



OFFICIAL REPORT
AITHISG OIFIGEIL

Public Audit and Post-legislative Scrutiny Committee

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PUBLIC AUDIT AND POST-LEGISLATIVE SCRUTINY COMMITTEE
23rd Meeting 2017, Session 5

CONVENER

*Jackie Baillie (Dumbarton) (Lab) (Acting Convener)
Jenny Marra (North East Scotland) (Lab)

DEPUTY CONVENER

*Liam Kerr (North East Scotland) (Con)

COMMITTEE MEMBERS

*Colin Beattie (Midlothian North and Musselburgh) (SNP)
*Bill Bowman (North East Scotland) (Con)
*Willie Coffey (Kilmarnock and Irvine Valley) (SNP)
*Monica Lennon (Central Scotland) (Lab)
*Alex Neil (Airdrie and Shotts) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Stephen Boyle (Audit Scotland)
Caroline Gardner (Auditor General for Scotland)
Michael Oliphant (Audit Scotland)

CLERK TO THE COMMITTEE

Terry Shevlin

LOCATION

The Adam Smith Room (CR5)

Scottish Parliament

Public Audit and Post-legislative Scrutiny Committee

Thursday 5 October 2017

[The Convener opened the meeting at 09:01]

Decision on Taking Business in Private

The Acting Convener (Jackie Baillie): Good morning and welcome to the 23rd meeting in 2017 of the Public Audit and Post-legislative Scrutiny Committee. I ask those in the public gallery to switch off their electronic devices, or at least switch them to silent mode.

Agenda item 1 is a decision on taking business in private. Do we agree to take item 3 in private?

Members *indicated agreement.*

Section 22 Report

“The 2016/17 audit of the Scottish Government Consolidated Accounts”

09:01

The Acting Convener: Agenda item 2 is an evidence-taking session on the Auditor General for Scotland’s audit of the Scottish Government consolidated accounts for 2016-17. I welcome to the committee Caroline Gardner, Auditor General for Scotland; and from Audit Scotland, Stephen Boyle, assistant director, and Michael Oliphant, senior audit manager.

I invite Caroline Gardner to make an opening statement.

Caroline Gardner (Auditor General for Scotland): Thank you, convener. As you know, the Scotland Act 2012 and the Scotland Act 2016 introduced significant new responsibilities for tax and spending, and those new financial powers bring not only fresh opportunities but new financial risks that need to be managed. They come at a time of continuing pressure on public finances and uncertainty about the implications of the United Kingdom vote to leave the European Union, and the changes increase the need for the Scottish Government to provide comprehensive, clear and consistent financial reporting to enable the Parliament and this committee to carry out their important scrutiny role.

The consolidated accounts are a critical component of that and of the Government’s accountability to the Parliament and the public. They cover around 90 per cent of the spending approved by Parliament in 2016-17—the elements for which the Government is directly responsible—and they show the amounts spent against each main budget heading and the reasons for any significant differences. They also show assets, liabilities and other financial commitments carried forward to future years.

My report sets out how the consolidated accounts relate to the Scottish budget as a whole and highlights the main financial management issues for the Government during the year. My opinion on the consolidated accounts is unqualified—I am content that they provide a true and fair view of the Government’s finances—but I would like to highlight four areas.

First, on financial management and reporting, the Scottish Government managed its budget for 2016-17 within the overall limit set by Parliament, and the accounts meet the legal and accounting requirements. The Government has a good record of financial management and reporting, and it is committed to enhancing financial transparency,

including by introducing a consolidated account covering the whole public sector.

I welcome the Government's steps to improve the presentation of the accounts. The recommendations of the budget process review group will bring further significant changes to financial reporting, including the introduction of a medium-term financial strategy. Longer-term planning is essential for effective decision making, and the Government's reporting on the current financial position and future plans and forecasts should support financial sustainability, transparency and accountability. That will allow Parliament to take a broader perspective in its tax and spending decisions, and to hold the Government to account for its overall management of public finances.

The second area is governance. Last October, the Scottish Government put new governance arrangements in place to reflect the demands created by constitutional change and new financial powers. The success of the arrangements will be determined by how they operate in practice; in particular, the culture and behaviours of those involved will be central to ensuring effective scrutiny and challenge. I will keep the revised arrangements under review as part of our continuing audit work.

The third area is performance. The consolidated accounts contain a performance report, which complies with Government reporting requirements. The emphasis is on financial performance against budget with signposting to more detailed performance information such as that in, for example, the national performance framework. There is further scope for the Scottish Government to develop its annual reporting to provide a more rounded picture of its overall performance.

Finally, I draw the committee's attention to two specific matters arising from the audit of last year's accounts: first, the continuing risk to the common agricultural policy futures programme, and how this is reflected in the accounts; and secondly, the closing position on the 2007 to 2013 European structural funds programmes, leading to the repayment to the European Commission of £31 million in grants received by the Scottish Government.

The committee's evidence session on the Scottish Government's consolidated accounts is a central element of parliamentary scrutiny of the Government's finances. My report on the 2016-17 audit is designed to support that, as well as scrutiny and accountability more generally. As always, convener, my colleagues and I are happy to answer the committee's questions.

The Acting Convener: Thank you very much, Auditor General. We will start with Colin Beattie.

Colin Beattie (Midlothian North and Musselburgh) (SNP): Overall, Auditor General, this is a pretty good report. Why is it a section 22 report?

Caroline Gardner: That is a very good question. As the committee knows, section 22 reports have traditionally been reserved for cases in which there is a problem in an audited body. However, that is not the statutory basis for such reports; the statutory basis is that I can use them to bring to the committee's attention anything that I think appropriate arising from the audit of the accounts. The history of this section 22 report goes back three years to the introduction of the new financial powers under the Scotland Act 2012 and the committee's request at that point that I consider bringing an annual report to it alongside the consolidated accounts audit, reflecting the fact that the accounts cover £34 billion of public spending and that the level of risk and volatility involved is increasing rapidly as the 2012 and 2016 acts are being implemented.

Colin Beattie: Presumably, then, you will continue to have it as a section 22 report in years to come.

Caroline Gardner: As Auditor General, I think that it is an important part of the accountability for that £34 billion. As the committee knows, the audited accounts of all public bodies are laid in Parliament and are available for this committee to scrutinise, but I hope that it is useful to have a report from me that pulls out what I see as the key features of the year and provides a look ahead at what is coming.

Colin Beattie: Moving on to capital borrowing, I want to look at non-profit-distributing projects, which were brought in as an alternative to private finance initiatives or public-private partnerships—whatever you want to call them—on the basis that they would be cheaper to run and would have better controls. However, I thought that they were being structured in such a way that they did not come on the books as public sector projects.

Caroline Gardner: I will ask the team to respond in a moment, but committee members might recall that this came up as an issue last year in relation to the 2015-16 consolidated accounts. The background was that the rules covering the national accounts—not the financial reporting but the national statistics—had changed because of different European statistics requirements, and that meant that the Office for National Statistics classified the Aberdeen western peripheral route as a project that needed to be on the Government's balance sheet.

On the back of that decision, the Scottish Government decided that three other projects that were structured in a very similar way should also

be brought on to the balance sheet and would therefore need borrowing cover. I think that what you are recalling is that, at the same time, the Government reviewed other projects that were still in the pipeline and aimed to structure them as far as possible in a way that would keep them off the balance sheet. Obviously, there is a trade-off in that respect between the direction and control that the Government has, which is one of the factors that drives the classification of projects as public sector or not, and the extent to which bodies are accountable back to Government for the funds that they are spending. There is a judgment involved in that.

Colin Beattie: So the same thing is not happening across the board with NPD projects.

Caroline Gardner: The initial decision related to four projects that were structured in a very similar way, and our understanding is that the Government has reviewed the structuring of other projects in the pipeline in a way that it feels keeps them off the balance sheet. We are confident that the accounting treatment in 2016-17 is correct, but we will keep that under review.

Colin Beattie: Do you agree with the Government that the other projects should be off the balance sheet?

Caroline Gardner: That decision is not for us but for the Office for National Statistics. It is good that the Government has reviewed the projects, and we will keep in view the application of the ONS guidelines and the accounting treatment that flows from that. Perhaps Stephen Boyle can add to that.

Stephen Boyle (Audit Scotland): The Auditor General has covered the key point that the driver behind bringing the projects on to the Government's balance sheet was the ONS decision, rather than the decision being specifically initiated by the Government itself.

Colin Beattie: Have any of the other projects been reviewed by the ONS? In other words, do we have a process or structure that has already been tested and found to be okay?

Caroline Gardner: It is true to say that the projects themselves have not been reviewed, but what we have—and which is available generally—is the ONS's work programme for the areas that it intends to review. The Government looks at that in making its own decisions, as well as at the broader guidelines with regard to the European system of accounts requirements. We do not expect any further change, but it is always a possibility.

Colin Beattie: The reclassification clearly put the capital budget under some pressure.

Caroline Gardner: It did. In order to meet the accounting requirements, the Scottish Government agreed with Her Majesty's Treasury that it could use the borrowing powers in place for 2015-16 and 2016-17 to cover the required headroom, and that squeezed out other capital spending.

Colin Beattie: But from this year on, that situation should relax a bit because of the new powers.

Caroline Gardner: There are still limits on borrowing, although they increase every year. Michael Oliphant is in a good position to talk you through the current position.

Michael Oliphant (Audit Scotland): In relation to the capital spending that is still to come for the four projects, we found included in the 2017-18 budget a figure of £190 million required for the ONS classification. That is obviously less than was required in 2016-17, so the Government is probably through the woods with regard to the initial capital budgeting spend required for the four projects.

Colin Beattie: In paragraph 25 of your report, you talk about the block grant and the forecast tax income from Scottish taxpayers and say:

"No adjustments will be made to future Scottish budgets should the actual tax received in 2016/17 differ from this forecast."

I thought that there was a review process in place to assess whether the forecasts were correct before things were set in stone.

Caroline Gardner: This is the transitional year, which means that, for 2016-17, the block grant adjustment stands and there will be no later adjustment to it for reconciliation. However, from 2017-18 onwards, there will be an adjustment. You are quite right to point this out as one of the elements that will obviously increase the risk and volatility in the Scottish budget in future. Receipts might be higher than forecast, in which case the budget will be better off; or they might be lower, in which case it will be worse off. That will be an issue from 2017-18 onwards, but not in 2016-17.

Colin Beattie: My final question is about the budgeting cycle. You always encourage people to make a longer-term forecast and have a three or four-year budget. Is it not very difficult for the Scottish Government to do that when it does not know how big its cheque will be?

Caroline Gardner: As the new financial powers come in, that sort of approach is becoming more possible and more important. One of the recommendations in the budget process review group's report, which I mentioned in my opening statement, is the introduction of a medium-term financial strategy that will look ahead five years at

what is likely to happen to the economy and, therefore, to devolved tax revenues; provide some indication of the block grant, which will still be around 50 per cent of what we spend based on UK Government projections and Office for Budget Responsibility forecasts, for example; and look at broad trends in spending based on things such as demographics and policy as it stands now. As a high-level strategy, it will be affected by policy and environmental changes, but the budget process review group felt that it was an important starting point for budgeting and parliamentary scrutiny. I think that the recommendation has been accepted by the Parliament's Finance and Constitution Committee and the Cabinet Secretary for Finance and the Constitution.

Colin Beattie: I can understand the need to do forecasts for the elements of the tax that are within our powers, but the block grant is subject to not just economic pressures, but other budget pressures in the Westminster Government. We have had cuts virtually every year and, as far as we know—although we do not know what will happen in November—they will continue to some extent. That makes it quite difficult for the block grant to be projected.

09:15

Caroline Gardner: It is certainly impossible to know what the firm figures will be, but the block grant will still make up 50 per cent of the resources available to the Government. As a result, projecting ahead what might happen to it and having a range of possible scenarios for upside and downside risk gives a sense of how much overall resource the Government has to plan with and the choices that it is making in each individual year's budget.

Colin Beattie: Thank you.

The Acting Convener: I want to pursue a couple of points on capital borrowing and the reclassification of projects. I think that it was Michael Oliphant who mentioned a projected figure of £190 million in 2017-18 for four projects. Is there any capital requirement for those projects beyond 2017-18?

Michael Oliphant: I do not know the detail of that. We would need to look at subsequent budgets—for example, the forthcoming 2018-19 budget—to know whether any more funding was required in relation to those projects. I was referring specifically to the budget as we know it for 2017-18.

The Acting Convener: So the Scottish Government does not profile ahead and look at forthcoming liabilities.

Michael Oliphant: We would expect the Scottish Government to be doing that in terms of what is publicly available through the budgets.

The Acting Convener: That is helpful to know.

Given that so much capital was used as a result of the reclassification of the four projects, was an opportunity lost, with other projects being reprofiled as a consequence?

Caroline Gardner: We explored that issue in some detail with the committee last year, but I recognise that, since then, many new members have come on to the committee. As we conveyed to the committee and as, I think, the Scottish Government confirmed, it was possible to manage that by reprofiling the projects that were coming through, particularly—and this brings us back to Mr Beattie's question—the projects that were reviewed to see whether they needed to be structured differently or whether they had to come on to the balance sheet. Some of those projects were delayed, which meant that the spending profile went further out.

The Acting Convener: That is helpful.

Finally, I seek clarification on paragraph 29, which states:

"capital pressures arising from NPD projects as a result of the ONS classification would have to be absorbed within capital DEL limits with capital borrowing powers to be used as intended."

Does that mean that there is no access to the new capital borrowing powers, or can the Scottish Government spend up to the limit of the new powers?

Caroline Gardner: The intention is for the capital borrowing powers to be available to be used as intended from the 2017-18 budget onwards. The capital departmental expenditure limit was used to cover the implications of the reclassified NPD projects.

The Acting Convener: That is helpful.

I have one final question before I move on to Bill Bowman. We now have new borrowing powers that can be used in the event of economic shocks. The powers were not triggered last year, but my understanding is that that has now happened under the eligibility criteria. Has the Scottish Government publicly indicated that anywhere?

Caroline Gardner: It is not indicated in the accounts before the committee today, and there is no expectation or requirement that it should be. I again refer back to the budget process review group's report, which recommends, first, that there be an annual fiscal framework outturn report to demonstrate how all the elements of the fiscal framework have been used in the year and, secondly, that there be mid-year reporting on

budget revisions to pick up exactly that sort of point.

The Acting Convener: Okay. Thank you very much.

Bill Bowman (North East Scotland) (Con): Good morning. I looked through your report and focused more on the accounts themselves, which I presume you have with you.

Caroline Gardner: Yes.

Bill Bowman: I have a number of questions. I may need a little bit more information on some of them but I will focus on a couple of points just now.

My first question is on the remuneration of ministers. Page 33 of “The Scottish Government Consolidated Accounts for the year ended 31 March 2017” states:

“The First Minister has a benefit-in-kind for 2016-17 of £334 arising from the provision of accommodation at Bute House”

The comparative figure for the previous year is £93.81. Do you know how that figure is calculated?

Michael Oliphant: I am afraid that I do not have the details in front of me now, but we can come back to the committee on that.

Bill Bowman: But that would be an audited number.

Michael Oliphant: Yes.

Bill Bowman: You do not remember anything about that. It just seems a strange number.

Caroline Gardner: It is a low number.

It is worth making it clear that Stephen Boyle and Michael Oliphant lead the audit team but, as you would expect for an audit of £34 billion, there is a much wider team behind us. We are happy to revert to the committee after the meeting with more detail in relation to any questions on which we need to get more information.

Bill Bowman: Okay. The next question perhaps follows on from Jackie Baillie’s questions about liabilities. It relates to page 62 of the consolidated accounts, which shows the consolidated statement of financial position—or the balance sheet, as I would have called it.

If I understand the statement correctly, the total current assets are £2.4 billion, and the total current liabilities are £3.4 billion. The accounts say that they are prepared on a going concern basis. We might think that that is an obvious thing for a Government, but if it is lacking £1 billion in current assets to meet its current liabilities, is there something in the accounts that explains how that will be dealt with?

Caroline Gardner: You are absolutely right—the tests that we need to apply to the Government and to public sector bodies are different from those that would apply to many private sector bodies, for obvious reasons.

I will ask Stephen Boyle to talk through the audit approach on that.

Stephen Boyle: Thank you, Auditor General. In public sector bodies we quite commonly see that liabilities can outstrip assets. In our audit approach, we often consider carefully how the flow of funds coming into the organisation in future years will secure its long-term future. As the Auditor General has mentioned, the nature of public sector bodies and the assumptions that we are able to make about the flow of funds give us certainty to allow us to consider, in the round, going concern implications. We follow that through as part of our approach under auditing standards to ensure that it is considered fully by audit committees. Through the representations that we seek from the principal accountable officer, we ensure that senior officials are sighted on the implications around that and that we have considered it fully prior to the signing of the Auditor General’s opinion on the accounts.

Bill Bowman: So they do forecasts of the cash flow.

Stephen Boyle: Yes, indeed.

Bill Bowman: And there is no doubt that the Government will have the funds to settle the amounts.

Stephen Boyle: Forecasts have been done, and the ratio of assets and liabilities that is presented in this year’s accounts is not an unusual position. Having considered what the Government continues to show through its position, the receipt of funds through the block grant and now the additional revenue from tax-raising powers, and what we have seen on past ability to settle debts as and when they have arisen, we are content that that is a reasonable position to adopt.

Bill Bowman: Should the accounts say anything as to why that is not an issue? The only reference that I could find to “going concern” was in the statement on responsibilities, which says that the accounts have to be prepared

“on a going concern basis”,

and that seems to be the end of it.

Caroline Gardner: That is a good question. It reflects the value of having on the committee somebody with your professional background, which is grounded in a private sector setting.

As Stephen Boyle has said, our starting assumption is that, through the Scottish consolidated fund, the Government is able to draw

down all the block grant that is set at the beginning of the year from the UK Government, which has very significant tax-raising and borrowing powers to meet its commitments. From 2016-17, the Scottish Government itself now has tax-raising powers that it could use were it finding it difficult to meet its liabilities. That is another reason for our feeling that the medium-term financial strategy is so important—it means that we are not looking at one year at a time, as the accounts do, but looking out over a five-year period.

Bill Bowman: You recommend that a further consolidation be done. Would that show a different position?

Caroline Gardner: It certainly would, which is why I have been recommending it for the past few years. The balance sheet is a key part of any set of financial statements. That is the terminology that I grew up with, as you did. The balance sheet that we have in front of us does not include some very significant liabilities, such as wider pension and borrowing liabilities across the public sector—in particular, local government—that are fairly significant in total. Neither of those is a liability that would fall immediately to the Scottish Government in the event of problems, but, in practice, the Scottish Government would certainly have a responsibility to step in and ensure that the liabilities were met.

There are also very significant assets in other parts of the public sector that are not shown here. We have whole-of-Government accounts for the UK as a whole, to which Scotland contributes. We do not have that equivalent balance sheet consolidated for Scotland as a whole.

Bill Bowman: Is that just a recommendation, or have you had a response from the Government that it will do that consolidation?

Caroline Gardner: I first recommended it in 2013. The Government has since made a commitment to introducing it, and we are now in a dry-run period where it is doing preparatory work to strip out the double counting, related party transactions and so on that would be involved. I cannot require its introduction, but the Government has committed to doing that.

Bill Bowman: We might follow that up.

The Acting Convener: Indeed.

Liam Kerr (North East Scotland) (Con): Good morning. I will start with the overall budget. The accounts show that the total net expenditure was £33,870 million, which is £85 million less than was budgeted. You have a table that shows various areas that did not receive quite as much as was budgeted for, such as education, social security and justice—underfunded is the wrong word, but you know what I mean. I think that people will be

surprised by that. What happens to the £85 million that was not spent? I think that people will look at this and say, for example, “Education doesn’t have a great deal of cash swilling around in it, so why isn’t that money being spent on it?”

Caroline Gardner: I will start off and then ask Stephen Boyle to come in on the specifics of the underspends that are shown in the accounts.

It is worth noting that the £85 million, although it is a large number, is only 0.025 per cent of the overall £34 billion or so that was spent by the Scottish Government last year. It is DEL money, to use the jargon, which can now go into the Scotland reserve and be carried forward for use on similar types of spending in the future. It is not lost to Scotland; it is carried forward. However, you are right that there is an opportunity cost of money not being spent in-year on the things for which it was intended.

Stephen Boyle: The narrative part of the Government’s accounts describes why budgets were overspent or underspent, and it draws attention to a couple of the areas that you mentioned, Mr Kerr. In particular, it highlights underspend in education as a result of the timing of the initiation of the attainment fund and the availability of that budget next year. It explains that, when projects were identified and initiated in the middle of the year, the projects to deliver that fund had not come through in sufficient time. Nonetheless, the accounts identify that that budget will be carried forward for use in 2017-18.

Liam Kerr: I understand. Let me press you on that. On page 8 of your report, you mention health and sport, on which there was an overspend of £112 million. Of course, no one ever wants to go over budget, but I think that, by and large, people would be sympathetic with an overspend on health. However, that overspend apparently

“mainly related to an increase of £160 million to the provision used to assess legal claims against health boards.”

Are you able to explain that? Is that right—£160 million to assess legal claims?

Caroline Gardner: Not quite. The increase was in the provision in the accounts for possible future costs, which may crystallise in future years. I am not sure whether Stephen Boyle or Michael Oliphant is best placed to give you more detail.

Liam Kerr: Forgive me, Auditor General—do you mean the cost of the litigation if the claimant is ultimately successful?

Caroline Gardner: Absolutely. It is effectively the cost of the damages rather than the cost of assessing the cost, if that makes sense.

Michael Oliphant: The adjustment this year is a technical change in how the model is calculated, which brings an additional provision of £160 million. It is important to note that that is categorised as annually managed expenditure, which the Treasury provides annual budget cover for, so it does not affect the spending power of the health budget. We understand that what was available by way of spending power for health was used up in 2016-17.

Liam Kerr: Just so that I am clear, the national health service in Scotland effectively makes provision for £160 million to pay off successful or settled claims against it. A bill has been introduced, the end game of which would be increased access to justice. Logically, that might mean more claims against the NHS. Do you get a sense that the Scottish Government, having already provisioned £160 million, will provision even more in the event that that bill passes?

09:30

Michael Oliphant: I do not know whether that is factored into the figures. I do know that the Scottish Government's approach is similar to the approach that applies across the UK. I do not know whether a specific Scottish adjustment is included.

Caroline Gardner: I would expect that it is not. Most of the accounting adjustments that are made reflect the legislation that already applies to the health service and other services, but it is one of the things that could come into play in a medium-term financial strategy. If a change of that nature were likely to have significant impacts on costs in an area, that should play into the thinking about what will happen with spending on health over the longer term.

Stephen Boyle: Clinical and medical negligence claims have been a feature of health board accounting for many years. Typically, health boards have assessed those claims in terms of their likelihood and proximity to payment on a scale going from 3 to 1. A grade of 3 has driven a provision and a grade of 1 has led to what has been categorised as a contingent liability, in accounting terms—that is the grade that reflects the highest likelihood of settlement. The increase in the provision is, essentially, an on-going review of the likelihood of payment. That has been captured appropriately in the accounts.

Liam Kerr: The report says that the amount that was raised from the land and buildings transaction tax and the Scottish landfill tax was £633 million, which was £38 million less than the forecast amount.

Living in Aberdeen, I would say—speaking purely anecdotally—that the LBTT has killed the

market, and that the reason for the reduction in projected receipts is that the market has reacted negatively to the introduction of the LBTT. I assume that the Scottish Government would disagree with me. What does its analysis say is the reason for the depressed receipts?

Caroline Gardner: Last month, the Scottish Fiscal Commission published the first of its annual forecast evaluation reports. Those reports will go back to the forecasts that fed into each Scottish Government budget and compare them with the outturn, when that is available, and will do their best to explore the differences, based on the ways in which the model worked, the inputs to the model and what happened in practice.

As you would expect, when representatives of the Scottish Fiscal Commission appeared before the Finance and Constitution Committee a couple of weeks ago, the difference that you mention with regard to the LBTT was a significant element of the discussion.

The report stressed two things. The first was that the forecasts that fed into the 2016-17 budget were those that were made in December 2015 for the first time, with a new tax for Scotland that had a different structure from the predecessor tax, which was the old stamp duty, and that, therefore, there was always likely to be a greater forecast error. Further, there were changes to the tax, with the late introduction of the additional dwelling supplement just prior to the start of the financial year.

Secondly, with regard to the quality of the forecast, the report identified that the biggest variation was around the movement in house prices across Scotland, with the movement in the north-east not being a major contributor in that regard. The biggest contributor seemed to be that the forecast had assumed that house-price growth would return to trend after the financial crisis in 2008, when in fact—as is the case with many other parts of the economy—it is still below trend.

It is clearly important that the Government and the Parliament have a clear picture of how forecasts relate to outturns and how forecasts are improving over time as our collective experience gets better and the data improves for the particular taxes that we are looking at.

Liam Kerr: On page 5 of your report, you say that the Scottish Government managed the LBTT shortfall

“through underspends in its overall budget.”

Do you have any sense of which other budgets suffered in that regard? That is perhaps too pejorative a way of putting it. Do you know which other budgets did not get quite as much as a result of that underprojection?

Caroline Gardner: The table on pages 7 and 8, which has information that is taken from the Scottish Government's accounts, gives the major areas in which there were those movements. As always, there are areas in which spend will be lower than expected anyway and areas in which the amount that is spent depends on demand from external parties for the funding that is available. The Government was able to manage that within the overall budget to the £85 million that you identified in your first question. I do not think that we have any evidence that there were areas that went short in that sense but, as I said in my answer to the convener earlier, money that is not spent on the purpose for which it was originally intended obviously has an opportunity cost.

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): It is indicated on page 12 of the report that there was a higher-than-forecast receipt of £74 million from LBTT and SLT in 2015-16. I understand that that is still held in reserve and that any shortfalls in 2016-17 were met through various underspends elsewhere. The point that you have made and which was made in the Finance and Constitution Committee about the ebb and flow of forecasting being a bit of a black art was well made.

I want to ask a broader question about scrutiny. You mentioned the Finance and Constitution Committee. As you well know, the Parliament and the Finance and Constitution Committee had some difficulty with the scrutiny process last year. I think that that was mainly because of the timing of the budget, the compressed timescale for scrutiny that we had in the Scottish Parliament, and the fact that, during the year, it was not clear to some members of that committee how some unplanned expenditure was achieved and what impact that might have on the wider budget. That led the committee to request a revised framework for scrutiny that would give all members of the committee and, indeed, the Parliament the chance to see the ebb and flow of cash throughout the course of the year and a clearer insight into that. Will you say a wee bit more about how it is planned that that will be rolled out, how it will work and how it might aid members of the Finance and Constitution Committee and other members of the Parliament?

Caroline Gardner: Absolutely, but before I do, I note that you referenced in particular the ebb and flow in the land and buildings transaction tax from 2015-16 into 2017-18. Of course, that tax has more in-built volatility than most taxes, because the non-domestic, non-residential element of it tends to depend on a very small number of very high-value transactions. Therefore, there tends to be more shifting.

The main part of your question was about in-year scrutiny of the budget. The budget process review group, of which I was a member, considered that very carefully. We know that there will be more volatility and that that will move in different directions for different devolved taxes and different expenditure lines, but the process as a whole—the big picture rather than what is happening line by line and month by month with individual taxes—is probably the most important thing. The group recommended that there should be mid-year formal reporting back to Parliament when the autumn budget revision comes back to Parliament that sets out the overall picture on where revenues and expenditure are higher or lower than expected, the main reasons for that, the action that the Government is taking to manage that, including the use of its revenue-borrowing powers and the use of the reserve, which the report refers to, and how that will play through into any budget revisions that are requested for Parliament to approve.

On balance, we thought that doing that once during the year in the run-up to the budget process was more likely to be useful than having quarterly or monthly reporting at this point, although we were very conscious that the New Zealand Treasury, for example, simply publishes monthly management accounts that show the picture at each point in time. Scotland might want to develop that approach, but we felt that, at this stage, that would risk crowding out the big picture and the decisions that need to be taken in that context.

Willie Coffey: On unplanned expenditure and the miraculous appearance of money to fund particular initiatives, how much better and clearer will things be with the new process, so that members can see where money is moving from department to department, for example? How clear will that be for everyone?

Caroline Gardner: Our budget process review group recommendations were absolutely intended to provide that. There were two key things. One was the need to make it easy to see the big picture by pulling together in one place not just these accounts, but things such as the non-domestic rate account and the Scottish consolidated fund account that sit next to them but are not drawn together. It should also show the Scotland reserve and the use of borrowing powers, and the movements in each of those headings across the year compared with the budget. That would help. At the moment, you have to work quite hard to pull that picture together, even if you are an accountant with access to all the numbers. People in Parliament and across Scotland would find that much more difficult than we do. We think that it should be there, straightforwardly, for people to use.

The second recommendation was one that the group feels quite strongly about and it is about efforts to separate the numerical presentation of the budget from the political presentation of the narrative that goes alongside it. For example, I know that there was a fair bit of confusion last year in the Finance and Constitution Committee and Local Government and Communities Committee about the local government settlement, because some people confused the figure in the budget with figures for the overall funding that was available to local government, which took in things such as the amount that was available from council tax increases and from the £250 million that went to integration joint boards from the health service.

Separating out the presentation of the numbers in a technical sense from the political presentation that any Government will want to do will also help to provide clarity.

Willie Coffey: The Finance and Constitution Committee will do that regularly over the course of the year. Is there scope for the Public Audit and Post-legislative Scrutiny Committee to look at such figures on a quarterly basis, or do you think that we should continue to wait until the consolidated annual account comes out before we get our chance?

Caroline Gardner: That is obviously a decision for the committee. As you might expect, my view is that there is a particular value in audited figures such as those in the consolidated accounts, which have been through the process of audit and in relation to which all the relevant auditing and accounting standards have been tested out. Comparing the audited figures with the budget to understand what has changed and the reasons for that change would be a strong way of closing the loop. Since Parliament was established, a lot of attention has been paid to the budget, for obvious reasons. The committee has the chance to compare the two, to understand the differences and to make recommendations that can improve things for the future.

Monica Lennon (Central Scotland) (Lab): I want to return to the issue of underspend, which Liam Kerr mentioned. I apologise because, unlike Bill Bowman, I do not have a copy of the consolidated accounts in front of me. However, I want to pick up on the underspend in relation to the communities budget. My question relates to housing and infrastructure spending. From the report, I can see that there is £62 million of underspend, which mostly relates to the housing budget and the infrastructure loan fund. Can you unpick that and say how the situation differs from last year?

Stephen Boyle: You are right: there is an underspend of £62 million. In the accounts, the

Government looks to explain movements from actual to budget to give some context to that analysis. I apologise, because we do not have a lot of the detail that underpins that movement, but the reason why the spend on the infrastructure loan fund, which was established during 2016-17, was not as high as anticipated related to the availability of sites for new provision from councils and private sector providers. There is an inevitable lead-in time before sites become available and money can be spent, and that was not all in place during 2016-17 to allow the spend to go through as had been anticipated in the original budget.

Michael Oliphant: It is always a challenge, particularly when new funds are created, to identify what the profile of spending will be, particularly if a fund is set up over a number of years.

The infrastructure loan fund is for loans to non-public sector organisations, and it is prioritised for housing. As Stephen Boyle said, there were timing challenges with getting sites available so that the money could be spent in 2016-17. The underspend in relation to the loan fund was partially offset by higher demand in the help-to-buy scheme. That gives you an indication of the extent to which demand activity drives whether there are overspends or underspends in certain areas.

09:45

Monica Lennon: Thank you—that was helpful. I appreciate that, as you say, the scheme is fairly new, but a house building and infrastructure loan fund was launched back in 2011. What is the difference between the two schemes?

Michael Oliphant: There are a number of schemes within the infrastructure loan fund, but I do not know the detail—that would perhaps be better explained by the Scottish Government. We looked at the loan fund in 2016-17 by way of the treatment through the consolidated accounts.

Monica Lennon: The reason that I am asking is that it is a new scheme and I do not know how it differs from the previous schemes in terms of the criteria and so on. Given that we have had a model since 2011, it would be good to see what has happened over the past few years.

Caroline Gardner: You asked how the underspend compares with underspends in previous years. I have just checked last year's report, and the underspend last year was £163 million in the same portfolio. We said that that was due mainly to reduced revenue and capital spending on demand-led housing projects. There will be a significant underspend again, but the underspend was larger last year than in 2016-17. As Michael Oliphant says, if you are interested in the detail of the schemes, the Scottish

Government would be well placed to talk you through that.

Monica Lennon: Thank you. I will follow that up. That is at least a bit of an improvement.

I am trying to understand what is going on. You talked about the “availability” of sites or land. Are you able to say a bit more about what is understood by “availability”?

Stephen Boyle: Probably not, unfortunately. The purpose of our work in the area is to assess not only the performance against the budget, but the actual spend that has gone through in the year relative to what has been presented for audit. We are content that the number that has been presented is a reasonable and accurate figure. We would be happy to get back to the committee with more detail, and I am sure that the Government would be able to set out how the nature and pattern of the availability of sites has translated into spend.

Monica Lennon: Okay. I do not know whether you are able to give me an answer today, but it will be useful to get this on the record. In previous evidence sessions, we have talked about city deals, which have a big role to play in providing infrastructure and development on the ground. The accountability around that is quite interesting. When we see an underspend in a loan fund such as this and we know that the Government’s aim is to ensure that we solve the housing crisis and get development in the right places, is there any flexibility to move money around or work with partners such as local government?

Caroline Gardner: In broad terms, the Government has flexibility to move money between budget headings. In earlier exchanges, you heard how it was able to do that to reflect the lower-than-expected receipts from the land and buildings transaction tax. However, some parts of the budget are ring fenced, for good reasons. One of the tables that we have looked at shows things such as non-cash DEL and the AME funding, which are there for specific purposes and cannot be used for other purposes. Equally, some of the funding that is coming into city deals is match funding from the UK Treasury to match either Scottish Government funding or local authority funding, and it cannot be used in other ways.

I am currently carrying out a piece of work jointly with the Accounts Commission that is looking at city deals more generally because of the complexities of the accountabilities that are involved. That work will, I hope, be published next year. Its aim is to drill down further than just the accounting treatment of the numbers in order to explain what is planned and what is being achieved with those significant amounts of funding.

Monica Lennon: I have a brief question about the help-to-buy scheme, which I cannot see on the page in front of me. From memory, I think that there has also been an underspend in the help-to-buy budget—is that correct?

Michael Oliphant: I do not think that the accounts go into that detail, but there was some background information about where the movements in the budget would apply. If, as we move towards the year end, the Scottish Government has identified a potential underspend in one area, it will use some of that money to meet the higher demand for the help-to-buy scheme.

Caroline Gardner: You are remembering the evidence that the committee took on the CAP futures scheme and the loans that were made available to farmers as payments were delayed. Some of the funding for those loans came from the financial transactions fund, which covers the help-to-buy scheme, among other things. However, as Michael Oliphant says, our report does not go into that level of detail, nor do the accounts.

Stephen Boyle: The only other context is the financial transactions budget. Exhibit 3, on page 10 of the report, sets out the overall outturn against the HM Treasury budget for the financial transactions budget for the year.

Monica Lennon: Thank you. Overall, it is a good report. Last year, I asked a few questions about the way in which information was set out and about performance, and those points have been taken on board. That is a positive development.

I have one final question. Liam Kerr raised the issue of the underspend in education. I have taken an interest in the baby box scheme, and a lot of positive work is being done around that. The Government will keep the scheme under constant evaluation, which probably means that items will be added to the scheme as it goes forward. Can you tell me what your report means by

“Re-profiling of Baby Boxes spending to 2017/18”?

Michael Oliphant: Yes—£6 million was reprofiled to 2017-18. That is £6 million that the Government did not spend in the financial year 2016-17 that will be added to the budget for 2017-18. We understand that, in 2016-17, the Government focused more on the design and procurement of the scheme, and some of the spending that was earmarked for 2016-17 was for the planned purchase of stock that was no longer required because of the stage that the scheme was at. All that funding will be added to the budget for 2017-18.

Monica Lennon: Does that funding sit within the education budget, or is it in the health budget?

Michael Oliphant: It is in the education budget.

Monica Lennon: Was it always in the education budget?

Michael Oliphant: I do not know whether it has moved from one budget to another. As far as I know, it was in the education budget. At the start of 2016-17, there was a change in portfolio structures and a number of budget headings moved from one portfolio to another to match changes in ministerial portfolios.

Monica Lennon: Thank you. That is helpful.

The Acting Convener: Let me follow that up with a question on underspend. Last year was, I think, the first time that the Government anticipated underspend and reallocated it within the budget before we had the outturn figures. Is that good accounting practice?

Caroline Gardner: Longer-term financial planning is definitely good accounting practice. We have had a gradually evolving set of arrangements that allow the Government to do that, starting with the budget exchange mechanism between the UK Government and the Scottish Government and moving on to the Scotland reserve, which is formally there to smooth the moving of money from one year to another. I would expect that to be done, as far as possible, in a planned and transparent way that made it clear that funding was, for example, being held back from the current year in order to make investments in future years or, alternatively, that investment was being made in the current year to secure savings in the longer term—another reason for having a medium-term financial strategy.

In a budget of £34 billion, what look like very large numbers are very small percentages, and the smoothing is happening to a relatively limited extent. Nevertheless, it is important that Parliament and its committees understand those movements to ensure that they see the bigger picture and understand the longer-term consequences of what they are seeing.

The Acting Convener: I recall a previous finance secretary allocating a budget that was, say, £100 million over what was allowed for in order to reduce underspends. That practice seems to have stopped. Would you encourage that as good practice in the future?

Caroline Gardner: I do not recall the specific example that you are referring to, so I will be careful. It is never good practice to have a budget that does not reflect what you expect to achieve during the year or, indeed, that is not explicitly linked to the outcomes that you want to get from it. However, in a budgeting context in which there is little room for manoeuvre, that is the sort of thing that we see.

Since I have been in this job, I have recommended longer-term financial planning in the health service because a focus on hitting a specific revenue resource limit tends to drive bad behaviour about getting spending out of the door at the end of March, rather than planning for the longer term. The whole budgeting context needs to support good financial management.

Alex Neil (Airdrie and Shotts) (SNP): I want to follow up Liam Kerr's question about the legal provision for the health service. Is the £160 million provision for a specified number of years?

Stephen Boyle: We can certainly come back with our understanding of the detail of work in that area. Legal claims can take many years to get from receipt through to any final decision.

Alex Neil: From what I can remember of my time as health secretary, payouts came to about £60 million or £70 million per year. How long does the provision last for?

Stephen Boyle: As you say, payouts can vary. The provision will last for as long as it is deemed necessary for it to be in place, and until there is certainty that a claim and any corresponding amounts will or will not need to be settled.

Alex Neil: However, based on actual payouts, could you come back to us to tell us how long you estimate the provision will last? From memory, it would last about two years if it was meant to cover the entire legal bill.

Stephen Boyle: The difference to the budget will come through a reassessment of the total legal bill, as opposed to any expectation of future flow of funds in close proximity.

Alex Neil: Could you please give us a fuller explanation of that as part of your follow-up, so that we understand it?

Stephen Boyle: Of course.

Alex Neil: It is important. We are becoming more like America in terms of people suing the health service, so it is an area to keep a close eye on in the future. My second point—

Bill Bowman: Excuse me, could I get a clarification on that point? There is another £300 million in the accounts for contingent liabilities in respect of clinical and medical compensation payments. Therefore, in addition to what is provided, even more could come in. Will you build that into your explanation?

Stephen Boyle: Yes.

Alex Neil: It would be useful to have a briefing that brings everything together, including actual payouts over, say, the past three years.

Caroline Gardner: We can certainly do a briefing for the committee on how the system works. If you want to drill into the actual payouts beyond the numbers, that should be taken forward with the Government.

Alex Neil: The briefing is to see the flow of the numbers, how long the provision will last, and why there is £300 million vis-à-vis £160 million, with the purpose of two provisions.

Caroline Gardner: That is accountant's trickery; we will explain how it works. *[Laughter.]*

Alex Neil: Trickery with a capital "T".

Caroline Gardner: It is a very small "t".

Alex Neil: My second question is about quite a number of portfolios where the Government gives guarantees; for example, housing has income revenue guarantees, and the economy has guarantees given to businesses rather than loans or grants or investment. How are guarantees dealt with in the accounts?

Caroline Gardner: That is a very good question. We are all turning to the relevant paragraph in the report, which is paragraph 33 on page 14. I will ask Stephen Boyle to talk through how it works.

Stephen Boyle: We have looked to capture guarantees in the report, and we have placed them in the specific context of the hydro plant in Lochaber and the guarantee that the Government entered into for the purchase of electricity, if I recall. The accounts aim to show the Government's potential liability should there be a material change of circumstances in the provision and it needs to step in. In that particular example, it has been shown as £21.4 million. Similar to the previous discussion about claims, the proximity of that will depend on what happens with the viability of the provider and any change in price. The accounts show it as a potential liability that could crystallise in the future. They are able to quantify that liability, unlike some others—that is a particular test on accounting standards.

Alex Neil: Do those liabilities and the provision of those liabilities in any way affect the ability to spend money within the budget?

Stephen Boyle: No.

Alex Neil: Does it not impact on the revenue or capital budget?

Stephen Boyle: They are not directly connected but it is correct that the accounts adequately capture potential liabilities.

10:00

Alex Neil: I understand that but it is about the impact that it has. For example, with the

guarantees given to housing developers under the housing guarantee scheme, there can be a multitude of housing developers. Is there an upper limit? Is there a formula for deciding the upper limit to which the totality of guarantees can go?

Stephen Boyle: I think that the answer to that would be no. Ultimately, it will depend on the risk appetite of the Government as it considers schemes in the round. Our interest in that is that it is fully disclosed in the annual accounts.

Alex Neil: The issue is really disclosure but it does not really impact on the budgets themselves, per se.

Stephen Boyle: That is correct.

Caroline Gardner: However, as you suggest, it is important that the guarantees are transparent and that Parliament sees how they build up over time. They are disclosed in the notes to the accounts, on pages 108 and 109. We look at these closely and we test, first of all, that they are being treated properly in accounting terms—they should not be contingent liabilities or provisions—and secondly, we keep an eye on how they change as they accumulate over time.

Alex Neil: The risk is obviously key.

Caroline Gardner: That is right.

Alex Neil: That is helpful. My final question is on PFI and NPD projects. We have touched on the Aberdeen western peripheral route, which was affected by reclassification. There are two issues. The first is about the transparency of PFI deals in particular but also NPD projects to some extent. Secondly, there is a value-for-money issue around both. There is a general acceptance that NPD projects are better value for money than PFI ones but are they as good value for money as they could and should be?

I presume that value for money would be the subject of a specific piece of work by you, Auditor General, and would not be relevant to the consolidated accounts, so I will pursue transparency. The famous Hairmyres PFI deal is now more than halfway through the contract period. When I was the health secretary, I asked for a copy of the contract. The civil service asked if I really wanted a copy of the contract. I said, "Yes, I really want a copy of the contract—I want to read this contract." The civil service supplied the contract to me and it stacked up to a height way above this desk; it was huge and very complicated.

One thing that became clear to me when I was health secretary was that nobody was really monitoring these PFI contracts. They were not being policed and quite frankly, the contractors were getting away with financial murder, in my view. Are you satisfied, particularly in relation to

PFI contracts, about the level of policing by the relevant bodies such as health boards?

Caroline Gardner: I agree with you entirely about transparency. The PFI NPD arrangements to which the Scottish Government is party are again included in the notes to the accounts and you can see some information there. There is separate information in the quarterly report that comes to the committee about capital projects, which shows how far the revenue commitments have got from the 5 per cent headroom limit set by the finance secretary. However, it is very hard to see the overall picture and how the costs compare with each other.

Monitoring of almost all public-private partnership schemes, to use an umbrella term, is done by the individual body—whether it is a health board, a local authority, or a further education college—that holds the contract. As you say, the contracts are very complex. The ones that I have seen recently tend to come on a DVD rather than on stacks of paper just because of the size of them.

It is important that monitoring focuses on the right issues and receives the right degree of attention, given the financial commitments involved and the impact on the services that are provided to people, which are often critical services in education and health, for example. It is not something that we look at directly unless a problem appears through our audit work. However, we are planning to do another piece of work on public-private partnerships more generally. It is getting under way and will report late next year. It will look at the state of play on all of this.

Audit Scotland produced a piece of work about a decade ago that still stands up in many ways. We have not refreshed that to look at value for money, governance and other arrangements that need to be in place around the current set of projects to ensure that the public purse is receiving what it is paying for.

Alex Neil: Through the Scottish Futures Trust, we brought a team into the Larbert hospital in Forth Valley. The team quickly identified breaches of the contract, which resulted in savings. However, we are not doing that on anything like the scale on which it is happening in many health boards south of the border, where multimillion pound recurring savings are being made because monitoring teams that have been brought in are identifying major breaches of contract, which opens up the whole contract and gives the public sector the ability to renegotiate many of the terms and conditions.

I understand that Hairmyres hospital, for example, is the responsibility of Lanarkshire NHS

Board, but should we not be taking a much more robust approach to ensure that the Lanarkshire NHS Boards of this world are actually being as robust as they need to be to get a better deal and to ensure that contracts are being properly adhered to?

Caroline Gardner: The Scottish Futures Trust has made a big contribution by bringing that expertise and the ability to negotiate better contracts and understand the workings of the ones that are in place. I do not know what they have done in terms of reviewing other current contracts, like the Forth Valley one, and that is something that I will take away and look at. It is a good question.

Alex Neil: It is also something for the Accounts Commission to consider, because a lot of the contracts relate to schools, and they are some of the worst, in my view. That is certainly what the evidence suggests. The problem is that, when you try to get information about the terms and conditions of those contracts, organisations such as health boards and local authorities hide behind the commercial confidentiality rule. My view is that those things should all be open. I can see why you might need to maintain a degree of commercial confidentiality during a negotiation, but I think that the public are entitled to know where their money is going once the deal is done.

Caroline Gardner: I am a strong advocate of transparency and I agree with you on that. The specific point about how well the implementation of contracts is being reviewed once they are up and running is a very good one that I will take away.

Alex Neil: I think that potentially significant savings could be made in a number of portfolios if a more robust approach was taken throughout the public sector to PFI, and to a lesser extent NPD, projects.

Liam Kerr: My question is about European structural funds, and about paragraphs 65 to 67 of your report. I hope you will forgive me if I try to translate it into language that I understand, because I find it rather complex. Pick me up if I translate it wrong. As I understand it, there were suspensions on the ability of the Scottish Government to draw down funds relating to the 2007 to 2013 schemes, and that, as a result, the Scottish Government went ahead with some projects in anticipation of receiving some funding. The Scottish Government made provision of £14 million in case those funds were not forthcoming, and it turns out that they are not forthcoming. However, your report seems to say that that £14 million provision was significantly short and that, in fact, the liability—the money that needs to be paid back to the structural funds—is £31 million. The

report goes on to talk about the net cost being £21 million. What is going on there?

Caroline Gardner: It is not just you—it is very complicated. What you have just described is very close to what we are trying to say in the report, and I will hand over, with gratitude, to Michael Oliphant to help you with the detail.

Michael Oliphant: I will do my best to simplify a complex matter, but I might have to complicate it a little more to begin with by talking in euros, because the payments made by the European Commission are in that currency.

Given that it is the closure of the programme, it is useful to talk about the programme as a whole from 2007 to 2013. In that period, €820 million was available to the Scottish Government and around 70 per cent of that was declared as eligible expenditure, which is €744 million. The total that was actually received by the Scottish Government was more than that; it was €781 million. That leaves a difference of €37 million between the grants declared and the total received, which translates to the £31 million that is the liability and is the money that goes back to the European Commission.

Liam Kerr: I understand. So, at some point, the Scottish Government has to find £31 million to give back to the European Commission.

Michael Oliphant: That money went through the accounts in 2016-17 so, in effect, it has been returned. It is subject to final checks by the European Commission. The Scottish Government will submit an audited report that reports the £31 million liability, but the European Commission will do its own checks—it is due to report by March next year, I think. The final position might change but, as far as we know, the liability is £31 million.

Liam Kerr: That will be finalised in March 2018, but the committee had a letter from the Scottish Government in April 2017 in which it was of the view that the amount owed was £13.3 million. Is it simply the case that the figures that you talk about in the report came out after the letter? If that is right, does the Scottish Government accept that we are potentially in the hole for £31 million?

Michael Oliphant: I think that there is a timing difference between the letter that the committee received and the report. The letter probably refers to the £14 million provision that was created last year. What we found through this year's audit is that that has now crystallised into a liability that is higher and more significant at £31 million.

Liam Kerr: There is a big difference between what was provisioned for and what the Scottish Government is liable for. Is that an easy mistake to make?

Michael Oliphant: It probably comes through the final declaration. A lot more activity goes on to reconcile amounts that have come from the Commission from projects that have had self-corrections applied or from spending that was withdrawn when internal checks perhaps revealed poor documentation or issues that would have meant that the Commission would not approve that spending. There was a lot more activity, particularly in the last quarter, that settled on the higher amount.

Liam Kerr: Paragraph 67 of the report seems to come at it from the other end. While that was going on, various projects were happening and some people or companies were contracted—you call them “project sponsors” and by that I guess that you mean people who were engaged to deliver. You say that, as a result of that delivery, the Scottish Government has overpaid by £16 million, which it now seeks to take back from the people who delivered the projects. You say that the Scottish Government is invoicing for the extra £16 million, but what are the realistic prospects of getting any of that back when, presumably, the deliverers were engaged in good faith and they delivered and invoiced in good faith?

Michael Oliphant: It is a difficult position. As you said, £16 million has been overpaid to project sponsors. In terms of the recovery of that—

Liam Kerr: Forgive me for interrupting, but what does “overpaid” mean?

Michael Oliphant: That is money that was paid to project sponsors that was not eligible expenditure and was required to be sent back to the European Commission. That has been settled between the Scottish Government and the European Commission in previous years, so that is money that is due to come back to the Scottish Government.

Liam Kerr: But it was presumably legitimate for the project sponsors to be paid. It was not their mistake, was it? They were presumably contracted to deliver whatever it was they were supposed to deliver.

10:15

Michael Oliphant: Yes, absolutely. I think that it was hoped that that money would come from the European Commission through eligible expenditure. The Scottish Government pays grants to project sponsors in advance, and then, once a year, makes a declaration back to the European Commission to receive money for that.

Caroline Gardner: It might help to give a couple of examples of the sorts of things that cause errors that can lead to repayment or to funding not being available from the European

Union. The Scottish Government accepts applications from a range of bodies—they might be other public bodies or community associations—for projects or grants that are eligible under the terms of the scheme. It approves some of that within the total funding that it has available. However, there are things that project sponsors are required to do as a condition of receiving that money, such as meeting procurement rules, having particular controls over how that money is spent and keeping an audit trail. If it becomes clear later that those conditions have not been met, the funding is not eligible to be reclaimed from Europe—that is part of the £31 million that you have been talking about—and the bodies that spent the money are not entitled to receive some or all of it from the Scottish Government. The Government is having to make a difficult judgment about reclaiming that money from those bodies.

We mention briefly in the report—we spent some time on this last year—that when projects went into interruption and suspension, the Scottish Government focused on improving controls to ensure that much less spending fell into the category of not being eligible for European structural funds. What we are seeing is the tail of the money that went out before those changes came into place.

Liam Kerr: I understand. The money has gone out to third sector organisations, perhaps—

Michael Oliphant: There are a number of different organisations—universities, colleges, private sector organisations, third sector organisations and local authorities. It is a combination.

Liam Kerr: Presumably, for perfectly legitimate reasons, which the Auditor General set out, the Scottish Government could go to those bodies and say, “Can we have our significant funds back, please?” Those bodies might have spent money on a project and may no longer have those funds. If so, is it not more likely that the Scottish Government needs to write off £16 million?

Stephen Boyle: As Michael Oliphant mentioned, as part of the invoicing process that is under way, the Government’s correspondence with the bodies concerned includes a provision for appeals to be factored into associated invoices. We thought in particular about whether there is certainty about the ultimate receipt of the £16 million in terms of the disclosure that is captured in the accounts. The amount is not captured with certainty as an asset or an anticipated flow of funds back to the Government because of the nature of the appeals process that is detailed.

Liam Kerr: Michael Oliphant talked about the distinct 2007 to 2013 programme. Another

programme is now running for 2014 to 2020. Has there been any impact on those projects as a result of the issues with the 2007 to 2013 programme? I think that the Scottish Government says that the start of some of those projects has been delayed. Has there been a significant impact? If so, what is it?

Michael Oliphant: The monetary impact is quite separate; the new programme is distinct from the 2007 to 2013 programme. Interestingly, the new programme is being applied with a lot of focus on the management of controls, which is where some of the problems with the previous programme arose. We understand that the Scottish Government is still designing and improving those controls, although the European Commission has approved the overall controls framework for the programme. The letter that the committee received back in January outlined some of the principles that the Scottish Government hopes to apply. We will look at that with interest in our forthcoming annual audit covering 2017-18.

Bill Bowman: Paragraph 59 of the report, on the CAP futures programme, takes us back to your figure of £60 million. Can you clarify what the Government had booked in relation to that?

Caroline Gardner: Stephen Boyle will take you through that.

Stephen Boyle: The £60 million to which you refer was the figure that we captured in our June report on the CAP futures programme follow-up, in which we identified a potential penalty relating to CAP payments. The figure of £60 million was based on our estimate of potential fines arising from not just the timing of payments but the assessment of the existing control environment. That assessment was translated, in part, into the disclosures that are in the consolidated accounts.

It goes back to our earlier discussion about the certainty and timing of some of those liabilities. The certainty element was captured in the provision of £2.5 million in respect of penalties, and this year’s accounts also include an unquantified contingent liability. We have sought to explain the reason for that in exhibit 6, which shows the interaction that can take place between payment agencies and the Commission. Any potential penalties that come from the Commission are always subject to negotiation and further timing. Our judgment, on the basis of the disclosures, was—similar to the clinical negligence claims that we talked about earlier—that it is a mixture of both a provision and a contingent liability.

Bill Bowman: You spoke about £60 million and the Government booked £2.5 million—is that correct?

Caroline Gardner: Yes. It has booked £2.5 million in 2016-17 as a provision and then the unquantified contingent liability for the future.

Bill Bowman: If it had booked the £60 million, would you have just ticked that and moved on?

Stephen Boyle: No, I do not think that we would. Our audit work is always subject to discussion and reference to auditing and accounting standards.

To cut a long story short, we think that both figures are correct. The figure of £60 million was based on a methodology for calculating the potential liabilities. When it comes to translating that into what is appropriate for capturing in the audited accounts, we think that that is better reflected by way of unquantified contingent liability.

Bill Bowman: Convener, we seem to be reading the numbers and then having to go to the notes to read the words before starting to make a judgment. It goes back to what Alex Neil was looking at earlier. We should perhaps read notes 15 to 17 of the consolidated accounts and add the numbers up in our heads. I would guess that an external analyst would just add the contingent liabilities in and say, "These numbers could go out the door." We are talking about better disclosure and more transparency, but we are having to read quite small print about unquantified contingent liabilities, and it is quite difficult even for somebody who is familiar with such terms to know what they mean. In the front part of the accounts, where there is all the discussion about what the Government has done, does it go into the detail of what those things might mean?

Stephen Boyle: There is reference to the CAP futures programme in the narrative—

Bill Bowman: But generally, within contingent liabilities, contingent assets, indemnities and guarantees. I know that there is reference to the ability of a Government to give guarantees and the authorisation limits—I do not know whether you have looked at that in any of your work. It looks as though there are quite a lot of issues in the consolidated accounts that might require a bit more detailed reading for a layperson to pick up. I will be interested to see how the NHS medical claims figures come out, as there are some quite big numbers involved.

Do you get the impression that the Government is putting things into contingent liabilities, to be fed back in the future as they have to be, as opposed to being careful and prudent and making the full provision that should be made now?

Caroline Gardner: As Stephen Boyle said, we test those questions carefully, as any auditor would, to make sure that the accounting treatment

is correct. My reporting—the annual audit report that is produced and published and the section 22 report—aims to bring that picture together. We are seeing improvements in the Scottish Government's reporting; the narrative has improved over time, the disclosures are fuller than they have been and we continue to encourage and push it to include disclosures where we think that they ought to be there.

It is also true that the importance of those figures is increasing as we are now a tax-raising as well as a spending Parliament. This is a milestone year with the introduction of income tax powers on all non-savings, non-dividend income and the greater level of volatility that that brings. Both my recommendations and those of the budget process review group are about getting more of that transparency in future to the financial statements and to the budget, so that people can see the relation between the two.

Bill Bowman: We will take the review of the health provisions as a good test case and see how we get on.

Michael Oliphant: We will need to go through the notes and add up the numbers. Paragraph 33 of our report outlines where the liabilities can be quantified; that is an estimated £429 million.

Bill Bowman: Is that the report that will come to us?

Caroline Gardner: Yes.

Bill Bowman: I take that as a useful number but, within the financial statements, I do not think that there is a summary.

Michael Oliphant: No.

Bill Bowman: Is there any information in your report that is not available from the accounts, or is it all drawn from the accounts?

Caroline Gardner: It is drawn from the accounts and from our insights into them from our wider audit work. The aim is to pull out what is of interest and, we hope, useful to this committee and Parliament more widely.

Bill Bowman: Is there any additional disclosure that is new?

Michael Oliphant: We pull in information for some of the exhibits, particularly the one that reconciles the Scottish budget to the HM Treasury budget—that comes from budget documents—and there are one or two disclosures that come from the audited accounts of other bodies.

Bill Bowman: Thank you.

The Acting Convener: I thank witnesses for their evidence this morning. I move the committee into private session.

10:27

Meeting continued in private until 10:38.

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