



OFFICIAL REPORT
AITHISG OIFIGEIL

Public Audit and Post-legislative Scrutiny Committee

Thursday 10 November 2016

Session 5



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Pàrlamaid na h-Alba

Thursday 10 November 2016

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PUBLIC AUDIT AND POST-LEGISLATIVE SCRUTINY COMMITTEE
8th Meeting 2016, Session 5

CONVENER

*Jenny Marra (North East Scotland) (Lab)

DEPUTY CONVENER

*Alison Harris (Central Scotland) (Con)

COMMITTEE MEMBERS

*Colin Beattie (Midlothian North and Musselburgh) (SNP)

*Liam Kerr (North East Scotland) (Con)

*Monica Lennon (Central Scotland) (Lab)

*Alex Neil (Airdrie and Shotts) (SNP)

*Gail Ross (Caithness, Sutherland and Ross) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Leslie Evans (Scottish Government)

Caroline Gardner (Auditor General for Scotland)

Gordon Smail (Audit Scotland)

Alyson Stafford (Scottish Government)

Mark Taylor (Audit Scotland)

CLERK TO THE COMMITTEE

Terry Shevlin

LOCATION

The David Livingstone Room (CR6)

Scottish Parliament

Public Audit and Post-legislative Scrutiny Committee

Thursday 10 November 2016

[The Convener opened the meeting at 09:02]

Decision on Taking Business in Private

The Convener (Jenny Marra): Good morning and welcome to the eighth meeting in session 5 of the Public Audit and Post-legislative Scrutiny Committee. I ask everyone present to switch off their electronic devices or switch them to silent mode so that they do not affect the committee's work.

Item 1 is a decision on taking business in private. Does the committee agree to take in private agenda item 3, which is consideration of the evidence that we will receive under item 2, on "The 2015/16 audit of the Scottish Government Consolidated Accounts"?

Members *indicated agreement.*

Section 22 Report

"The 2015/16 audit of the Scottish Government Consolidated Accounts"

09:02

The Convener: Agenda item 2 is an evidence session on the Auditor General for Scotland's report "The 2015/16 audit of the Scottish Government Consolidated Accounts".

I welcome to the meeting Caroline Gardner, Auditor General for Scotland; Mark Taylor, assistant director at Audit Scotland; and Gordon Smail, senior manager at Audit Scotland.

I invite the Auditor General to make an opening statement before I open up the session to questions.

Caroline Gardner (Auditor General for Scotland): Thank you, convener.

The Scottish Parliament's financial powers are increasing, with new responsibilities coming for taxes and spending. The Government's budget and accounts for 2015-16 reflected for the first time the new tax and borrowing powers that are set out in the Scotland Act 2012. With further powers now flowing from the Scotland Act 2016, our public finances are becoming increasingly complex. Transparency in budgets and financial reporting to support scrutiny and decision making has never been more important.

The consolidated accounts are a central component of the Government's accountability to Parliament and the public. They cover around 90 per cent of the spending that was approved by Parliament in 2015-16: the elements that the Government is directly responsible for. They show the amounts spent against each main budget heading and the reasons for any significant differences. They also show the assets, liabilities and other financial commitments that have been carried forward to future years.

I prepare a section 22 report on the Scottish Government's accounts each year to highlight significant matters that arise from the accounts and to support the committee's scrutiny. That reflects the central role of the accounts and the scale of the change that is now under way.

My report sets out how the consolidated accounts relate to the Scottish budget as a whole and the new powers that are being introduced, and it highlights the main financial management issues for the Government during the year. It is important to state for the record that my independent opinion on the consolidated accounts is unqualified. That means that they provide a true and fair view of the Government's finances.

I would like to highlight three areas from my report, the first of which is financial management and reporting. The Scottish Government managed its budget for 2015-16 within the overall limit set by Parliament, and budget management during the year was effective in managing total spending.

The accounts meet the relevant legal and accounting requirements and I welcome the steps that the Government is taking to improve its accounts, develop commentary on its financial position and explain how other accounts—such as the devolved taxes account prepared by Revenue Scotland—are linked.

As the new powers are introduced, though, there is a lot to do to ensure that the Parliament and the public have the information that they need to fully understand and scrutinise spending priorities and plans, how public money was spent and what was achieved. I am particularly pleased to note the commitment in the permanent secretary's letter to the committee signalling the production of a consolidated public account for audit in spring 2018. We will of course work with the Scottish Government to support this important process.

Secondly, the consolidated accounts contain a performance report, which complies with the principles of the Government reporting requirements. The emphasis is on financial performance against budget, with signposts to where more performance information is available, for example in the national performance framework. There remains scope for the Government to develop its annual reporting to provide a more extensive analysis of its overall performance.

A common theme that comes from my performance audit work is the potential for better alignment of plans and funding with the national performance framework. We also often find that plans for implementing policy and reforming public services lack important measures of progress. More clarity is needed to support Parliament in its scrutiny and accountability role.

Finally, I would like to highlight two specific matters arising from the 2015-16 consolidated accounts: first, the impact of the classification decision by the Office for National Statistics about the Aberdeen western peripheral route on the capital budget and borrowing plans in 2015-16; secondly, the position on the European structural funds programme, which led to a permanent loss of grant to the Scottish Government.

The committee's evidence session on the Government's consolidated accounts is an important milestone in the scrutiny of the Government's finances. My report on the 2015-16 audit is intended to support the process, as well as

support scrutiny of and accountability in the Parliament's work more generally.

The Government has a good record of financial management and reporting, governance arrangements are generally effective and the national performance framework is well established. Together, they form a strong base for the developments that are needed to meet the challenges ahead.

As always, convener, my colleagues and I are happy to answer questions.

The Convener: Thank you very much, Auditor General. The first question is from Alison Harris.

Alison Harris (Central Scotland) (Con): Good morning, Auditor General. This is purely out of interest. I notice that this is an unqualified audit report and that it is true and fair. In your experience, has there ever been any other kind of report?

Caroline Gardner: I think that for the Scottish Government's consolidated accounts, the opinion has been unqualified for the past 11 years. I have been in post for four years so I would be struggling to talk to you about the reasons before that, but clearly it is a long track record.

Alison Harris: It was just out of interest.

I noted what you said relation to performance reporting. My concern is that there does not seem to be an overall picture of the Scottish Government as a whole. How can we monitor and measure progress without that? Are you aware of anything that is coming into place that might help with that?

Caroline Gardner: The point about how we link what the Government spends with what it plans to achieve and what it actually achieves is one of the key messages coming out of my report on the accounts this year.

As I say in the report, the Scottish Government's annual report complies with requirements by having a performance report in it. That report talks mainly about financial performance and then signposts the reader to other sources of information such as the national performance framework. That is a decent starting point but I think that there is scope for bringing the two more closely together.

As an accountant, you will be very aware that the financial performance is only one half of the picture and that you need to tie the two together. We think that there is room to draw out the overall picture by making those links more explicit, particularly the links between the money that is spent and what it is spent on, and the impact on the outcomes that the Government is trying to improve.

Alison Harris: Yes, that is very true.

My other question is about the European funding. What concerns me is that three out of the four programmes were suspended—sorry, “interrupted” is the correct word to use. In fact, four out of four were interrupted, in the end. Do you have any idea about the implementation of any management control systems to try to avoid errors that have been made in the past and ensure that the Government receives full value from the European Commission projects?

Caroline Gardner: Yes. It is important to say that the problems that were encountered were encountered a bit further down the spending chain in the bodies that were receiving grant funding and spending money on the Government’s behalf. It is clear that the Scottish Government has accountability for the controls that are in place right through the chain. I will ask Mark Taylor to talk you through the action that has been taken.

Mark Taylor (Audit Scotland): As the Auditor General explained, the concerns arose from how the whole system has been managed over time.

The European Commission has been working with the Government to do two things. One is addressing the spending in that period, which is what led to the estimated £14 million loss of grant funding. The other is thinking about what the control system and the controls will be in the future. The Government has put in place plans that it thinks will address the concerns of the Commission. The system allows the auditor—in this case, the auditor is the internal audit service of the Scottish Government—to do some work on that. It has done some work and will continue working to ensure that the improvements that have been put in place in the new control system are the ones that applied in practice.

Alison Harris: Are the new controls now in place?

Mark Taylor: There is a new control system in place, although its effectiveness is still to be tested.

Alison Harris: The controls should certainly be more effective with the new system in place than they were when it was not in place.

Monica Lennon (Central Scotland) (Lab): Like Alison Harris, I have an interest in performance and outcomes. Paragraph 54 of the report talks about

“the potential for greater alignment of resources and actions”.

Will you say a little more about the opportunities to align resources? Does anything in the response that we had from Leslie Evans give you

confidence that the Scottish Government is more on track with that?

Caroline Gardner: In paragraph 54, we mention one example of the link between the Government’s economic strategy and the actions and activities that Scottish Enterprise, Highlands and Islands Enterprise and others undertake. It is not easy to link directly through in order to trace how what the agencies do and how they track their progress is expected to improve the outcomes in the Government’s economic strategy and to trace what changes are being made if things are not moving in the right direction.

An example that might be closer to the committee’s experience is from the national health service and social care. In the report that I published last week, one common theme was that some measures that are used to hold health boards to account on acute service targets and the annual financial targets are not clearly linked to the overall aim of having everybody able to live happier and healthier lives at home or close to home.

The issue is about making links more explicit and recognising that, although outcomes are often long-term changes that might take a generation to have an impact, we need to know in the short term whether we are moving in the right direction. We are looking for interim measures and milestones for where we expect to be across a longer period. The national performance framework is widely recognised as being a really good development, but it will not have the full effect that comes with the knowledge of how outcomes are improving over time until it is fully linked up to the everyday spending plans, strategies and actions that public bodies undertake.

Monica Lennon: Is having more and better indicators an effective way to achieve that? Could we be overloaded by indicators, or is there a balance to be struck?

Caroline Gardner: I recognise the concern behind your question, and a concern in health and social care in the past has been that people have felt overloaded by indicators. For me, the issue is not the quantity of indicators but knowing that we are moving in the right direction and measuring the right things. That has not always been the case—sometimes there has been a gap or a lack of information about whether we are doing what we intend to do.

Mark Taylor: To add to what the Auditor General said, there is an opportunity to set out more of the interim steps and to provide clarity about what pots of money are being used to achieve things in the shorter term in a way that contributes to the desired longer-term outcomes. A bit of clarity is needed about what the milestones

are for any new initiatives and for projects that are in place.

More generally, there is also an opportunity to set out how the money is being spent on services that are being developed, what it is being used for and what the outputs are expected to achieve in a way that contributes to the overall outcomes.

Monica Lennon: From what we are told in annex A to Leslie Evans's response, it looks as though you have welcomed some of the changes. Page 5 says:

"The Scottish Government has made the following improvements to the 'expenditure reporting'"

and

"Other streaming and simplification has been applied to make the accounts more accessible ... These changes have been welcomed by the Auditor General."

Are you able to say what those changes were and whether you are satisfied that it is job done?

09:15

Caroline Gardner: Absolutely. I ask Gordon Smail to talk you through that.

Gordon Smail (Audit Scotland): The accounts form a very large document that covers a lot of ground. The Auditor General said that we noticed this year a step up in the front end of the accounts where they talk about financial performance. There is a lot more description and analysis of the financial position, the performance against budget and key elements of what the accounts contain. We see that as a big improvement, as it helps with the understandability and readability of the accounts. A lot is covered in the accounts and the document is complicated, so that approach is helpful.

The next stage is what we do to link that information to performance, which we have just had a conversation about. Our sense is that the accounts meet the requirements—there is no doubt about that—but the issue is where performance is reflected. There may be scope to say more in the accounts or somewhere else, but we really need the overall picture.

It is worth adding to what colleagues have said that there is a point about the whole system. When the budgets are brought forward, they should say what is intended to happen to the money and how it will be spent, and there should be outturns at the end of the year, whether that is in the accounts or elsewhere, to show how the money was spent in actuality and what was achieved from it.

That answered the question the long way round. The short answer is that there have been improvements, but there is still some way to go.

Monica Lennon: In all countries and Parliaments, politicians throw big numbers around when we are asked about difficult challenges. We say, "Oh, we're spending X amount more" on particular issues. Are there examples of best practice and of Governments doing things better in other countries and jurisdictions? Is there anything that we can learn? Will we ever reach a point at which the public really know whether we are getting value for money and whether life is getting better for people? Is it ever truly possible to learn that from a report?

Caroline Gardner: That is a really good question. We are not saying that this is easy to do right. We have looked at examples from around the world to ensure that we play our part in thinking about what Scotland needs with the new financial powers, and New Zealand has been one of the places that have most impressed us. It aims to take a preventative approach, like that in Scotland, that is focused on outcomes. In many parts of what it does, it has been rigorous about using analysis. For example, in the criminal justice system, it has used analysis to identify which people, families and children are most at risk and are using services most and what would be needed to help to improve their lives in ways that are good for them and which reduce the demands on the criminal justice system, social work and the health service more widely. It uses its budget planning process to move resources around to meet its aims.

New Zealand also does very well with its comprehensive budget information, which aligns programmes with the way in which money is being spent and moved between budget headings. It is transparent in reporting how money has been spent at the end of the year and in monthly accounts that are published to let people see what is happening. That is done in really interesting ways, and that process seems to be much less politicised than those in Scotland and the United Kingdom. I am interested in how New Zealand achieves that. We can learn a lot about comprehensiveness and transparency.

Monica Lennon: That is a helpful reply. Thank you.

Liam Kerr (North East Scotland) (Con): Good morning. The first thing that I will inquire about is paragraph 13 of the report, which says:

"total net expenditure during the year was £33,308 million, £392 million less than budget".

What happens to the underspend? Does it get sent down south in some way or clawed back? Can it be carried over to the following year?

Caroline Gardner: I ask Mark Taylor to talk you through that. I apologise in advance for the fact that the matter is complicated.

Mark Taylor: Exhibit 3 on page 9 is the best exhibit to refer to, as it attempts to answer the question; it also aligns very much with the provisional outturn statement that the Cabinet Secretary for Finance and the Constitution gave to Parliament in June. The challenge is that the consolidated accounts and the budget in Scotland operate to slightly different rules from those that the Treasury budget operates to, so the two need to be reconciled, and we explain how that works in the report.

Exhibit 3 sets out the different elements of the underspend and how they apply at whole-budget level, with an explanation of how each element is—or is not—able to be carried forward. The elements towards the top of page 9 feature in the provisional outturn statement and carry-forwards in relation to net resource departmental expenditure limits and capital DEL. All financial transactions can, in general, be carried forward under the budget rules. Additional money—when the money that is received is greater than expected—from devolved taxes is able to be carried forward, too.

A couple of elements that relate to annually managed expenditure and non-cash DEL cannot be carried forward because of the nature of such expenditure. Those elements do not give the Government any additional spending power; they are technical accounting measures of expenditure. Annually managed expenditure is underwritten by the Treasury, so it does not affect the overall spending power under the current arrangements for devolved government.

We are content that all the underspend that was able to be carried forward has been carried forward through a number of devices. I am happy to dip into some of those.

Liam Kerr: I think that I follow you. A significant element of the £392 million remains available for employment by the Scottish Government. I presume that it can choose how to use the money—the money is not ring fenced in any way, is it? It could be applied to a sector that is crying out for money.

Mark Taylor: There is a degree of ring fencing in the carry-forward. Under the current arrangements, each part of the carry-forward has a label on it and the money must be used for those purposes. Probably the best example of that is from the capital DEL financial transactions carry-forward. I direct you to the figures that are about midway down the table on page 9 in the underspend and overspend column, which show that the underspend was £40 million. The Government has the ability to carry forward that money, but it can use that money only for the purposes of financial transactions, which are loans to help business. There are rules about that. The

Government can to a degree decide to apply different elements of the carry-forward to different things, but elements are ring fenced and the Government needs to manage the spend within the requirements.

Liam Kerr: I understand. If I were to say that there was an extra £392 million available and the Government could apply it to the NHS, for example, would that be too simplistic an analysis?

Mark Taylor: Yes. Furthermore, that analysis would be incorrect, because that would not be able to be done. Another example is from the carry-forward in the reserves. The devolved tax revenues that are carried forward in the cash reserve can be used only for a specific purpose in the next year—to offset any underrecovery of devolved taxes against next year's forecast.

With the introduction of the Scotland reserve from 1 April 2017, there will be much more freedom in how reserves might be used, but there will still be rules for different pots of money and what that money can be used for.

Liam Kerr: I understand. At paragraph 25, you talk about residential land and buildings transaction tax being

"in the lower part of the range forecast ... £27 million less than forecast".

It seems to me—based on purely anecdotal evidence—that, up in the north-east, higher-end sales dropped off after the land and buildings transaction tax came in. Have you identified why there has been a shortfall on what was forecast? Has the extra tax depressed the market?

Caroline Gardner: It is not easy for us to be clear about what has driven changes in the revenues from each devolved tax, and we will have more devolved taxes from April next year. The Scottish Fiscal Commission has published a report on the outturn for 2015-16 against the forecast that the Scottish Government produced and which the commission had endorsed. We can certainly refer you to that readily after the meeting.

It is worth saying that the first year of a new tax is always complicated because we do not necessarily have good information beforehand. The Parliament agreed to the Scottish Government's rates for the tax well in advance of the start of the financial year and there was a late change to respond to measures in the UK Government's budget. A lot was going on in that year, but the Scottish Fiscal Commission has given its best analysis of what was behind the changes in land and buildings transaction tax and the landfill tax for that year. Does Mark Taylor want to add anything?

Mark Taylor: Without getting into the specifics of LBTT and the policy decisions on it, I make the

general comment that what was new last year and will be a feature of the Scottish budget is that there will be higher-level forecasting of taxes, block-grant adjustments and, ultimately, social security expenditure. Inevitably, forecasts are not accurate predictions of exactly what will happen: there will always be a degree of uncertainty. That approach is a shift in the financial management of the public finances in Scotland and it will be a big challenge to manage that.

Forecasts and data can get better. We can do what we can and the Scottish Fiscal Commission will do what it can to make the forecast as accurate as possible, but we will all need to manage and live with the underlying uncertainty of the forecasting process.

Liam Kerr: For my final question, I will stay on page 10 of the report and refer to paragraph 27, which mentions the Aberdeen western peripheral route. I want to understand the issue a little better. Can you explain the reclassification? I perhaps come at this from a significant level of ignorance. I understood that the initial money for the route and for such projects was not part of the public budget and was not on the national balance sheet, but for some reason the route had to be reclassified on to the national balance sheet. The report states that it was an Office for National Statistics decision to reclassify the project, but I have it in my mind that it was something to do with European regulations or procurement rules. Can you clarify that for me, please?

Caroline Gardner: We will do our best. Your understandings are both correct and those aspects are part of the picture. The Government had initially intended that the Aberdeen western peripheral route and a small number of other projects would in effect be off the public sector—the Government's—balance sheet. It thought that the way in which its financing had been structured would allow that. That would have meant that all the project's costs were met from the revenue budget over a period of years and there would be no need for cover from the capital budget to get that project and the others under way.

The ONS is responsible for applying European rules to Government projects across the United Kingdom and for making sure that they are classified correctly as being on or off the public sector balance sheet. The ONS has a programme of projects or initiatives that it reviews and the Aberdeen western peripheral route came up in its 2015-16 programme. Its decision was that that project should be classified as public sector, so it should be on the balance sheet and should require budget cover from the Scottish Government's capital budget. The Government decided that it would be prudent to apply the same approach to a handful of other projects, which we list in the

report. That led to a fairly significant call on the Government's capital allocation for 2015-16 that it had not initially expected. We set that out in the report but, as you said, the picture is complicated.

Liam Kerr: So the Government had to find an extra £392 million that it had not budgeted for.

Caroline Gardner: I ask Gordon Smail to reply to keep me right on the figures, but the principle is correct.

Gordon Smail: That is absolutely correct. It is worth stepping back a stage in response to your question. You are right that there is a recognised system across Europe for how countries deal with matters in national accounts—it is statistical rather than based on international financial reporting standards, so that is a difference and another complication. A consequence of that system rolled down and affected the classification of the Aberdeen western peripheral route.

You are right that the Government was faced with a fairly significant task in changing its plans for capital spending and borrowing. It had to accommodate the additional charge against its budget in-year, which it did successfully, as we say in the report. The consequence of that affected the year that we are talking about—2015-16—and there will also be an effect in the current financial year.

The effect on budgets is shown by some of the things that we highlight in the report, such as reprofiling—stopping doing some things then spending further down the line. As we say, the Scottish Government successfully managed that in 2015-16.

09:30

Liam Kerr: I presume that it is a complete coincidence that the figure of £392 million is the same as the underspend that we looked at.

Gordon Smail: Absolutely.

Liam Kerr: Could the reclassification from off balance sheet to on balance sheet have been foreseen? At the planning stage, when the risk register or some such was being put together, did no one think that that could happen?

Gordon Smail: First, I make it absolutely clear that the accounting in the Scottish Government accounts that we are considering today complies with all the requirements. It has been done properly.

Such transactions are complicated. When the rules change—I mentioned that the European statistical rules changed—that has to come through, which means an intense and technical assessment of individual projects. As the Auditor General said, the ONS publishes a programme of

things that it will look at and measure against the statistical rules to see whether national budgets and the like are affected.

The question is difficult to answer. When faced with the issue, the Scottish Government had to react, and it entered negotiations. As I said, there may be no straightforward answer to a lot of this, and there has to be discussion. The issue is all about the balance of control of individual projects and where the risks and responsibilities lie. There are fine judgments in there. As the Auditor General said, the Government decided, on the back of the decision on the Aberdeen western peripheral route, to look at similar projects and plans and get ahead of that. Those other projects have not been assessed yet, but the Government recognised the similarities in the way in which they were put together and applied the same methodology to how those projects roll through into its budget.

A programme of work is involved. There are fine judgments as to whether projects are on or off the balance sheet in terms of the national accounts statistics.

The Convener: On that point, reclassification has happened to colleges and to the peripheral route in Aberdeen. Could the ONS reclassify anything else? Are you confident that the Scottish Government is looking right across the public sector to assess the potential impacts, so that we do not see these losses again?

Gordon Smail: These are actually classifications: the road in Aberdeen was a classification—it was the first time that it had been assessed against the new rules that were coming through the European system of accounts.

The ONS has a programme of work. It looks at various things—for example, more recently it has been looking at whether housing associations are public corporations and what the consequences are of that. The Government will be well aware of the ONS's programme of work and can look at its own relationships with other organisations and with transactions, as we have discussed in relation to some of the capital projects. There are things that the Government can do to adjust the balances between itself and organisations and transactions, which can affect that fine judgment about where things sit. That has consequences in terms of the balance of accountability and control, but that is perhaps for a further conversation.

The short answer is that there is a programme of work and the Government has to deal with things that come up. As Mark Taylor said, this will become more business as usual for the Government—such things will tend to arise in the course of business in the normal way.

The Convener: You are saying that the Government can look at this and has the programme of work to refer to. Are you satisfied that it is assessing the potential impact of any reclassification right across the public sector?

Gordon Smail: If we take the example of the Aberdeen western peripheral route, the Government moved very quickly to look at projects that were structured in a similar way and felt that it would be prudent to apply the same approach to them. The Government will be very aware of what is happening. It will be looking at the ONS's programme of work and trying to anticipate the outcome. As we see in the example in the report, the evidence shows us that there can be a significant impact on capital plans and borrowing. It is really important that the Government keeps on top of that. The committee may want to ask the Government how it keeps an eye on that type of thing.

Caroline Gardner: May I add to that briefly, convener? You mentioned college reclassification in your question. That is slightly different from the capital infrastructure projects that we have been talking about this morning, and indeed from housing associations. In the case of the colleges, the ONS decision was a result of the Government's college reform programme. Again, I think that the Government was aware that there was a risk that it would have that effect, but it was felt that the increase in control and direction that the Government would have would counterbalance the downside, if you like. That was a slightly different case, but it would be worth while to explore the question with the Government.

The Convener: Okay. Thank you.

Colin Beattie (Midlothian North and Musselburgh) (SNP): Auditor General, the report is fairly positive, on the whole. The key issues are the one or two things that we have already discussed. The capital side is certainly a wee bit of a concern. Was the Government right, in view of the ONS reclassifying the Aberdeen western peripheral route, to voluntarily reclassify the other projects?

Caroline Gardner: As Gordon Smail suggested, there is probably not a right or wrong answer. It is a question of judgment and the balance of control in each individual case. The Government felt that it was a prudent approach to take given that the other projects were structured in a very similar way to the Aberdeen western peripheral route. It felt that it was worth taking that approach and taking the early budget hit that that would involve in order to remove any doubt. However, you might want to explore the question with colleagues from the Government later on.

Colin Beattie: I understand that there have been some modifications to the non-profit-distributing model. Will that result in the projects no longer being classified as public sector projects?

Caroline Gardner: My understanding is that the Scottish Futures Trust has been looking at the financing models that it has been developing and the one that was initially put in place for those projects, to make sure that future projects can remain off balance sheet while still achieving the Government's objectives. Because the ONS has not yet done its review, as Mark Taylor highlighted, we do not know what the impact will be on the decision, but there is always that trade-off between Government control and distance that needs to be managed. I think that Mark Taylor would like to add to that.

Mark Taylor: I can give a bit of detail on that. The Government redesigned the arrangements for hub projects, which are another class of project. That might be what you are referring to. By doing that, it was able to lessen the risk of reclassification to the public sector in that set of projects.

The four projects that are set out in the report are standard NPD projects—if there can be such a thing. With the new borrowing powers, the Government now has a range of other options for how it funds capital projects. We are aware that the Government will be looking at how it uses that range of options, and it might be able to talk to you about where it has got to with that.

Colin Beattie: I am particularly interested in the matter because I think that the Newbattle high school project in my constituency has been done under the revised NPD model. I do not know the extent to which Audit Scotland has looked at that model.

Mark Taylor: I am not entirely sure about the status of Newbattle, but I suspect that it will be one of the projects under the new model around hub projects. Our role is not to assess whether that is the right or wrong model or the way in which it works. We have previously made the point that there needs to be a balance between control and direction, which are sometimes needed for good reasons, and the classification that results from that. The trade-off between those things is a judgment for the Government to make.

Colin Beattie: It might be helpful for the committee to understand the new model and how it is composed, if you have information on that. I presume that only one model is currently in use as an alternative.

Caroline Gardner: I think that briefings are available that we can bring to the committee.

Colin Beattie: That would be helpful.

As you said, the capital budget has been affected. In paragraph 30 of your report, you list a few significant things that the Government has sought to do to cover that. I am particularly interested in the second bullet point, which refers to

“re-profiling of loans to Scottish Water”.

What are the implications of that? You say that the loans have been

“delayed until nearer the point when Scottish Water needs this cash funding”.

I hope that, with good management, that would be done anyway.

Caroline Gardner: We will keep an eye on the impact of that on Scottish Water and on the Government's accounts during this year's audit work and in future years. Why the Government thought that it was appropriate to decide to close the budget gap in 2015-16 would be a good question to ask colleagues from the Scottish Government later on.

Colin Beattie: I would like to know a little bit more about the reprofiling of loans. That implies a bit more than just managing more tightly when the draw-downs take place.

Caroline Gardner: Absolutely. The relationship between the Government and Scottish Water is complex and important, given the scale and importance of Scottish Water's capital investment programme. We are looking at that quite closely. Mark Taylor may want to add details about that, but we would need to come back to the committee on the overall impact in future years. The decision was taken in 2015-16.

Mark Taylor: I will add a little detail.

There is a multi-year commitment to funding for Scottish Water within which there is a degree of discretion for the Government on the years in which funding is provided. That links to how fast the work is going and when Scottish Water's requirement is, of course. The Government can consider when, in its best judgment, those funds should be applied in conversation with Scottish Water. One of the opportunities that it took in closing the gap that arose from the ONS classification, which we have explained, was to think about the exact timing of some of that funding and in which year it should be applied to ensure that that married up with Scottish Water's needs.

Colin Beattie: The fourth bullet point in paragraph 30 mentions

“postponement of uncommitted grants and lower than forecast expenditure on demand-led capital funding schemes”.

You gave examples of portfolios, but what about the type of projects that are being affected? Does “uncommitted grants” just mean grants that have not been drawn down?

Caroline Gardner: It is more than not having been drawn down—they have not been committed. People have not applied and been approved for grants, so the money is still available for use. In that case, a decision was taken to reallocate it.

Colin Beattie: So the Government did not just whip the money away from projects.

Caroline Gardner: It reallocated money from a portfolio or policy area, but not from people who already had commitments that entitled them to grants. Therefore, it was able to spend the money.

Colin Beattie: Okay. So nobody was deprived of money as such. No projects were stopped because of that.

Gordon Smail: My understanding is that some of those projects were demand led. Therefore, it is about a lack of people coming forward to take up grants that were available. As the Auditor General said, there is an element of that alongside the demand-led element. There are different aspects to the matter.

Colin Beattie: What does that cover? Does it cover housing?

Gordon Smail: Yes. Part of the portfolio is housing—one element involved applications from people for affordable housing.

Colin Beattie: Were housing associations an element?

Gordon Smail: I do not know. The Government has schemes in which money that is provided scores against the capital budget. On the capacity that it was able to generate to meet the ONS challenge, it could absorb that through fewer people coming forward for elements of the grants that were available. Beyond that, I do not have any details on the individual grants.

Alex Neil (Airdrie and Shotts) (SNP): I want to change tack a wee bit and ask more about the revenue side than the expenditure side. Obviously, this is the first year of our moving into a situation in which the Parliament will have more significant tax-raising powers—as the Auditor General said, they will increase next year.

I want to explore the role of the Scottish Fiscal Commission a wee bit. I caveat and qualify my comments by saying right away that I fully understand the difficulties and challenges of trying to accurately forecast Government revenue for next month, never mind next year or the next two or three years.

09:45

I have two questions. The Office for Budget Responsibility has not always got it right, to say the least, whereas New Zealand, which you mentioned, has a very robust Fiscal Commission-type set-up. The forecasts for LBTT and the landfill tax were underestimated by around 13 per cent. Is 13 per cent within acceptable parameters, or would you expect a more accurate level of forecasting—plus or minus—as time goes on and expertise increases?

If I were still in government and a spending minister discussing proposed cuts, I would be asking myself whether the finance minister was deliberately underestimating his revenue and squirreling away the difference in the new reserve account for a rainy day. Is the Fiscal Commission genuinely independent? What resources are available to it? Does it have an independent view of the Scottish economy, or does it just extrapolate from the OBR's forecast, which is based on the UK Treasury model of the UK economy? It seems to me that the Fiscal Commission will play a fairly pivotal role in the management of Scotland's public finances. I am trying to get an understanding of all that, including the extent to which you, as the Auditor General, examine the robustness of the Fiscal Commission's deliberations.

Caroline Gardner: There was an awful lot in that question, Mr Neil, but I will ask colleagues to come in and we will do our best to ensure that we have covered as much of it as we can. I am sure that you will understand that there are also some bits in there that we cannot cover.

First, I agree whole-heartedly that the question of forecasting taxes will become central to the Scottish Government's budget in ways that it has not been in the past. Over a very short period of time, we are moving from a situation in which about 10 per cent of the money spent in Scotland by the Scottish Government is raised in Scotland, mainly through council tax and non-domestic rates, to a situation in which—when the Scotland Act 2016 powers are fully in place—about 52 per cent of the money will be raised here from a range of different taxes. The tax forecast and the block grant adjustments will bring variability and volatility that will need to be managed.

The forecast will be key to providing some stability to Scotland's public finances but, as Mark Taylor said in response to an earlier question, there is no such thing as a correct forecast. We know that from experience across the UK and globally, particularly in times of uncertainty such as those that we are living in at the moment.

Last year's tax forecasts were endorsed by the Scottish Fiscal Commission. There is no doubt in

my mind that there is complexity in the first year of a new tax. We are still uncovering areas in which we do not have good enough Scotland-specific data on what has happened over a period of time and what might happen in future. There was an element of that in relation to the two devolved taxes last year.

We also saw some uncertainty or, rather, we saw the behavioural effects that were produced by the way in which the taxes were announced, with a relatively early Scottish budget, in comparison with the UK budget, which allowed some forestalling to happen, a later move in the UK budget and a response by the Scottish Government. All of that produced some changes to the assumptions that had been used by the Government and endorsed by the Fiscal Commission in its original forecasts. The position should improve over time—we will develop better data; indeed, we will need better data on things such as VAT in Scotland when the Scotland Act 2016 comes into effect. I am sure that the same will be true of Scottish taxpayers in relation to the Scottish rate of income tax: there will be behavioural effects and the effects of political decision making that are hard to foresee now.

You asked about the finance secretary's use of the budget reserve—it is currently the budget exchange mechanism, but from next year it will be the budget reserve. As Mark Taylor said, the budget exchange mechanism has constraints on its use at the moment. Funding that is put into it because of higher-than-expected revenues from devolved taxes can only be used to make up shortfalls in those same devolved tax revenues in future years. From April 2017, when we move to the budget reserve, there will be a degree more flexibility—instead of having the limitation on how the funds are used, there will be a cap on the total amount that can be carried forward.

Mark Taylor might want to add to that, but my point is that that volatility needs to be managed and that there is a need for much more clarity and transparency about the way in which those streams interact to help Parliament make good decisions and scrutinise the Government's performance, and to help people across Scotland have their say on what matters to them.

Mark Taylor: Alex Neil asked about the Fiscal Commission's independence, establishment and resourcing. The issue was subject to a great deal of consideration by the previous Finance Committee. We very much recognise the importance of that independence and unbiased forecasting, and we think that the proposed way in which the Fiscal Commission is to be established will give it the basis for operating in an independent manner. We expect it to operate fully

independently and robustly with regard to the forecasts that it makes.

It is also worth mentioning that there will increasingly be an opportunity for independent commentators to comment on some of the forecasts; indeed, we are beginning to see that already, and there is an opportunity to benchmark some of that as well as benchmarking how the machinery of Government works. It is not our role to second-guess forecasts or to look at the detail of forecasting methodology but, as part of our continuing range of work, we will look at the governance of all those bodies and how effectively they operate within the overall system.

Alex Neil: Given how important the Fiscal Commission will be, it might be useful for the committee to get a presentation from it, perhaps some time in the new year. We need a detailed understanding of all aspects of this.

I want to mine the issue of the new reserve a bit deeper. Is there any limitation on how much can go into it? Obviously, the current arrangements limit how much can be carried forward as spend for the following year, but what are the limitations on and the basic rules for the reserve?

Mark Taylor: You are testing my knowledge of the detail, which we will be happy to provide. Broadly speaking, however, there is a limit on how much can be put in and taken out in individual years and how much can be held in total.

Alex Neil: Can you tell us what those limits are?

Mark Taylor: We will come back to you with the detail. From memory, however, I think that the overall limit is £700 million. The Government might be able to confirm that today, but we will come back with the detail.

Alex Neil: Okay. What happens if, say, there is an underestimate of revenue to the tune of 13 per cent, as there was last year, and you are already up to £690 million from the reserve? After all, you are not really sure until the end of the tax year what your final tax take will be; it is some time after the end of the financial year before you know the final figure. How is all that reconciled?

Caroline Gardner: I am going to help Mark Taylor out here. His memory was very good, but we can complete the picture for you, Mr Neil. You might recall that, at the beginning of the current parliamentary session, we published a short briefing paper on Scotland's new financial powers in which we aimed to set out some of those questions. The reserve has an annual limit of £350 million going into it, with, as Mark Taylor has said, an overall limit of £700 million.

You are right that, in the theoretical situation in which the reserve was butting up against the £700 million, there would be a limit on how much more

could go in during that financial year. That is why the ability to strategically manage the Government's finances and to see the whole picture—what is happening with the revenue budget, the tax receipts that are coming in and the capital spend—is so important. The Government would not want to end up with an underspend—

Alex Neil: And then lose it.

Caroline Gardner: —if a chunk of it could not be put into the reserve. That is why we think that the big picture is so important.

Alex Neil: As I understand it, the new Scottish reserve has three elements, including any excess tax revenue—if I can put it that way—beyond what had been forecast. I suppose that the finance minister is not obliged to put it into the reserve and can use it for additional spend, but for the purposes of this discussion let us assume that the Government plays a prudent game and puts it into the reserve. Am I right in thinking that it can put into the reserve that excess revenue, any revenue underspend and any capital underspend?

Caroline Gardner: I think so, but we need to confirm that.

Alex Neil: Those are the three elements.

Caroline Gardner: Yes.

Alex Neil: When you want to spend the money in the reserve, if you have put X amount of capital underspend into the reserve, can you spend that money only on capital? Is it the same with the revenue side?

That is question number 1. Question number 2 relates to the reserve's excess tax element, if I can call it that for the purposes of this discussion. Can that be spent on either capital or revenue, or not?

Caroline Gardner: You are helping us to demonstrate successfully the complexity of the matter. Mark Taylor can answer your two specific questions.

Mark Taylor: There are two parts to the answer. First, the detail of how the new reserve will work in practice is still being worked out between the Treasury and the Scottish Government. The principle is that the range of new powers will give the Government much more flexibility in managing the whole picture. The reserve is one element, and borrowing powers are another. One of the big issues in the future will be the way in which those two elements work together.

The Auditor General made the point that the Government needs to take a well-thought-through, principles-based strategic approach to managing the risk and complexity around all that as it moves forward.

Alex Neil: It is obviously a moving-the-goalposts situation until we get the final detail.

Mark Taylor: We are all in a situation in which, as we go on, more decisions are made and more things become clear.

Alex Neil: I have one simple and straightforward question that is not really related to what I have just asked about. Does the 5 per cent rule still apply, whereby no more than 5 per cent of revenue can be used to support borrowing, public-private partnership or non-profit distributing type projects?

Caroline Gardner: That is very much a question for the Government. The 5 per cent rule is not a rule in the same way as the elements of the fiscal framework are. The Government made a commitment that it would keep the revenue consequences of capital investment that is made through approaches such as the NPD model to no more than 5 per cent of the DEL budget. As far as I know, it is not contained in the fiscal framework. The Government might still want to take a prudent approach to managing its budget in the longer term, but its current position on the commitment is a question for the Government.

Alex Neil: It is not a statutory requirement but a Treasury understanding, basically.

Caroline Gardner: It is straightforwardly a Scottish Government commitment.

Alex Neil: Okay—thank you.

The Convener: Auditor General, the underspend in education immediately struck me as quite large. There has been so much debate recently on education, which has the largest departmental underspend at £196 million. The Auditor General explained that that is due to a technical accounting adjustment relating to student loans. Does that account for the whole underspend?

Caroline Gardner: My colleague Gordon Smail will give you the details, but you are right: the bulk of the underspend relates to the way in which the value of the student loans book is calculated each year, and it depends on the likely repayment levels from it.

Gordon Smail: That is the short answer. Within that, approximately £82 million relates to the reassessment of the student loan book and the complicated methodology that is used to value the total amount of student loans that are outstanding to the Government. That makes up a large element.

The accounts themselves give more detail on the differences in budgets in the portfolio, but that is the bulk. I do not have any other detail to hand.

The Convener: I am sorry but did you say that £82 million can be accounted for by the student loan adjustment?

Gordon Smail: Yes, that is right.

The Convener: So we are still talking about an underspend of £110 million in education.

Gordon Smail: That is right. The Auditor General may have the accounts.

Caroline Gardner: We are doing a team job between us, convener.

The accounts break it down into more detail. Of the total, as Gordon Smail said, £82 million relates specifically to the loan book. The other significant figures include the Scottish Further and Higher Education Funding Council at £46 million and learning at £30 million. The committee might want to explore the detail of that with the witnesses in the next part of today's meeting.

There are notes in the accounts as well—Mark Taylor will pick that up for you as we play team-tag here.

Mark Taylor: The accounts explain significant variances in detail. Pages 68 and 69 of the accounts set out some of the detail of the other reasons behind the education position; I am sure that the Government will be able to talk the committee through some of that.

The Convener: Okay, but you said that £46 million comes from Scottish funding council underspend and £30 million comes from learning.

Mark Taylor: The big figures that I have in front of me are the £30 million underspend on learning, the £13 million underspend on children and families, £87 million on higher education student support, which is the student loans issue that Gordon Smail described, and £46 million on the Scottish Further and Higher Education Funding Council.

The Convener: That is quite significant for a department, is it not?

10:00

Caroline Gardner: They are obviously big numbers in absolute terms. Our starting point is that all Government spending is intended to achieve positive outcomes for the people of Scotland, so the figures are significant in that sense. On the other hand, in the context of a budget of approximately £4 billion, the figures are relatively small. It is important for us to keep that proportion in mind. It is one of the largest underspend areas in the budget, but each of the numbers is relatively small. It will be worth exploring that with colleagues in the next part of the meeting.

The Convener: Thank you. On the figures in appendix 1 on page 22, I know that pension pots are difficult to predict but, just out of interest, do you know why there is a £23 million underspend on the teachers' and NHS pension schemes? Is that a regular occurrence?

Gordon Smail: I do not have the direct answer to that. Again, I think that it is worth looking at the figures for the NHS and teachers' schemes, which are the big ones, in the context of the overall spend. Further, we are looking today at the consolidated accounts, which are separate from the schemes' accounts and cover a range of work. It is worth reflecting on the fact that there are many underpinning sets of accounts, including separate accounts for each of the major pension funds—that might give more insight. However, in the context of a budget of more than £3 billion, £23 million is a relatively small amount, particularly in the pensions area.

The Convener: Previous parliamentary audit committees have called on the Scottish Government to produce accounts that would cover the whole public sector. For the benefit of the new members on this committee, Auditor General, can you explain the practical benefits of producing whole public sector accounts?

Caroline Gardner: Absolutely. I know that committee members are always looking for additions to their reading load, given their commitment to the committee's work.

The Convener: Always. [*Laughter.*]

Caroline Gardner: I commend to you a report that we published back in 2013 called "Developing financial reporting in Scotland", which was our starting point for why we think that this issue matters. In brief terms, against the backdrop of the greater volatility and greater opportunities and risks that the new financial powers bring to the budget of the Scottish Government and the Parliament's role in approving the budget and then scrutinising at the end of the year how it has been spent, we think that there is room for bringing together the whole public sector into one place to give an overall picture.

One example of why that is so important is the fact that those financial statements would include a balance sheet—a statement of the financial position—that would go beyond what the committee has in front of it today to include the pensions liabilities of local government and all the other public sector pension schemes, and give an overall picture of the liability and how it is changing over time. It would also give a picture of total borrowing across the Scottish public sector, with the Scottish Government's new borrowing powers, as well as the borrowing that local government has been able to do over a number of years now.

Again, it would give the committee a picture of how that is changing and where the risks and opportunities might be: either to invest more in Scotland's infrastructure or to recognise that there might be risks in an environment in which interest rates start to rise again after a long period of low rates.

That is just one example of why we think that it is so important to have accounts for the whole public sector. They would bring the whole picture together so that Parliament and people across Scotland would have in one place a single picture of what Scotland's public finances look like. It is worth noting that we have whole government accounts at the UK level, and they include Scottish information, but we do not have the national picture for Scotland itself; it is time that we did.

The Convener: Okay. Thank you. My colleagues have touched on performance reporting; I have a question on that. What is your view of the Scottish Government's written submission, which sets out its plans to develop financial and performance reporting?

Caroline Gardner: I very much welcome the commitments that are set out in the permanent secretary's letter to the committee—we feel that it covers the right areas. As always, it is often not until we start to see prototypes and examples of how they work in practice that we see how they will fulfil the needs of Parliament and people more widely who have an interest. We are committed to working closely with colleagues in the Government and to giving our views as they develop. However, I will reserve opinion on how well what I think is needed is fulfilled until we have something slightly more worked out than the commitments in the letter.

The Convener: I have asked you previously about the preventative agenda. Given what the Government has set out, do you think that the Government is likely give us the information that we need in order to work out whether the preventative agenda and spend on it are working?

Caroline Gardner: It is very much a question of how that is done. The areas that are covered could well cover the areas that would enable the committee to get that picture. As I described in response to an earlier question, more information is available in the New Zealand process about what prevention means in specific portfolios, and there is even more information available in relation to specific groups of people and communities.

As I said in my report—it is a recommendation—there is room for more development in Scotland on the link between a commitment to improving an outcome, the particular strategies and plans that are in place and how money follows them. What the permanent secretary sets out in her letter

could achieve that. I would like to see more development in practice.

The Convener: We will have to wait and see how it goes.

Caroline Gardner: I am afraid so.

The Convener: Okay. Thank you.

My biggest concern in the report is paragraph 76, which indicates that there is

“a permanent loss of grant”

of £14 million

“to the Scottish Government which it cannot now recover.”

Can you comment on that, please?

Caroline Gardner: Gordon Smail is best placed to talk you through what is behind that £14 million figure.

Gordon Smail: The report describes the process that has happened in terms of “suspensions and interruptions” in individual programmes. In normal circumstances, if problems emerge in a programme that runs for six or seven years, the Government—this applies across the whole of Europe—can withhold some of the claim that projects are making but recycle it, as we have described it. In other words, if it is agreed that there have been problems and that they will be put right, the money can then, over time, be made available again for other projects.

The problem that is indicated in paragraph 76 is that the period for the accounting scheme that has been referred to ended in 2013. The programmes are complicated and take a long time to conclude. It is worth noting that the final accounting for the 2007 to 2013 programme will not happen until spring next year. At that point, a line will be drawn right across the whole programme and we will then know the whole position.

However, with regard to what paragraph 76 indicates about what the Government did to get the suspensions lifted, it meant in a practical sense that the money could start flowing from Europe to—in this case—Scotland. The correction to the previous claims for eligible expenditure was accepted by Europe and the suspensions were lifted, therefore the funds could start flowing again into Scotland. However, because of where we are with the 2007 to 2013 programme, there is no opportunity to recycle money and therefore the accounting reflects that likely permanent loss of £14 million grant.

The Convener: The suspensions are because there are problems here in Scotland.

Gordon Smail: Yes—absolutely.

The Convener: Why are there problems here in Scotland?

Gordon Smail: The suspension or interruption process that the European Commission puts in place is to protect European money; it is to ensure that the money that Europe wants to spend on the projects is used for the intended purposes. There is a sequence of events involving the Scottish Government and partners including councils and the individual projects in communities—for example, infrastructure projects or projects that help people back into work. If problems emerge, such as audit trails not being kept on how money has been spent, audit trails not being as good as they should be or rules around procurement not being followed, that leads to what the audit process calls errors. The errors are then looked at on a sample basis across the population, which leads—in this case—to the European Commission suspending the projects until things are put right.

It is a complicated process, but I hope that that explanation gives some sense of its key elements.

The Convener: It does. You talked about a chain of places where an error could occur, from the Scottish Government right down to local authority grant funding. Is there a pattern of where the errors are occurring? I am concerned about that. Communities like mine in Dundee receive structural funds; other members represent communities around the country that could have lost some of that money from Europe. Do we know where the errors are occurring?

Gordon Smail: The errors will be identified through audit sampling of individual projects, but I do not have the detail of that. What is important, though, is the effect on the programme overall. Ultimately, the responsibility rests with the Scottish Government, in the technical sense that it is the what is called the managing authority for the project. The Scottish Government is therefore responsible for dealing with any errors in the system and, indeed, the financial risks.

Caroline Gardner: You are absolutely right to ask the question, convener. To summarise what we are saying here—it is a complex picture—the money, on the whole, will have been spent for the benefit of communities. The problem is that the Scottish Government is not able to recover £14 million of the total budget that was available, so that money is not available for other purposes across the Scottish budget.

The Convener: Yes, but the issue is not new. “The 2010/11 audit of the Scottish Government Consolidated Accounts” said:

“a loss of European funding to Scotland ... arose because Scottish Government procedures at the time did not meet the standards required to ensure the use of funds complied fully with EU legislation.”

That was six years ago. Are you saying that there has been no improvement since then?

Caroline Gardner: I do not think that we are saying that. There was certainly mention of the matter in the 2010-11 audit report. You will forgive my being unable to comment in more detail on that. I was not Auditor General—actually, I was not even in Scotland—at the time.

We are seeing in the 2015-16 report specific problems that were identified through the audit process with the projects that were in place at that time. As Gordon Smail said, the Government has been working with the European Union to make sure that the controls that are in place for the next project from 2014 to 2020 are robust and will meet the European Union's requirements.

The failings have led to a loss of grant of £14 million in 2015-16 for the previous programme up to 2013. I would not say that there has been no improvement, but problems were identified in 2015-16 relating to the previous programme.

The Convener: There has certainly not been sufficient improvement such that we have managed to resolve the issue and ensure that we receive all the money that has been allocated to us by the EU. Are there long-term institutional weaknesses with how the Scottish Government deals with EU funding?

Caroline Gardner: I will ask colleagues to come in in a moment, if I may. Your characterisation of there being quite a long chain is accurate, and there are always risks in that. The Government is intentionally passing European funding through to what are often quite small community organisations, which spend the funding on important community-based projects involving people who are not used to complying with significant audit requirements. That is not an excuse: it reflects the issue's being not as straightforward as it appears on the face of it. Gordon—would you like to add to that?

Gordon Smail: No. I think that your response covers the matter.

The important point is about the Government having in place the right management processes and making sure that those are enforced down through the system. We have described it as a complicated chain of events. When there are problems in individual projects that manifest themselves up through the system through suspensions and interruptions, ultimately, the buck stops with the Government; the Government has to deal with the financial consequences of that.

The Convener: I do not want to go into too much detail on this, but there are huge problems with how the Scottish Government delivers and implements the common agricultural policy. We are seeing the money disappear through structural funds. Does the Scottish Government have a problem dealing with EU funding?

Caroline Gardner: The two issues are quite separate.

The Convener: Okay.

Caroline Gardner: We are seeing a specific problem with controls at local level that has led to the Government being unable to recover the £14 million grant.

The Convener: Okay. I thank the panellists very much indeed for their evidence this morning. I suspend the meeting for a comfort break.

10:13

Meeting suspended.

10:19

On resuming—

The Convener: I welcome from the Scottish Government Leslie Evans, permanent secretary; Alyson Stafford, director general finance; Aileen Wright, deputy director, finance; Nicola Richards, director of people; and Anne Moises, chief information officer. I welcome you all to the meeting. Before I open it up to questions, I ask the permanent secretary to make an opening statement.

Leslie Evans (Scottish Government): I do not have very much to say, convener, except that it is important to recognise that, as I am sure you will have heard in your previous discussions, we are in a very special moment in financial and fiscal terms and particularly in how we explain and account for what we spend and earn. Over the next few years, the balance of funding and income for the Scottish Government will be changing consistently from a tax base of around 12 per cent in 2015-16 to something nearer two thirds of our income by 2019-20. As a result, much of what we might want to concentrate on this morning relates to how we are preparing the Government for that kind of landscape, both institutionally and in terms of our practices, our reporting and the information that we share with you, with Parliament and with the people of Scotland.

The Convener: Thank you very much indeed. I open it up to questions from members. Would you like to kick off, Monica?

Monica Lennon: I am happy to, convener.

Good morning, panel. In the previous evidence session with the Auditor General and her team, we talked a lot about performance and having a sense of outcomes. I think that you have covered quite a lot of that in your response, and I have asked the Auditor General about the matter, but I wonder whether you can give us more of an update. You mention in your response the new governance

arrangements that went live at the beginning of October. I accept that it is only November—

Leslie Evans: Indeed.

Monica Lennon: —but can you give us an update on that and on how things are going?

Leslie Evans: I can give you an update on those two elements which, although linked, are also distinct.

With regard to performance, we have been looking at refreshing the national performance framework and its 16 outcomes, which you will be familiar with, and updating it in the context of the Government's other focuses and ambitions. For example, we have been looking at introducing new material on fair work, biodiversity and the environment, and the place of communities.

Aside from that very specific work on the national performance framework, something that is just as important in this context is a particular board, which I asked Alyson Stafford to take over last year and refresh this year, that is looking at the performance of and priorities for the whole of the Scottish Government, how the outcomes are explained and the milestones for achieving those outcomes. With each director in the Scottish Government who has a responsibility for a national performance outcome, Alyson Stafford has been looking at the lines of accountability, the budget and the specific projects and actions that are leading to progress, which, as you know, is monitored on the Scotland performs website. The draft budget will also contain information on how each of the 16 outcome measures is being articulated and what is contributing to them, and Alyson Stafford might want to say a little bit more about that, too. A lot of work is being carried out on actual performance reporting and how we measure long-term outcomes through the inputs and efforts that we are making day to day and week to week.

Another issue that I am sure has come up in your discussions is how we ensure that all of this work sits alongside the set of accounts, which is highly technical, and how we make the two elements as real as possible. We are taking some steps to explain to the wider public as well as Parliament how these two things interact and the cause and effect aspects. Again, Alyson Stafford might want to say a little bit more about that.

On the governance side of things, when I first became permanent secretary, I instigated a fresh look at our governance arrangements. I did so for a couple of reasons. First, it is just good practice; indeed, the Cabinet Office down south recommend that such a look be taken every five years or so, which is roughly the period of time since they were last looked at. Secondly, I am acutely aware of the future for the Scottish

Government; the challenges and opportunities presented by the new powers, some but by no means all of which relate to tax; and a whole range of other external contexts and factors, some of which we have heard about and have been experiencing in recent weeks and, indeed, days. Governments cannot stand still, and we need to ensure that our governance arrangements operate with due transparency; aid clear decision making and make it effective; and allow us to be clear about performance and direction. I can, if you wish, say a little bit more about the changes that I have introduced.

Monica Lennon: I would be interested to get an understanding of the different options that are available to Government in terms of indicators and milestones. I touched on that with the Auditor General. There is a sense that there may be a lack of indicators, but having the right indicators is as important as the quantity. I am sure that there is a menu of different options. What are some of those options and which ones are preferable?

Leslie Evans: As you know, the national performance framework is now enshrined in law, and Scotland is in a very special position, being a leader in the area. We are the first Government to introduce a wholly outcomes-focused approach, and others are following us. Just last week, I was in Northern Ireland, which is drawing on our model in developing an outcomes approach although, interestingly, it is looking slightly differently at how it uses indicators and measures to show people the long-term outcomes—they are usually long term—as well as how it is progressing and what is helping it to move along that route.

At present, we are looking at the accountabilities in particular areas. For example, we have done some great work in justice, where the justice strategy lays out clearly the specific strands of work that will contribute to the outcomes that have justice implications, and indeed those that will contribute to other outcomes that we would not call justice outcomes but which are still important. For example, there is a justice element to children having happy and healthy lives.

That model works very well and we are encouraging other parts of the organisation—Alyson Stafford is working on this with directors—to see whether it or another model might enable us to have a consistent approach and to share that information at the right times during the year, including as part of the draft budget. The information that you will see in the draft budget in a few weeks' time will include an increased element on all of the 16 outcomes.

Alyson Stafford (Scottish Government): There is a model here, and we can make sure that we provide it if the committee wants to see it. Last year, the material that was provided alongside the

draft budget included not only a trail of indicators—the trend material that is really important—but also some explanation of the connections between the outcomes in the national performance framework and the activities that take place and how that links to the budgets.

Providing money is not the only thing that a Government can do to ensure that an outcome is delivered. There is a broad range of things. For example, if we look at environmental issues, we know that societal issues, public attitudes and changes in technology are important and it is good to be able to see those various contributing factors.

The national performance framework, which is our absolute benchmark, built on the best practice that was available when it was established roughly nine years ago. Next year will be its 10th anniversary. The Community Empowerment (Scotland) Act 2015 said that it would be for the Administration of the day to do a refresh every five years. Over the next few weeks, a dialogue and consultation process will start that will take a good, hard look to ensure that the indicators are fit for purpose for the future. That is very important given the different span of responsibilities that the Parliament as well as the Government will have going forward. We will use Carnegie UK and Oxfam Scotland to engage with people across Scotland—as well as the usual suspects such as those who have academic or technical views—to ensure that we reach out.

One of my observations from working with directors and, in particular, looking at the justice model that was mentioned, is that there can be a huge gap between the overarching outcomes and some of the indicators. It is important to have connectivity into what people have to do differently if we are to see the outcomes that we want to see. The justice work has been about building a community of interest, and that whole-system approach has been one of the major areas. I am pleased that other directors are now seeing that, as a method, how we do these things is as important as what we state as the outcomes and what we want to achieve.

There is particular work around environment, climate change and land reform. That portfolio has produced a draft portfolio-wide basket of outcomes and priorities, and it is working with its communities to ensure that there is a line of sight so that people can see how the changes are really going to make the difference that we want. Also, in education, the national improvement framework has been aligned to the national performance framework.

10:30

Obviously, a number of those things have happened since the election in May and the publication of the programme for government on 3 September. They are providing methods of ensuring that there is a line of sight so that people can see how the ambitions that have been set out, alongside the outcomes, are being developed.

In the draft budget, for which we have a publication date of 15 December, the material that you will have seen last year will go a stage further and will pull in the roles and activities of public bodies. Obviously, the budget was designed around what is in the scope of the Scottish Government but, as I have just said, we all know that things are delivered through arm's-length bodies, community groups and a range of other contributors to make a difference in Scotland. There will be further development of that in the draft budget in December.

I hope that that answers some of the points that you raised.

Monica Lennon: It was helpful. I know that your team has been working hard, and I see in your letter that Scottish Government directors met over the summer. There has obviously been a lot of discussion and thinking about the issue. During those discussions, can directors and senior managers point to policies and initiatives that are not working as well as they should or are not as effective in contributing to outcomes as ministers, or indeed the public, might expect? I am quite new to the committee, but we have looked at a number of Audit Scotland reports, and it is sometimes difficult to know where the weak points are—or sometimes we know that, but the policy does not appear to have been revisited. From your discussions in recent months, has anything jumped out that needs to be looked at again?

Leslie Evans: In general terms, the role of directors and those who work with and support them, particularly analysts and statisticians, is to ensure that we continue to pursue evidence-based policy. That is an important part of their responsibilities. Policies should not come into being without a clear understanding of what their impact is likely to be and the evidence that shows the timing of the impact over a period of months or years, depending on the ambition of the policy.

It must be borne in mind that we often end up testing policies—the word “pilot” is used frequently in the public sector—and those tests are usually done with very good reason, which is that we think that we have evidence as to why something is going to work. The evidence may tell us that something will work, but that might not follow through to how it is implemented, how people respond to it and how it interacts with what I call

the real world. Therefore, we have to constantly scan and see whether, although the evidence shows rationally that a policy will work, there are issues with implementation, the behaviours that it is producing or unintended consequences. Directors and the policy colleagues with whom they work always attend to and look at that dial. Therefore, nothing is set in stone. It is part of good policy making to ensure that decisions and the impact of policies at arm's length in the real world are constantly monitored and checked to see whether they work.

Monica Lennon: I appreciate that general picture, but are there any examples, from all that monitoring and evaluation, of policies that are not working as effectively as they should be, or is everything brilliant?

Leslie Evans: I will endeavour to come back to you with some examples—I cannot think of any at the moment. I can think of examples from my time in policy making where shifts have been made and emphases have been changed. Actually, I can think of an example from justice that might illustrate the position. Years ago, around the time when we were taking our first baby steps on outcomes, we had a group of people who were working as part of the justice system and doing their best to make that system work. The issue was the interaction and cause and effect between the parts of the justice system. That was the issue that we needed to address and to make sure that we were pursuing in the leadership of the relevant organisations. We wanted those people to work together in such a way that they saw themselves as part of a whole system. Although that is not a policy per se, it is quite an important element of how we introduce change to achieve outcomes. It involves getting people round a table metaphorically and in reality, and getting them to say, “If I do this in my part of the system, what difference will it make to your part of the system and to the public that we're all serving?”

I will come back to you with an example or two once I have had a bit more time to think.

Monica Lennon: I would appreciate that.

I am mindful that some of the points that the Auditor General raised in her report have been accepted and addressed in your letter to the committee, but I am aware that it was highlighted in last year's report by the Auditor General that there was still scope for the Government to develop and improve on its annual reporting. You said in your opening remarks that, with more powers coming to the Scottish Parliament, there is an issue around readiness. Given that some that improvements have been identified that you are working towards and that additional powers are coming to the Parliament, can you give us an

update on how well the Government is prepared and where we need to get to?

Leslie Evans: Sure. I will ask Alyson Stafford to come in on that. The main issue from our point of view is the institutional landscape and readiness that we have already put in place. You will be aware of the Scottish Fiscal Commission; we are also doing other work to ensure that our budget reporting is as timely and as full as it needs to be.

On finance reporting per se, some of the activity that Alyson Stafford mentioned has enhanced and will continue to develop the details of what we share and to make connections between new parts of our responsibilities. For example, Revenue Scotland will produce a report on the taxes that it has gathered over the past year, and we will make cross-references to that so that we do not see the issue in isolation from other parts of the finance estate.

We can make the accounts more streamlined, more accessible and simpler, but they will always be a highly technical document. The committee will know better than I do that accounts are always highly technical documents. From our point of view, the important thing is that we ensure not only that we do what we can to make them accessible and simple but that the surrounding suite of documentation or references connects to those accounts to make them more transparent and easier to navigate.

The information that Alyson Stafford referred to that will accompany the draft budget, which come out before the end of the financial year, should give some hot facts and figures and provide some clarity. That information should be easier to navigate and a bit less technical in nature than the accounts, which will always be subject to certain constraints and compliance issues and will never make the best bedtime reading. It will become more important for us to be outward facing and accountable to the public on the kinds of facts and figures that they need to know.

Alison Harris: I will take Monica Lennon's point slightly further. Transparency is vital as we go forward. What is being done to strengthen and sustain transparency? Could you give me some examples, please?

Leslie Evans: The first one is the role of the Scottish Fiscal Commission, which is the body that is responsible for scrutinising and considering our intentions and the targets that we set for creating income through taxation. The commission is another part of the institutional landscape that gives—at arm's length from and independently of the Scottish Government—an assessment of how our tax-raising powers are being executed and whether we are fulfilling our responsibilities in that regard.

As I mentioned, additional material will be provided to the public that will show in a more transparent and obvious way what it is that we are doing, how we are doing it and what those facts and figures tell us. As I said, as part of the draft budget, additional information will be provided about the performance framework. All those things will give people the opportunity to see and understand the connectivity between the new elements of the financial responsibilities that the Government has taken on.

Would you like to add to that, Alyson?

Alyson Stafford: Yes, certainly. As the permanent secretary has said, a broad church of organisations are part of the architecture that supports the greater fiscal responsibility that Scotland has now.

It is important to point out the Scottish consolidated fund, which is where there is an account of all the income that comes to Scotland to be disbursed. We have set out in that a greater exposition of the different income sources that ultimately sit behind the Scottish budget.

A number of players are also producing financial information. We have mentioned Revenue Scotland, and we know that our tax in this financial year involves the Scottish rate of income tax, which will bring into the mix reporting from HM Revenue and Customs, because it collects and administers that tax. HMRC has set out in its published accounts certain elements that refer to the business that it is preparing for in order to administer and collect that tax in Scotland. We expect that it will produce an extract, too, because SRIT will become one of the more material figures. In this year's budget, the figure for income tax that is raised in Scotland is estimated to be £4.9 billion. For next year, because of the changes under the Scotland Act 2016, it will be a much more material figure.

It is important that we continue to bring into focus the transparency that we ourselves will be honouring. We have made a pledge around open government, so that transparency is in with the bricks—it is part of how we will continue to do business. In addition, we all want to see transparency from the other partners who are part of our fiscal responsibility landscape.

What will we see that will be different over the next period? Before we publish the draft budget on 15 December, we will put out a short guide that to assist the general public and, as far as that would be helpful, Parliament as a whole, in understanding what the changing landscape is. It is going to feel very different to us. The importance of sustainable economic growth is part of that, and we will need to link in heavily to the sustainable growth strategy that was published earlier this

year. That is about having inclusive growth here in Scotland.

By 31 December, we will have set out a statement for the outturn report for the whole of the Scottish Administration for the past financial year. At that point, all the accounts that utilise some of the Scottish budget that comes to us will have been set out in the public domain. We will distil that information, put it together and produce it so that Parliament can see it.

In January 2017, we will publish a snapshot of the 2016 position. That will start to pull together, in a more accessible format, information that is in our and all the other bodies' accounts so that you can see what has been changing around the assets, the investments that we have been making and the liabilities. Again, that will be done within the boundaries of the Scottish Administration; local government will not be brought in. However, it will certainly cover all the other areas in the budget.

We can say a little bit more about what our further steps will be, if that would be useful.

Alison Harris: I just wanted to go back to—

The Convener: Excuse me a minute, Alison. I will bring you in to ask the next question. I ask members and those on the panel to keep their questions and answers a bit shorter and sharper, because I want to get through all members' questions, if that is okay.

Alison Harris: You said that you are going to let the public know about the draft budget. Will that be in the form of a brochure that will be posted out to everyone? Did I understand that correctly? Was that what you meant?

Alyson Stafford: It will be an accessible guide. I was not expecting necessarily to post it out to everyone, because of the overhead costs of doing that; rather, the guide will be there for Parliament, and we will put it on our website, so that there is material that people can start to use.

Alison Harris: The only way that people will be able to use the information is if they know to go and look it up. I am asking about this because it is important that people appreciate the huge change that is coming to Scotland. I misunderstood you; I thought that the public were going to be given further information. Instead, it will be up to us—

10:45

Leslie Evans: Sorry, I did not mean to interrupt. I think that the intention is that the information will be made available online. We can do things such as signposting—the Parliament is a huge element in that—to ensure that people are aware that that is where they go to find the information.

Alison Harris: Thank you. That is what I wanted to have clarified.

Liam Kerr: There was a significant underspend on the budget last year, an element of which can be carried forward or spent by the Government. What analysis is done on what the underspend is going to be and when does that analysis happen? When does the Government know how much it will have in its pot that it had not anticipated?

Leslie Evans: As you would expect, Alyson Stafford and her team track the spend throughout the year. The executive board receives monthly reports, which were introduced as part of the governance changes that I referred to earlier, so there is constant monitoring of spend.

As you might expect, a lot of spend goes out at the very beginning of the financial year and there is a range of policy-driven reasons why we might delay or spread other spend across the year. We have a significant milestone around October when all directors are given thorough support in checking that their spend is where we think that it should be, although, as I mentioned earlier, not all spend is profiled equally across the year. That is an in-year check that the forecasts on spend that individual directors and their teams are making are accurate. At a time of such constraint, we cannot afford people to be thinking that they might or might not spend funds, so we introduced that very robust and challenging—but supportive—process to allow people to say, "Actually, I think that this might be different; we might be spending a bit more or a bit less."

Many of our bigger budgets are demand led. Members will know, from the work on pensions, that some of those pensions lie in a part of the budget that is not the annually managed expenditure, and that is real cash going out. We have to constantly anticipate what the demand might be—it is not what we might choose to spend, but what we might have to accommodate.

There is a constant scanning process and Alyson Stafford uses that to provide forecasting for ministers and me, as principal accountable officer, on what we think that the outturn is likely to be. It is a bit like landing a helicopter on a postage stamp: it is an art. The fact that we are now at 0.5 per cent—in terms of Her Majesty's Treasury budget figure, which we measure our underspending on—is pretty good and better than last year, when it was 0.7 per cent.

Alyson Stafford might want to say something about what happens nearer to the time—at the end of the financial year—when we understand that we have an underspend and about what we do with things such as the transfer into the following year so that we do not lose any of that underspend.

Alyson Stafford: That tracking is a dynamic process and it needs to take cognisance of what is happening across the whole landscape. The important thing to note is that our make-up under the Scottish Parliament and the Scottish Government control regime means that we have to live within the budget and we cannot overspend. To be clear, there will always be a level of underspend. Although those numbers sound large in absolute terms, we work within extremely tight margins in relation to the whole budget and, because we cannot overspend, there is an element of ensuring that we are on just the right side of the line.

That dynamic environment includes areas in which budgets rely on people demanding them; where people take up, or the case is made for people to utilise, particular budgets—we use the phrase “demand led”. Each year, we try to keep the budgets taut and realistic in relation to what we expect the demands to be and we track that carefully. From the point of view of being able to carry forward funds from one year to the next, we have very tight margins to work within under each element of a budget.

I can assure you that it has been the passion of every cabinet secretary for finance—and, equally, of the director general for finance—to ensure that Scotland loses no money whatsoever, and that is part of the tracking and the decision making. We have to work within—I will give you the percentages for this year—0.6 per cent of our DEL budget or resource budget. If it were anything more than that we would not be able to carry it forward and it would be lost, but we will not be in that position. The limit on our capital is 1.5 per cent and, on financial transactions, it is slightly larger, but that is on a much smaller number. Those are the levels of fine tuning that we have to work to and, within those margins, we are allowed to carry forward to the next year.

The Convener: Does that answer your question, Liam?

Liam Kerr: Yes. Thanks for that answer. I will move on to a slightly different area.

The revenues from the land and buildings transaction tax have been significantly lower than forecast. The figure of 13 per cent was mentioned earlier. What analysis is being done of the figures and the impact of the tax on house sales? What analysis is being done on future revenues and projections, and at what point will a decision be made on whether the endgame of the tax has been achieved?

Leslie Evans: I will ask Alyson Stafford to talk a bit more about the technical element of this.

As you know, the first year of any tax can be quite volatile, depending on what the tax is, in

terms of behaviours and the way in which people respond to the tax. In addition, just as we were bringing the tax into being, we had some slight interventions by the UK Government. We are analysing Revenue Scotland, and our housing policy colleagues will analyse what information we can discern from the first year of the tax, which will continue to inform policy and our future intentions. Indeed, the Scottish Fiscal Commission will use that information in its test of the reasonableness of future forecasts.

The Convener: I ask the panel to keep their answers as tight as possible, because we are running short of time.

Leslie Evans: We can leave it there, if you like.

The Convener: Thank you.

Alyson Stafford: Just to be clear, last year's tax receipts exceeded the forecast. There was a net positive receipt to Scotland of £74 million.

The Convener: Are you happy with that answer, Liam?

Liam Kerr: Sure.

Colin Beattie: Permanent secretary, your letter to the committee and the Audit Scotland report mention the new governance arrangements that went live in October. I presume that they have been in place since the beginning of October. Can you give us a feel for what those changes in governance comprise? What has been put in place?

Leslie Evans: We have changed the structure of the accountabilities within Government concerning who reports to whom—or, more likely, what reports to what, which is the board structure that we had previously. Most important, we have deepened and strengthened the knowledge base of our non-executives to enable them to challenge us and bring an independent and different perspective to the way in which the Scottish Government makes decisions and runs its business.

Although we are reducing the number of non-executives, we are strengthening their role, and they will be twinned—in other words, there will be two non-executives with each director general. For example, Alyson Stafford will have two. That will mean that the knowledge of the business, if you like, is strengthened in our non-executives. I was particularly keen to increase the challenge function within the organisation so that we get the benefit of those who are there to act as critical friends. There have also been changes to the structures of the boards—I can let you have a little map that we have been using—as well as to how we manage risk, because we have changed some of our risk processes, too.

That is just a quick snapshot, in view of the convener's request to be brief.

Colin Beattie: As the Auditor General pointed out, behavioural and cultural change is an essential part of that.

Leslie Evans: Absolutely.

Colin Beattie: How is that being managed?

Leslie Evans: We have been engaging with staff, because how they support the boards will be really important. When we introduced the changes, we engaged with the non-executives from a very early stage and asked them to give us a view on how our behaviours would act as a drag or a push in relation to the changes. Under a change process that I introduced when I became permanent secretary last summer, we have done quite a lot of work on the behavioural culture in the organisation as a whole. That process, which is called SG 2020, is very much about the organisation that we need and want to be by 2020.

We will also have to test whether the approach is working. We have a six-monthly review in place, and we are asking the director general, who is the Crown agent and who is not involved in the process, to come in with a couple of colleagues and check whether we have passed the tests that we have set ourselves. Much of it will be to do with whether we behave differently—whether there are more frank and open conversations—and whether we are getting feedback on that at each of our meetings, and that will make for a rich seam of information.

Colin Beattie: I want to move on to a different issue. We discussed with the previous panel the ONS reclassifications and their consequences, one of which is, as the Auditor General mentions in paragraph 30 of her report, the reprofiling of loans to Scottish Water. I want to understand the consequences of that. When you talk about reprofiling, you are not simply talking about delaying draw-downs of loans, as the Auditor General has said. There must be a fundamental change in the structure.

Leslie Evans: Yes. I ask Alyson Stafford to speak about that.

Alyson Stafford: With regard to Scottish Water, an investment programme is determined for a particular period. Obviously, there is an interface with the Water Industry Commission for Scotland and, on the basis of that, a loan profile over that period is set out. In 2015-16, we worked with Scottish Water to understand how it was delivering on that programme overall and the mix in respect of its supporting that investment either with cash that it had to utilise or through its continuing to need all the loan that had been pencilled in for it for that particular year.

There was no diminution at all in the delivery of the infrastructure investment that Scottish Water needed to take place in that year, and we were able to change the mix with regard to the extent to which it used its own cash and the extent to which it used loans from the Government. The full loan contribution from the Government over the period will be honoured, but we were able to take this approach, which made best use of public money at that time for Scottish Water to be able to continue to do what it needed to do for its programme and for us to ensure that key investments under the NPD programme—the Aberdeen western peripheral route and various other things in the NHS—could go ahead.

Colin Beattie: It is clear that reclassification had an unwelcome impact on the budget. Are people now satisfied that they understand the implications of the ONS reclassification, that that is reflected throughout the Government's budget and that they have a full understanding of what the ONS requires?

Alyson Stafford: There was a change at short notice in the rules that were applied—there was a change from ESA, or European system of accounts, 1995 to ESA 2010—and we needed to understand the implications of that for the NPD projects in question. They have all been taken into account in the financial year that we are looking at in these accounts and the subsequent budgets for this year and for 2017-18. The trajectory of the major projects under that scheme and the budgetary implications have been assessed, taken into account and managed as part of the whole capital programme.

As for the other aspects, I should say that this was all part of the £3.5 billion that was put into a new arrangement for bringing additional capital investment into Scotland. We had to do that because, in 2010, the main capital budget for Scotland was cut by over a third as a response to what happened with the financial markets around 2008-09. Obviously, commitments had been made to communities across Scotland about investments that were expected to take place, so the NPD programme was set up to deliver that. A lot of that delivery had already taken place, and we needed to find a way of accommodating these other things.

On your specific question whether we have now taken the reclassification into account, my answer is: yes, we have in those schemes. The contractual arrangements for the hub programme have changed; they remain as a private classification, and we still get additionality from that.

I also initiated an approach to have a more direct line of sight to the Office for National Statistics. Up until then, managing the relationship

had been the preserve of just the Treasury, and I insisted that we needed a line of sight and regular dialogue. That now happens; we now have a structured arrangement and programmed basis for engaging with the ONS to get a forward look on what it expects to come up in its programme. Indeed, it now publishes its programme periodically, and we are able to work with that in concert with the Scottish Futures Trust. We have also built through all the processes the appropriate relationships with Eurostat. That gives us the best possible intelligence not only of when changes are coming but, as this situation has shown, about the interpretation that these various statistical bodies can place on the pretty dry rule books that come out in relation to these things.

11:00

Alex Neil: I have two fairly quick factual questions. A bone of contention for some time now has been the fact that, unlike equivalent services in the rest of the UK, Police Scotland and, from memory, the Scottish Fire and Rescue Service are charged VAT. How much did that cost the Scottish Government last year?

Leslie Evans: I do not know whether I have the exact figure—Alyson Stafford might. I know, because I was involved in it when I was director general for justice and learning, that we had constant contact through finance.

Alyson Stafford: I am happy to advise the committee of the precise figure. As an order of magnitude, it was just under £30 million. We will get the precise figure for you.

Alex Neil: So it was a very significant figure indeed.

Alyson Stafford: Yes.

Alex Neil: Are we still fighting the HMRC and the UK Government on this or have we given up?

Alyson Stafford: We continue to do that, particularly every time there is a change of personnel in the Treasury.

Leslie Evans: I bring it up regularly with my counterpart.

Alex Neil: Presumably, with assigned VAT revenues, it makes even less sense than it did before.

My second question is whether the 5 per cent rule still applies. Is it still the case that no more than 5 per cent of revenue can be used to support capital repayments?

Alyson Stafford: Yes. That necessary and prudent regime is in place to deal with the Government's exposure, compared with its budget, to those revenue-financed investments in

any one year. We have published updates since September 2013, and the latest update will be in the draft budget on 15 December.

Alex Neil: Given the importance of capital investment, and the previous discussion, would it still be prudent to increase that to 6 per cent, say?

Alyson Stafford: There is no plan at this stage to revisit that—

Alex Neil: That is not the question that I asked; my question is whether it would still be prudent. Would the impact of increasing that to 6 per cent be disastrous?

Alyson Stafford: We would have to assess what was appropriate, given that we are going to have a very changing risk landscape as we go forward. In the year that we are looking at—2015-16—around 12 per cent of income came from elsewhere; the rest came through the block grant. That money comes in, as we need to draw it down, in a very predictable and measured way; we have to predict a month in advance how much cash we will need each day and refine things as we get to that point. It is a very structured approach. As soon as an Administration moves to a more mixed economy, with receipts coming in from different tax sources in different schedules and different decisions needing to be taken, it moves into a very different financial risk landscape. In that context, I would not necessarily advise that the risk parameter be changed.

The Convener: Why was there a £196 million underspend in education?

Leslie Evans: The majority of that was to do with student loans—I will confirm that with my colleagues—although I know that there are other small pockets, in the context of the overall budget, which are probably to do with money that has not been drawn down or a project that has been delayed. Those moneys are not lost to the education budget. I do not know whether my colleagues want to say more about the split between loans and the portfolio spend.

Alyson Stafford: The figures are on page 69 of the accounts; equally, page 68 has commentary on the same portfolio. The most material element in the underspend is £82 million, which relates to a lower than anticipated write-down of an element of the student loan book. That is a valuation change. The most important thing is that that money cannot be used for anything else, so it cannot be redirected to any other aspects of education spend.

The Convener: That applies to the £82 million.

Alyson Stafford: That is right.

The Convener: How about the £46 million underspend for the funding council?

Alyson Stafford: That was to do with a release of cash reserves. The large element was £50 million, and the aim was to use that better across the portfolio.

The Convener: I am sorry, but can you explain what that means?

Alyson Stafford: The change was to do with historical timing differences. The funding council was funded on a particular financial year, and the issue was to do with how that sat with a particular academic year. That generated a cash reserve that could not be used in any other way, so it was more appropriate to release it.

The Convener: So that £46 million is still sitting there to be used.

Alyson Stafford: No—it has been released so that it can be used across the whole area. That is all part of taking into account balancing one thing with another.

The Convener: Across what whole area?

Alyson Stafford: The whole area of the Scottish budget.

The Convener: So the money is lost to higher and further education.

Alyson Stafford: No, because higher and further education bodies all had their grants allocated as required over the academic year.

The Convener: Forgive me, but I do not completely follow that. You are saying that the £46 million has been underspent in education and has been reallocated across the Scottish budget, but it has not been lost to education.

Alyson Stafford: In terms of the allocations from the funding council to the various sectors that require funding in any academic year, the commitments to those areas have been fulfilled. This is a technical area where a body had accumulated cash that it could not use because it had allocated the budget that was available to it. It is a technical point, so it is probably better for me to write to the committee about that, which I am happy to do.

The Convener: That would be useful.

What about the £30 million underspend in learning?

Alyson Stafford: That is another area where an element relates to demand-led funding. As you can see from the explanation in the accounts, there was a

“slower than anticipated requirement by Local Authorities for Free School Meals.”

The Convener: I am sorry, but I am not hearing you very well. There was slower than anticipated what?

Alyson Stafford: Demand from local authorities for free school meals.

Leslie Evans: Local authorities took up the opportunity to get funding rather more slowly than we expected—some were more ready than others. The demand will still be there, but it was not enclosed entirely in the financial year. We cannot stop that demand and we still have to be able to meet it. The issue is about the profiling of the spend. We thought that the spend would take place within a whole financial year, but it did not.

The Convener: Does the initial tranche of funding for the attainment fund come under the learning budget?

Alyson Stafford: Yes.

Leslie Evans: Yes, it does—that is the short answer. Attainment funding comes from the learning portfolio.

The Convener: Is there any underspend in the attainment budget? Can any of the £30 million underspend be attributed to underspend on the attainment fund?

Leslie Evans: We would need to go through the figures absolutely clearly, but the attainment fund is separate. I understand that the figures are not part of the attainment fund that has been recently set up—they are in addition. I would need to confirm that so that I am not giving you the wrong information.

The Convener: I thought that you just said that the attainment fund comes under the learning budget.

Leslie Evans: I am sorry—the attainment fund comes under the learning portfolio. It is part of the responsibility of the Cabinet Secretary for Education and Skills and therefore part of the overall budget. The attainment fund is a specific part of that. The threads that you see in the children and families budget are from one directorate in the portfolio that supports those who are in the very early years, which includes support on issues that are to do with free school meals and kinship care. If you are talking about the attainment fund specifically as opposed to attainment across the portfolio, that is a discrete fund.

The Convener: So that is not accounted for in the learning budget. Where would the separate attainment fund appear?

Leslie Evans: It would be in education and lifelong learning but, to my knowledge, it is not in the underspend that has been identified in higher education, the funding council or children and families. Perhaps it is easiest if we write to you to confirm and clarify that, so that it is clear what we are talking about when we talk about a portfolio, a

fund and underspends in specific parts of that portfolio.

The Convener: That would be useful. I do not know whether colleagues agree, but I do not think that any of us is clear about that. For reference when you write to us, my question is about where the attainment fund falls under all the headings. Is it split across headings? How can we know whether there has been an underspend in the attainment fund?

Leslie Evans: You are asking about the attainment fund per se.

The Convener: Could you write to us as soon as possible on that?

Leslie Evans: The attainment fund is new, so it would not necessarily feature in the current set of figures, but I will happily write to you.

The Convener: I felt that the first tranche of the money might feature in the report and thought that you might clarify that for us. However, you are not sure whether the £13 million underspend on children and families includes attainment fund money.

Leslie Evans: I want to be clear in technical terms so that I am not giving you the wrong information. Some of the threads might well be included in elements of how the attainment fund was set up. I do not want to give you the wrong information; it is much better if we give you the accurate detail in writing.

The Convener: Sure. Overall, if we exclude the £82 million underspend that was due to a technical problem with student loans, there was an underspend of £46 million on the funding council, an underspend of £30 million on learning and an underspend of £13 million on children and families. Those areas have all experienced significant cuts over the past few years. Are you concerned that the underspends are too hefty?

Leslie Evans: Alyson Stafford might want to talk about the underspends. In the context of the overall budget, the sums are relatively small. As you heard from her, it is a high priority for us to squeeze every pound out of our allocated funding each year. However, that is not always at our hand—it is not always possible when people are not ready or are unable to draw down funding from grant schemes that we produce and so on.

Alyson Stafford: A distinction exists between areas that have funds that are allocated to support the running of services, which go out on a regular profile, and areas where we rely on uptake, whether from communities, local authorities or interest groups. We always have to work through that dynamic for any budget in any one year, whether that is at the aggregate level or at the

level of portfolio areas such as those that you have focused on.

The Convener: Let us move on to EU structural funds. Paragraph 76 of the Audit Scotland report identifies that £14 million has been permanently lost to the Scottish Government's budget. Can you comment on that?

Leslie Evans: I understand what the report says, but it is not yet clear to us that that £14 million will be lost. The complete reconciliation will not take place until 2018; the money is part of a seven-year programme and quite a lot of the work that is being done—not just by us but by Europe—is still to happen next year. Therefore, we will not know for sure the final outturn of the programme or the reconciliation by Europe until 2018.

The Convener: That is interesting, because Audit Scotland seems sure. The report refers to

“a provision of £14 million to reflect a permanent loss of grant to the Scottish Government which it cannot now recover.”

Leslie Evans: We do not know yet, because we do not know what the final figures will be, but it may be possible for us to claw back elements of that funding from the projects' sponsors—not from the projects themselves—which were responsible for overseeing how the programmes were carried out and managed. We cannot be sure at the moment, but we may well be able to reclaim some funding. We are working on that.

The £14 million is there as a marker. We do not want to assume that we would not need to draw it down, but that might not be the amount of money that is needed.

The Convener: The report clearly states that, in Audit Scotland's opinion, that money is not recoverable, but you are saying that it might be.

Leslie Evans: It might be.

The Convener: When we heard evidence from Audit Scotland, the witnesses talked about the chain of places that the money is drawn down from—from the Scottish Government through local authorities, grants and different organisations. Are you aware of where the errors are occurring and where the money is going astray?

Leslie Evans: We know that most of the errors are occurring very much at the front line. As you said, there is quite a long chain that involves Europe, the Scottish Government and project sponsors—local authorities and so on—as well as the projects themselves, which are doing important and impactful work at the front line. In working with that part of the chain, we have to be aware of who needs to know what and what skills need to be available in each part of the chain. Some of the work that we are doing for the new

programme is very much intended to learn from what did not go well in the 2014 to 2020 programme.

11:15

We know, for example, that some people are trying deliberately to use the money for unintended purposes, although we see from the audit material that that is rare. The errors often have to do with recording information—particularly how people's time is recorded. For example, when a person is working half their time on a project that is funded through the European social fund and half their time on a project that might be funded through the local authority or another source, Europe has to be able to be shown how that work split takes place. Recording the information and producing the paperwork digitally or otherwise on the day that the auditor appears relates to how a project is tested on whether it is complying with some of the quite rigorous requirements

The Convener: Is it not your responsibility to put in place the arrangements and make sure that the reporting is being done properly?

Leslie Evans: It is our responsibility to ensure that programme sponsors are aware of and able to meet their responsibilities. First, for the next set of projects, we are doing a lot more work on the training and the guidance that are required for project sponsors and on the projects themselves, so that people understand what they are taking on. Secondly, we are doing more on checking and audit visits, so that we know about that earlier. Thirdly, we are going to look earlier in the pipeline at whether the necessary quality of information that is being recorded and shared is available for the auditors when they come in, because they come in at various times during the year and take random samples.

The Convener: With respect, you said exactly the same thing to our predecessor committee last year:

"it is my role ... to make it very clear to those who are in receipt of the funding that they must continue to put in place the measures that are required to ensure that there is accountability ... to that funding and that the public pound is tracked."—[*Official Report, Public Audit Committee*, 9 December 2015; c 36.]

Have you seen any improvement in the past year since you said that?

Leslie Evans: I have heard that there is greater understanding of what the role is. The issue is that we are coming to the end of a set of projects. We are looking at closing the projects down—as we have been doing for the work that is described in the report—then creating the next set of projects and learning from people's skills and capacities to manage European funding.

Last year, we spoke to and wrote to all the key programme managers, which included big establishments such as Glasgow City Council and Scottish Enterprise, about their capacity to ensure that their projects, which they had initiated, could comply with what are quite onerous—and rightly so, because it is public money—recording responsibilities. We will continue to remind them of their responsibilities.

The Convener: Has there been an improvement over the past year?

Leslie Evans: Yes, because there is a greater awareness of the responsibilities and the requirements.

The Convener: I do not think that either of the bodies that you mentioned—Glasgow City Council and Scottish Enterprise—would want to lose such significant sums of money.

Leslie Evans: Indeed. In fact, I personally spoke to Scottish Enterprise's chief executive about the matter when I came in as permanent secretary last year. She took rapid and robust steps to improve the governance and the recording of the projects under that body's auspices.

The Convener: The problem dates back to 2010-11—it was identified in the Auditor General's report for that financial year. Why has the situation not got better over six years?

Leslie Evans: We will not know the final outturn figure—it relates to the final errors and therefore the penalties that might have to be paid—for a bit longer. We also know that we might have the opportunity to recoup some money.

I do not think that we can deny that the arrangements are challenging and tough for very small organisations, which are often embedded in communities that have not necessarily—

The Convener: Glasgow City Council and Scottish Enterprise are not small organisations.

Leslie Evans: They are not, but the projects that they manage are frequently very small. Some of them are in committee members' constituencies and, as I said, they are doing splendid work. However, small groups of people who are doing really important work on the front line do not necessarily have the time or the experience to collate and produce information that is suitable for a robust audit. That is what the programme sponsors have been encouraging those who are involved in their projects to understand and to learn.

The Convener: You are saying that errors are occurring not only in small organisations but in large, established organisations such as Glasgow City Council and Scottish Enterprise.

Leslie Evans: The relationship is slightly different. Project sponsors tend to be big institutions, which sponsor a number of projects, many of which are very small. The sponsors have to be convinced when they take on and agree to the funding of projects that those who will manage what are often small-scale projects have the experience and the capacity to do the recording that allows the sponsors to make their returns to us and to Europe.

The Convener: It looks as though there are long-term institutional weaknesses with how the Scottish Government deals with EU funding. Do you agree?

Leslie Evans: No, I do not. I think that we are—

The Convener: Why are we losing £14 million?

Leslie Evans: We are not necessarily losing £14 million. The jury is out on whether that will be the case. In fact, every project that is funded under ESF loses an element of funding anyway—some lose up to 40 per cent of funding. Our record is that we retain at least 90 per cent of our funding; for the UK as a whole, the figure is between 80 and 90 per cent.

I am not saying that we are complacent—there is no room for that. I am saying that it is important that we learn—and we have learned—from the most recent programme and that we put that learning into place by revising the conditions, practices, guidance and expectations. An important change is that we will know earlier if issues are coming up in small projects, because the audit process will highlight them earlier in the system before they get to the reporting end of the programme, by which time it is almost too late.

The Convener: Are you happy with the progress that has been made over the past six years?

Leslie Evans: I cannot comment on the past six years; I have been responsible for the past—

The Convener: For the past year then.

Leslie Evans: There is undoubtedly more to be done, but people have a greater understanding of expectations and not least of the need to work closely with internal auditors on the capacity that is expected and on the quality of reporting that needs to be available.

The Convener: I am interested that you think that some of the £40 million is recoverable. Will you write to the committee when you receive information about that and let us know how much money you have managed to recover?

Leslie Evans: I will.

The Convener: Thank you. Will you also follow up on the attainment issues that I raised?

Leslie Evans: Yes—I have a note of that.

The Convener: Thank you very much. As there are no further questions from members, I thank the panellists very much for their evidence.

11:21

Meeting continued in private until 11:36.

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