated with the UK's withdrawal from the European Union.

Internal audit

48. The governance structures within the Scottish Government draw on several sources of assurance, with substantial reliance placed on the work of internal audit. An efficient and effective internal audit function is a key element of good governance. Internal audit review whether the framework of internal control operates satisfactorily, and proper arrangements are in place for the prevention and detection of fraud and corruption.
49. Each year, we undertake an overview of the Scottish Government's internal audit arrangements in accordance with International Standard on Auditing 610 *Using the work of internal auditors*. Our 2018/19 overview found clear improvements in the standard of internal

audit work undertaken compared with 2017/18. We did not find any areas of significant non-compliance with the Public Sector Internal Audit Standards (PSIAS).

50. The complex and uncertain environment within which the Scottish Government now operates means there is an increasing need for a strong and effective internal audit function. Our work found that Internal Audit continues to experience challenges in recruiting the necessary staff and skills required to deliver its audit plans. The 2018/19 Scottish Government internal audit plan was not complete by the year end and Internal Audit reported capacity issues in undertaking unplanned work such as investigating fraud or whistleblowing allegations. Recruitment campaigns during the year did not result in all vacancies being filled. In August 2019, Internal Audit agreed a co-sourcing arrangement with EY to help increase capacity and access specialist skills.
51. From 1 April 2019, the Directorate of Internal Audit and Assurance was formed which encompasses Internal Audit, the Digital Assurance Office (formerly Office of the Chief Information Officer) and the Project and Programme Management Centre of Expertise. The new Directorate is headed by the Director of Internal Audit and Assurance. It is critical that Internal Audit ensures that its independence is not lost in this new arrangement to ensure that it can support the organisation's assurance requirements with independent audit judgements and conclusions.

UK withdrawal from the European Union

52. The uncertainty over the UK's withdrawal from the European Union placed considerable pressure on the Scottish Government's capacity and capability during 2018/19. The Scottish Government made changes to its governance arrangements, processes and staff roles and responsibilities in preparation for the original planned withdrawal date of 29 March 2019. Resilience arrangements were adapted and used to direct and scrutinise preparations and assess the most critical risks, with a focus on civil contingencies such as food supply, public order and access to medicines. New processes for quick, short-term funding and staff redeployment decisions were put in place to support contingency planning, and around £32 million, using Barnett Consequentials, was used during the year to manage the associated funding pressures. Preparations evolved and intensified over the first quarter of 2019 with an increasing focus placed on a 'no-deal' scenario as UK and EU negotiations failed to reach an agreement.
53. Overall, the Scottish Government's preparations for EU withdrawal were reasonable and proportionate given the considerable level of uncertainty over the detailed implications of withdrawal. Scottish Government staff were expected to plan for EU withdrawal at the same time as working towards Programme for Government commitments resulting in additional pressures on staff wellbeing. Although plans were untested with the postponement of the withdrawal date, the initial work undertaken provides a good basis for the Scottish Government to develop further its resilience arrangements in anticipation of the UK's withdrawal on 31 October 2019.

54. Looking ahead, the Scottish Government will need to ensure that planning arrangements are sufficiently flexible to respond quickly to the scale and pace of change from any further developments. The significant risks facing the Scottish Government extend well beyond 31 October 2019, and they are expected to dominate the public sector landscape in Scotland for years to come. In addition to addressing the short-term risks of EU withdrawal, with or without a trade deal, the Scottish Government will need to ensure it is able to transition effectively to any new partnership or trade arrangements, new funding mechanisms and legislation, as well as responding to any adverse impacts on the Scottish economy and public finances.

Conclusion

55. The Scottish Government's Consolidated Account for 2018/19 meets the requirements of the FReM and my opinion on them is unqualified. This is a critical component of the Scottish Government's accountability to the Parliament and the public.
56. The ongoing significant risks and uncertainty emerging from EU withdrawal will pose unprecedented challenges for the Scottish Government's management of public finances over the next few years. It will be critical for the Scottish Government to be clear about its spending priorities and how it expects to address potential funding shortfalls. Good financial decision-making is essential to ensure value for money is achieved from the limited funds available. A greater focus on linking spending decisions to outcomes has never been more important and requires more attention from the government.
57. My audit work has highlighted areas for improvement to help support the Parliament and the public in their scrutiny of public finances in this new environment. This includes recommendations from previous audit work where action remains outstanding. The Scottish Government should:
- Develop a framework outlining its approach to financial interventions in private companies covering financial capacity, risk tolerance and expected outcomes.
 - Improve the quality of financial reporting to Parliament. This should include ensuring the basic components of a financial strategy are included in the medium-term financial strategy and the publishing of a public consolidated account to cover the whole public sector in Scotland.
 - Prepare a performance report that clearly links to the financial resources outlined in the Consolidated Accounts. Greater transparency around the Scottish Government's own performance towards meeting its strategic objectives would provide greater accountability for the use of its financial resources
 - Ensure its Audit and Assurance Committee provides greater scrutiny and challenge to better support the advice and assurances given to the Permanent Secretary and operates in line with good practice.
58. Working with Audit Scotland and the Accounts Commission, I will continue to support the independent scrutiny of Scotland's public finances through all our audit work.

The 2018/19 audit of the Scottish Government Consolidated Accounts

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