Introduction
1. Audit Scotland is the independent public sector audit agency undertaking the external audit of the majority of public sector bodies in Scotland. We do this on behalf of the Auditor General for Scotland (for the NHS and central government) and the Accounts Commission (for local government).

2. We welcome the opportunity to input to the Committee’s work.

Overall comments
3. The further devolution proposed in the Command Paper Scotland in the United Kingdom: An enduring settlement significantly extends the level of financial devolution to the Scottish Parliament. A transparent and unambiguous fiscal framework is an essential part of the revised arrangements in order that Parliament can effectively scrutinise proposed expenditure budgets and taxation proposals.

4. A fiscal framework has a number of key elements including:
   - Fiscal rules
   - Medium term budgetary framework
   - Budgetary procedures including effective scrutiny
   - Sound fiscal reporting
   - Fiscal institutions

5. Fiscal rules agreed between the UK and Scottish Governments and those set by the Scottish Parliament will form the basis for the fiscal framework.

6. A medium term budgetary framework is important in order to show the medium term effect of policy and budgetary decisions and to demonstrate the sustainability of public finances.

7. Budgetary procedures will, in future, need to consider the income side of budget setting as well as expenditure. This will cover the fully devolved taxes such as Land and Buildings Transaction Tax, partially devolved taxes such as income tax and assigned taxation such as VAT. Effective scrutiny of budget proposals will require comprehensive information on proposals and their effect as well as information on the sensitivity of variations in proposals on income or expenditure.

8. Sound fiscal reporting is important for Parliament to have a solid information base on which to make decisions. Comprehensive, reliable, timely and transparent information on past performance will help decision making and accountability and build confidence in Scotland’s ability to manage its finances in the new environment.

9. Fiscal institutions such as the Fiscal Commission provide independent assurance on forecasts and estimates which Parliament and Government use. The remit of such bodies is for Parliament to determine but its operation should conform to best practice guidance such as that provided by the OECD.

10. As Scotland’s public audit agency our main interests are in budgetary procedures and sound fiscal reporting and in particular the extent to which effective scrutiny is supported by transparent, comprehensive and reliable reporting. Audit Scotland’s reports Developing financial reporting in Scotland (July 2013) and Update on developing financial reporting (March 2015) provide more information.
Transparency

11. Underpinning all of these elements 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 expenditure from one year to another.

12. Particular areas where transparency will be important include:
   - Movements in the Scottish block grant arising from the application of the Barnett formula, Scottish income tax, devolved taxes baseline adjustments, assigned VAT receipts and welfare payment adjustments
   - Assumptions underpinning forecasts of Scottish tax revenues
   - Application of the no detriment principle
   - Reporting by fiscal institutions
   - Movements in borrowing
   - Use of any powers to create and use reserves

13. Mechanisms that can be used to increase transparency include reconciliations of amounts from one year to the next, explanations of variations from forecasts and tables showing movements of actual and forecast amounts over a period of years. We encourage audited bodies and auditors to use these mechanisms in their reports to make them more useful for readers.

No detriment principle

14. The Command Paper sets out the two ‘no detriment’ principles outlined in the Smith Commission report. The first point of no detriment is at the point of transfer of a function or tax power. There is already experience building through the devolved taxes and Scottish Rate of Income Tax of the ways in which this can be done using a mix of empirical data and negotiation.

15. The second no detriment principle covers changes in policies by the Scottish or UK Governments that have an impact on the other. This is a new and complex area and will be important for both Governments to reach agreement on those effects that will be subject to the principle and those that will not and of the ways in which the effects will be measured or estimated.

16. The examples in the Command Paper deal with changes in Government spending as a result of income tax changes and the impact of welfare eligibility decisions in Scotland. The Command Paper does not cover behavioural changes by individuals, for example, businesses choosing to pay owners through dividends rather than salary if the Scottish rate of income tax rises compared to that set by the UK Government for dividends. Some of the effects of policy changes can be readily measured such as the loss of tax revenue to Scotland if the personal allowance is increased but if a government changing tax rates causes individuals to relocate this would be much harder to measure. The Governments may therefore want to agree an initial list of direct effects that can be measured and only consider the indirect or behavioural effects at a later date if there is evidence of these being significant.
Further information
17. We hope that you find our comments helpful and should you require any further information please contact Russell Frith, Assistant Auditor General, Audit Scotland, 110 George Street, Edinburgh, EH2 4LH, e-mail rfrith@audit-scotland.gov.uk.