Submission by the Auditor General for Scotland to the Public Audit and Post Legislative Scrutiny Committee of the Scottish Parliament

Scottish devolution: a framework for audit and accountability

Summary

1. The provisions of the 2012 and 2016 Scotland Acts and the fiscal framework are fundamentally changing Scotland’s public finances. Where previously there was a clearer distinction between reserved and devolved areas, there is now an increasing number of shared areas where the UK departments and public bodies are involved in devolved matters. This includes areas that are critical to the Scottish Parliament’s activities and finances – including Scottish Income Tax, aspects of social security administration and assignment of Value Added Tax (VAT).

2. The UK and Scottish Governments are developing an audit and accountability framework for devolved powers. This sets out how the Governments agree accountability and audit should operate in newly devolved areas, alongside existing arrangements and specific legal requirements. Key aspects of this include:
   - the extent to which UK bodies report publicly on their devolved responsibilities and respond to requests from the Scottish Parliament for information and explanation about these
   - how the audit process operates to provide assurance and evaluation to the Scottish Parliament for devolved areas that are delivered by UK bodies.

3. The draft framework is clear that fully devolved activities undertaken by the Scottish Government or Scottish public bodies without the involvement of UK public bodies (such as devolved taxes or the management of the Crown Estate in Scotland) fall under the Scottish Parliament’s existing audit and accountability arrangements (referred to as model A in the framework). In my view this enables effective arrangements to support Parliamentary accountability in relation to these activities.

4. The draft framework also recognises that UK public bodies are accountable to the Scottish Parliament and Government in relation to matters of significant devolved interest in areas of:
   - shared competence (model B), where UK public bodies undertake devolved activities as an integral part of a UK-wide service (such as Scottish Income Tax administration)
   - shared delivery (model C), where UK bodies undertake devolved activities under agreement with the Scottish Government (such as aspects of social security administration)
   - shared interest (model D), where there is a distinct and significant Scottish interest in reserved matters (such as energy policy).

5. The specific nature and extent of these arrangements vary between these different types of situation, including provision for reporting to the Scottish Parliament and for relevant UK Accounting Officers to appear before it. Importantly the draft framework recognises that the
extent of this should be proportionate to the interest of the Scottish Parliament. In my view this provides a reasonable basis to enable direct accountability of UK public bodies to the Scottish Parliament for relevant matters.

6. The draft framework recognises the importance of auditing by national auditors as a key aspect of accountability for both fully devolved activities and other areas of significant devolved interest. The key strengths of the public audit model are reflected, including:
   - the independence of the audit process
   - the ability of auditors to report on their work in public
   - wider scope auditing that includes financial and value for money matters.

7. The draft framework also recognises the need for consultation between the Audit Scotland and National Audit Office (NAO) on audit work programmes covering matters of significant devolved interest in UK bodies. In my view the draft framework’s provisions in these areas include important components necessary to enable effective audit arrangements to support Parliamentary accountability.

8. The auditing provisions in the draft framework also provide me with some access to audit value for money directly in UK public bodies in relation to their delivery of devolved activities, such as aspects of social security administration that are undertaken by DWP (model C). As currently set out this is effectively subject to veto by the Comptroller and Auditor General (C&AG) and also needs to be agreed by the UK public body concerned (albeit bodies are encouraged to enable this). There is no provision for me to be able to audit value for money in areas such as the administration of Scottish Income Tax by HMRC (model B) or to conduct joint work. In my view in these areas the draft framework does not fully satisfy the needs that the Scottish Parliament has identified to support its scrutiny of devolved matters.

9. I make a number of observations about the draft framework in this paper, including suggestions for strengthening it to better support the interests and responsibilities of the Scottish Parliament. Ultimately decisions on this will be taken by Ministers through the Joint Exchequer Committee, informed by the views of the Committee on behalf of the wider Parliament.
Introduction

10. The provisions of the 2012 and 2016 Scotland Acts and the Fiscal Framework are fundamentally changing Scotland’s public finances. The full range of income tax powers set out in the 2016 Act are now in operation, and in the coming years it is expected that VAT assignment, devolved social security powers and further devolved taxes will be implemented. By the end of 2020/21, around £22 billion of public money will be raised directly in Scotland each year, accounting for more than half the Scottish budget.

11. 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 budget process. As Auditor General, I am committed to supporting the Parliament to develop world class arrangements for holding Government to account and improving the use of public money, working with colleagues in Audit Scotland.

12. The fiscal framework outlines policy principles for accountability to the UK and Scottish Parliaments in relation to devolved matters. Both Governments agreed there should be accountability of delivery bodies in both jurisdictions, together with a set of robust auditing arrangements. These will be agreed by Ministers through the Joint Exchequer Committee. On 26 January 2018 the Scottish Government and HM Treasury each wrote to the Public Audit and Post Legislative Committee (PAPLSC) to provide an update on the progress their officials have made in developing a framework for audit and accountability arrangements for devolved powers, together with the draft framework.

13. I welcome the Committee’s interest in this important area. I set out below my views on the draft framework, and describe how I expect the framework to apply in relation to the most significant new financial powers. My comments are informed by the views of the Parliament as expressed in the Public Audit Committee’s report of June 2015, previous evidence sessions with both PAPLSC and the Finance and Constitution Committee, and the work of the Budget Process Review Group. In my comments I have considered the extent to which the implementation of the framework is likely to enable the Scottish Parliament to scrutinise the use of the devolved powers.

Development of the framework

14. The Public Audit Committee (PAC) of the Scottish Parliament (session 4) previously considered how the audit and accountability environment needed to evolve in response to the further devolution of powers. In June 2015 it published a paper setting out three key principles underpinning audit reporting to the Scottish Parliament – proportionate, transparent and robust. These continue to provide a sound basis for the information the Scottish Parliament needs to hold to account those who collect or spend public money.

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1 http://www.parliament.scot/S4_PublicAuditCommittee/Public_Audit_Committee_-_Scotland_Bill_Response(2).pdf
The Budget Process Review Group published its final report in June 2017. This set out the results of a fundamental review of the budget process in light of the Scottish Parliament's new financial powers. Both the Finance and Constitution Committee and the Scottish Government welcomed the package of recommendations, and are committed to implementing them. This will involve significant changes to how the Scottish Parliament considers financial matters. The Group also emphasised the important role that audit reporting plays in supporting Parliament’s scrutiny of public spending, by providing independent, evidence-based assessment of the public finances, performance and value for money. In my view such an approach should apply across all devolved areas, irrespective of whether activities are undertaken by Scottish or UK bodies.

Our engagement with the Scottish Government has been constructive. In May 2017 the Scottish Government invited Audit Scotland to comment on a draft of the framework for audit and accountability. We provided our views and suggestions in response, and continued discussion with Scottish Government officials throughout the drafting process. We also confirmed our opinion that the views of the Scottish Parliament should be sought before final decisions are taken on the framework.

Scottish Government officials have played our views into their discussions with HM Treasury. Many of our suggestions have been adopted, alongside other changes to the framework. In my view the current draft has been significantly strengthened in a number of areas, which are highlighted below. In other areas our suggestions have not been taken on board, and my remaining concerns are also outlined.

On 26 January 2018 the Scottish Government wrote to Audit Scotland to invite any further comments on the current draft. We have shared this submission with officials in response.

**Direct parliamentary accountability**

The Scotland Acts of 2012 and 2016 and the fiscal framework have shifted the boundaries of the devolution settlement. Where previously there was a clearer distinction between reserved and devolved services, there is now an increasing number of shared areas where public bodies are responsible for providing services in more than one jurisdiction. This includes areas that are critical to the Scottish Parliament’s activities and finances – including Scottish Income Tax, aspects of social security administration and assignment of VAT. While it is appropriate for public bodies to be accountable to one elected legislature for the performance of the body as a whole, it is also important that UK public bodies such as HMRC and DWP that deliver devolved services are sufficiently accountable to the Scottish Parliament for their use of devolved funds and contribution to devolved activities.

Given the respective scope of the Scottish and UK Parliamentary and Government responsibilities, activities or issues that might not be significant for one jurisdiction may nonetheless be significant for the other. This means that audit and accountability arrangements need to be proportionate to each Parliament’s interests. For example, the extent to which UK bodies report publicly on devolved aspects of their responsibilities and

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respond to requests from the Scottish Parliament for information and explanation about these should take account of the relative importance of such issues in a Scottish context.

21. The draft framework includes a number of provisions that address these key requirements:

- it recognises that UK public bodies are accountable for the delivery of devolved services to the Scottish Government for services it has commissioned, and to the Scottish Parliament where it has approved the corresponding budget. UK public bodies should recognise and support the interest of the Scottish Parliament in scrutinising the delivery of public services that have a distinct and significant impact on its responsibilities. Accounting Officers in UK bodies also have accountability to the devolved administration that funds them (page 4).

- in providing information in its published annual accounts a UK public body is required to consider the respective interests of both Parliaments, as well as other stakeholders (page 5).

- specific provision is made for various forms of accountability and reporting by UK public bodies to the Scottish Parliament and Government in Models B, C and D. These models appropriately distinguish between different classes of arrangement where the Scottish Parliament has an interest in UK bodies’ activities (pages 11 to 28).

22. Taken together this provides a reasonable basis for UK public bodies and the relevant accounting officers to report on and provide evidence to Scottish Parliamentary Committees on areas with a significant Scottish Parliamentary interest. There are a number of aspects of this which in my view would benefit from further clarification:

the extent of Scottish Government’s accountability for the performance of UK public bodies in devolved areas

- The principles in the document (page 10) highlight that “the executive in the commissioning jurisdiction (the Scottish Government) is accountable to its own legislature (the Scottish Parliament) for delivery of services, regardless of the jurisdiction the public body providing the services is in (potentially a UK public body)”. The detailed arrangements for model B indicate that the Scottish Government is accountable for “the delivery of outcomes under the (agreement with the UK public body)” and would appear alongside the UK body at Scottish parliamentary committees. This is appropriate for Model C cases, such as aspects of social security, where the Scottish Government has chosen to commission a UK public body. But it seems less appropriate for model B cases, such as Scottish Income Tax, where the Scottish Government has no discretion about using UK arrangements and cannot be meaningfully held to account for the UK body’s delivery.
the extent to which the principles and detailed arrangements set out in the second half of the draft framework are consistent with the need for audit and accountability arrangements to be proportionate to Scottish Parliamentary interests

- As noted above, the text in the early part of the draft framework is clear for the need for such proportionality. In my view it would be helpful for this concept to be more clearly embodied in the principles set out on pages 9 and 10. Other than where specific statutory provisions are in place, the draft framework relies on the judgement of accounting officers for UK bodies over reporting on Scottish issues, and on these organisations reaching agreement with the Scottish Government about specific arrangements in each case. This provides the flexibility for arrangements to be tailored to specific circumstances. A key aspect of the review planned for 2021 should be the extent to which this approach meets the needs of the Scottish Parliament in practice.

the extent to which the accountability arrangements that apply in relation to UK public bodies apply to different components of the UK Government

- It is clear from the draft framework that UK Government departments such as HMRC and DWP are accountable to the Scottish Parliament for devolved ‘service delivery’ matters in the manner described above. It less clear how the framework applies to areas such as HM Treasury’s exercise of UK responsibilities under the fiscal framework (such as calculation of the block grant and VAT assignment), and whether such activities may be considered ‘service delivery’. The Scottish Parliament may reasonably expect the provisions of model D to apply, given these are reserved responsibilities with a significant Scottish interest. This would mean that it would have the opportunity to obtain information and explanations directly from the UK Government in such areas. The Committee may wish to confirm that this is how the framework is expected to operate, given the importance of this particular area to the Scottish context.

Audit arrangements

23. The draft framework clearly recognises where functions and services are devolved to Scotland, and are provided directly by the Scottish Government or by a Scottish public body (Model A, covering areas such as devolved taxation), that accountability and audit arrangements should follow those already established in Scotland. This means that the Scottish Government and its public bodies are accountable to the Scottish Parliament, I appoint the auditor of relevant accounts, and the functions and services are subject to my value for money reporting responsibilities. Any functions or services that are devolved in turn to local government in Scotland will come under the remit of the Accounts Commission. This arrangement appropriately supports the Parliament’s interests in relation to services that are fully devolved. I strongly welcome this approach.

24. The key principles of the public audit model are evident in the draft framework, which helps to underpin audit activity that supports accountability to the Scottish Parliament for devolved matters:

- independence – the draft framework provides for auditors to consider the respective interests of both Parliaments when deciding on their work programmes, but neither the Scottish or UK Parliaments, or the respective Governments are able to direct audit work.
The proposed arrangements for funding audit work on devolved matters through the usual Parliamentary processes (page 6) also help underpin auditor independence.

- reporting in public – the draft framework enables auditors undertaking specific pieces of audit work in relation to devolved matters to report on that work to the Scottish Parliament and to give evidence on the work they have performed.
- wider scope – the draft framework provides for audit work in relation to value for money and investigations, as well as the financial audit of accounts. I am content that it is appropriate and efficient for the NAO to undertake all financial audits of the accounts of UK bodies.

25. The provision in the draft framework for consultation between Audit Scotland and the NAO establishes a good basis for discussion between auditors about potential areas of audit that are likely to support the interests of the Scottish Parliament. The draft framework also provides for the Scottish Parliament to ‘seek audit information from a UK body’ by requesting that I engage with the C&AG. In practice I expect this to build on current approaches where the Parliament might make suggestions about the content of my work programme for my consideration alongside other relevant factors.

26. In my view the draft framework would be strengthened in this area by recognising that:
- in considering our work programmes both the C&AG and I will each form our own perspectives on the views and issues of the Scottish Parliament. While discussion between Audit Scotland and NAO will help inform this, our perspectives may from time to time be different. Audit Scotland should not have sole responsibility for representing the Parliament’s views or seeking information from the NAO on the Parliament’s behalf.
- we are well placed to support the Scottish Parliament’s consideration of Scottish related work reported by the NAO by drawing on our wider knowledge of the Scottish context. This is built up from other aspects of our work programme and regular engagement with the Scottish Parliament, Government and public bodies, and wider stakeholders. Such an approach already operates in relation to Scottish Income Tax, where we appear with the C&AG in the Committee’s evidence sessions. In my view there are opportunities to build on this to enable the Scottish Parliament to understand the implications of NAO’s work on devolved matters, and this should be provided for in the framework.
- in some areas joint work between the Audit Scotland and NAO may be valuable to support the interests of Parliament. For example there is the potential to support integrated audits of the interface between devolved and reserved responsibilities such as the impact on taxpayers or social security clients, the interfaces between tax and social security systems, or how the activities of the Scottish security agency link through to DWP systems.
27. The draft framework provides for me to have some access to UK bodies in relation to devolved matters. This would enable me to undertake audit work on devolved issues at UK bodies in limited circumstances. While I do not have a statutory right of access, there is a non-statutory requirement for public bodies to enable and support this work. In practice this is likely to mean that I would be dependent on the goodwill of UK public bodies to undertake such work. I welcome this recognition that there are circumstances where direct access to UK public bodies is necessary to support the scrutiny interests of the Scottish Parliament, but I am concerned that the proposed access may be significantly limited.

28. This limited access would apply only to circumstances where the Scottish Government has chosen to commission the services of a UK public body, for example for aspects of social security administration. It does not apply in areas where the Scottish Government has no discretion about using the services of a UK body, such as in the administration of Scottish Income Tax. In my view broadening the provisions for access to UK bodies to these circumstances would strengthen the framework and better satisfy the needs that the Scottish Parliament has identified to support its scrutiny of devolved matters.

29. The draft framework also requires me to confirm that the C&AG is content for any such work to be carried out and the UK public body to agree to the work being performed. In my view removing these requirements would strengthen the framework and better satisfy the needs that the Scottish Parliament has identified to support its scrutiny of devolved matters.

Taxation

Fully devolved taxes

30. Audit arrangements for Land and Buildings Transaction Tax and Scottish Landfill Tax are now well established. These fall under model A in the draft framework, using my existing powers and other aspects of the Scottish accountability model. I appoint the financial auditors of Revenue Scotland and the Devolved Taxes Account it prepares, and these activities fall within my value for money audit powers. In my view this arrangement is working well, and will extend to Air Departure Tax and Aggregates Levy as these powers are devolved.

Scottish Income Tax

31. Income tax administration is classified as model B in the draft framework, given that the Scottish Government is unable to withdraw and provide the service directly. Audit arrangements for Scottish Income Tax are set out in Section 80HA of the Scotland Act 1998. The draft framework rightly recognises that statutory requirements take precedence over the provisions of the framework.

32. The 1998 Act requires the C&AG to report annually to the Scottish Parliament on HMRC’s arrangements for administering Scottish Income Tax, the correctness of Scottish Income Tax revenues brought to account, and the accuracy and fairness of recharges to the Scottish Government. In response to a recommendation of the PAC in session 4 of the Parliament I report alongside the C&AG to provide ‘additional assurance’ under a Memorandum of Understanding with the C&AG. This confirms the robustness of the NAO’s audit and helps place its findings in a wider Scottish context. The C&AG recently made his third such report,
covering 2016/17 as the first full year of operation of the Scottish Rate of Income Tax. The Committee considered his report and my additional assurance report on 11 January 2018.

33. In its June 2015 paper, the PAC stated its opinion that:

“The Scotland Bill 2015 proposes devolution of a greater range and complexity of powers (such as the interplay between reserved and proposed devolved function in tax and welfare). We therefore question whether this ‘additional assurance’ arrangement remains appropriate. Our view is that a tipping point has been reached such that consideration should be given to enabling Audit Scotland and the National Audit Office to undertake joint performance audit work especially in relation to complex areas such as tax and welfare. Similar views were also expressed by CIPFA, the Law Society of Scotland and the Scottish Government”.

34. The draft framework does not significantly develop the audit model for Scottish Income Tax, and I have set out my views on this above. In my view, meeting the statutory requirements - which were established in relation to the more limited powers in the 2012 Act - should not limit the application of other aspects of the framework on a non-statutory basis given the increasing significance of the Scottish Income Tax to the Scottish Parliament.

35. I would also highlight that the draft framework does not explicitly provide for the ‘additional assurance’ model that is in place for Scottish Income Tax to be extended to other areas such as VAT assignment or aspects of social security administration undertaken by DWP. I set out my views on how the audit arrangements might be strengthened to better support the interests and responsibilities of the Scottish Parliament above. In my view in the absence of further development of the framework in these areas, the application of the ‘additional assurance’ approach should be extended to other relevant areas of significant devolved responsibility.

VAT assignment

36. Detailed arrangements for the assignment of VAT are currently being developed, prior to devolution from 2019/20. It is unclear at this stage which, if any, of the provisions in the draft framework will apply in relation to VAT assignment. In particular, it is unclear if this would fall under model B or model D. The arrangements for VAT administration in the round are clearly a reserved matter, but in my view the Scottish Parliament is likely to require assurance that the assignment arrangements agreed between the UK and Scottish Governments are being applied correctly, given the direct effect on the Scottish budget.

Social security

Scottish social security agency

37. The Scottish Government has announced plans to establish a social security agency to deliver devolved social security benefits as these come on stream. The direct activities of the agency will fall under model A in the draft framework, meaning that they are subject to my existing powers and other aspects of the Scottish accountability model. I will appoint the financial auditors of the agency and accounts it prepares for Scottish social security payments. These activities also fall within my value for money audit powers. In my view this is appropriate and enables effective arrangements to support Parliamentary accountability.
Interaction with the DWP

38. There is likely to be significant interaction between the administration activities of the Scottish social security agency and the DWP. The nature and extent of this will depend on the decisions of the Scottish Government and the agency as the new powers are implemented. Any activities undertaken by DWP in relation to the administration of devolved social security will fall under model C. This would mean that:

- the NAO will continue to undertake the financial audit of DWP’s accounts and I will appoint auditors to undertake the audit of the Scottish agency’s accounts as outlined above. There are well-established arrangements under international auditing standards to support any information exchange that may be necessary to support both financial audits.

- the NAO will consider the extent to which devolved aspects of DWP’s activities should feature in its performance audit work programme, informed by discussion with Audit Scotland. The NAO would report on any such work to the Scottish Parliament. Where the NAO decides not to undertake performance audit work in a particular area and I consider that such work is appropriate to support the interests of the Scottish Parliament, I would be able to carry it out and report to the Scottish Parliament, subject to agreement with both the C&AG and the DWP as outlined above.

39. I set out my views on how the audit arrangements might be strengthened to better support the interests and responsibilities of the Scottish Parliament above.

Other functions and bodies

40. In its June 2015 paper the PAC set out its initial observations on the audit and accountability arrangements which accompany the further powers set out in the 2016 Act in relation to twelve specific areas. The Scottish Government provided the Committee with an update on these functions on 12 May 2017. My comments on tax and social security are set out above; I offer the following observations in relation to the other areas:

- the Crown Estate Transfer Scheme came into force on 1 April 2017, giving effect to the devolution of the functions of managing the Crown Estate’s wholly-owned assets in Scotland. This falls under model A in the draft framework, meaning that they are subject to my existing powers and other aspects of the Scottish accountability model. I have appointed an auditor to undertake the financial audit of Crown Estate Scotland from 2017/18.

- the Railway Policing (Scotland) Act 2017 received assent in August 2017. The Bill confers railway policing powers on Police Scotland and the Scottish Police Authority in preparation for the integration of the British Transport Police (BTP) in Scotland into Police Scotland. The Act is an initial part of a larger programme of work needed to integrate the BTP in Scotland into Police Scotland. Ultimately, this activity would fall under model A in the draft framework, meaning that it will be subject to my existing powers and other aspects of the Scottish accountability model alongside the other activities of the Scottish Police Authority and the Police Scotland.

- responsibility for reviews of Scottish Parliament boundaries passed from the Boundary Commission for Scotland to the Local Government Boundary Commission for Scotland.
with effect from 18 May 2017. The Local Government Boundary Commission is an Advisory Non-departmental Public Body sponsored and wholly funded by the Scottish Government. As such its activity falls to be considered as part of my existing powers.

41. The other agencies and areas identified by the PAC are subject to specific provisions set out in the Scotland Act 2016, in some cases underpinned by detailed Memoranda of Understanding. The draft framework recognises that statutory provisions take precedence over its other provisions. Section 66 of the Scotland Act extends the group of bodies who can be required to provide information or appear before the Scottish Parliament in relation to the discharge of their functions in relation to Scotland to include the Commissioners of Northern Lighthouses, the Office of Communications (OFCOM) and the Gas and Electricity Markets Authority (OFGEM). Other specific provisions are made in relation to the other bodies covered by the 2016 Act.

Conclusion

42. Effective arrangements for audit and accountability for devolved matters are critical to ensure that the Scottish Parliament can effectively scrutinise how public money is raised and spent in its areas of responsibility. Alongside the statutory provisions, the framework being developed by the Scottish and UK Governments as part of the wider fiscal framework agreement sets out detailed proposals for how this will operate. As such it will determine the nature and extent of accountability the Scottish Parliament can expect in relation to services provided by UK bodies in devolved areas, particularly Scottish Income Tax, VAT assignment and aspects of social security administration that may be undertaken by the DWP.

43. I have made a number of observations about the draft framework, including suggestions for strengthening it to better support the interests and responsibilities of the Scottish Parliament. Ultimately decisions on this will be taken by the Ministers through the Joint Exchequer Committee, informed by the views of the Committee on behalf of the wider Parliament. Audit Scotland and I will, of course, continue to work constructively with the Scottish Parliament, the Scottish Government and the NAO to deliver our remit and responsibilities within the framework. I welcome the commitment in the draft framework to review its effectiveness alongside the wider review of the fiscal framework by 2021.

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