OFFICIAL REPORT
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Public Audit and Post-legislative Scrutiny Committee

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PUBLIC AUDIT AND POST-LEGISLATIVE SCRUTINY COMMITTEE
1st Meeting 2021, Session 5

CONVENER

*Jenny Marra (North East Scotland) (Lab)

DEPUTY CONVENER

*Graham Simpson (Central Scotland) (Con)

COMMITTEE MEMBERS

*Colin Beattie (Midlothian North and Musselburgh) (SNP)
Neil Bibby (West Scotland) (Lab)
*Bill Bowman (North East Scotland) (Con)
*Alex Neil (Airdrie and Shotts) (SNP)
*Gail Ross (Caithness, Sutherland and Ross) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Stephen Boyle (Auditor General for Scotland)
Michael Oliphant (Audit Scotland)
Tarryn Wilson-Jones (Audit Scotland)

CLERK TO THE COMMITTEE

Lucy Scharbert

LOCATION

Virtual Meeting

Scottish Parliament

Public Audit and Post-legislative Scrutiny Committee

Thursday 14 January 2021

[The Convener opened the meeting at 10:00]

Decision on Taking Business in Private

The Convener (Jenny Marra): Good morning, and welcome to the first meeting in 2021 of the Public Audit and Post-legislative Scrutiny Committee. I have received apologies from Neil Bibby MSP.

Agenda item 1 is a decision on taking business in private. Unless any member indicates otherwise, I will assume that everyone agrees that we should take items 3 to 5 in private.

As no member has indicated otherwise, we agree to take those items in private.

Section 22 Report

"The 2019/20 audit of the Scottish Government Consolidated Accounts"

10:00

The Convener: Item 2 is consideration of the section 22 report "The 2019/20 audit of the Scottish Government Consolidated Accounts". I welcome Stephen Boyle, the Auditor General for Scotland; Michael Oliphant, audit director, Audit Scotland; and Tarryn Wilson-Jones, audit manager of audit services, Audit Scotland. I understand that the Auditor General would like to make a brief opening statement.

Stephen Boyle (Auditor General for Scotland): Good morning. I am presenting this section 22 report on the 2019-20 audit of the Scottish Government under section 22 of the Public Finance and Accountability (Scotland) Act 2000. The Scottish Government's annual consolidated accounts are a critical component of its accountability to Parliament and the public. The consolidated accounts cover about 88 per cent of the budget that was approved by Parliament in 2019-20. The accounts show the amounts that the Government spent against each main budget heading and the reasons for any significant differences. They also show the assets, liabilities and other financial commitments that the Scottish Government is carrying forward to future years.

My independent opinion on the consolidated accounts is unqualified. That means that I am confident that they provide a true and fair view of the Government's finances and that they meet legal and accounting requirements.

I will highlight three areas in my report. The first is on budget performance. The end of the 2019-20 financial year coincided with the most challenging period that the Government has faced since devolution. The Covid-19 pandemic brought significant challenges and risks to the Scottish Government, alongside existing pressures. The consolidated accounts show that total net expenditure during the year was £39.385 billion, which was £669 million more than budget.

As the financial year drew to a close, the Scottish Government announced plans for two large business support schemes to respond quickly to the impact of Covid-19 on businesses. Although funding for the schemes was not included in the Scottish budget until 2020-21, the actions that the Scottish Government took prior to the end of March 2020 created a constructive obligation under accounting standards and, therefore, the related costs amounting to £912 million are included in the 2019-20 consolidated accounts, which led to an overspend against budget for the year.

The second area is on financial management. My report highlights the status of Government loans and guarantees to private companies such as Ferguson Marine Engineering Ltd, Burntisland Fabrications Ltd and Prestwick Airport Ltd, for which the valuations of financial support have deteriorated. I repeat the recommendation made by my predecessor that the Scottish Government needs to clearly outline its plans for future investment in private companies, including its approach to risk tolerance, financial capacity and expected outcomes. In doing so, the Government needs to ensure that there is greater transparency over the financial support that is provided and the value of public funds that are committed.

The third area to highlight is financial reporting. As the committee will be aware, the Government postponed the publication of its third medium-term financial strategy, which will now be published later this month alongside the draft Scottish budget. The move to a later publication date allows the Scottish Government to better reflect the likely impact of the pandemic on public finances, including options for ensuring financial sustainability.

Inevitably, though, the later publication date will mean that, compared with the timescales of recent years, there will be less time for Parliament to scrutinise the strategy prior to the budget. That will be particularly challenging for Parliament, considering the number of significant concurrent risks that will impact public finances in the short and medium terms, and the difficult choices that will likely be required on public spending. There is a need for the strategy to make clearer the links between planned spending options and the expected outcomes that are outlined in the national performance framework, in order to aid Parliament's understanding of the financial risks and opportunities that emerge from the Covid-19 pandemic.

My colleagues and I would be delighted to answer the committee's questions.

The Convener: Thank you very much, Auditor General. I will begin questions from the committee with one from Graham Simpson.

Graham Simpson (Central Scotland) (Con): Good morning, Auditor General. It is unusual for us to speak to each other in this format, but there we are. I will start the questioning on the topic of financial support that is given to private companies, which you mentioned in your opening remarks. As you said, the past two section 22 reports, which we got from your predecessor, highlighted the need for the Scottish Government to be more transparent about its overall approach to that. Although you said something about it in your opening remarks, you do not appear to go quite as far. Can you give further guidance on what you are looking for the Government to do and why?

Stephen Boyle: You are right that that has been a recurring theme in section 22 reporting during the past few years.

In paragraphs 32 and 33 of the report, we looked to capture aspects of the steps that the Government has taken since the recommendations that Caroline Gardner, the former Auditor General, made in her reports around the need for a framework. I should state that I do not think that the steps that have been taken by the Government yet equate to a framework. I will say a bit more about what we think needs to happen.

The Government has made some progress with the guidance to accountable officers of public bodies on the steps that they ought to take when considering interventions in private companies. That is welcome. We also referred to the Government's development of a database of companies that it might consider strategic and as possible candidates that are suited for intervention. There are signs of progress.

However, I do not think—this is set out in the report—that that equates to a framework for interventions in private companies. There are three main areas of progress still to happen. The first is that the Government should better set out its risk tolerance or appetite for this level of intervention. The second is that it should consider what financial capacity it would make available for such investment types and, importantly, the third is what the expected outcomes that it intends to achieve from this type of intervention in private companies are.

As we set out in a fair amount of detail in the report, the type of interventions that have taken place so far—the high-profile ones—have not been successful in Government returns. We considered the quantification of the value of some of those investments in the report. It is particularly important that progress is made in that area, especially as we look at the impact of the pandemic and the likely further call on Governments for financial intervention. If it is the case that there is challenge for businesses in the coming months, and it is likely that the Government will have the prospect of further investment opportunities, it is important that it has a sufficiently rounded framework with which to make such decisions.

There is also further opportunity for reflection on the lessons learned by feeding into the framework all the investments that have been made thus far and any particular learning that can be used to create the rounded framework that Caroline Gardner called for—a call that I repeated in my report.

Graham Simpson: That is clear enough. You are looking for clarity on the situations in which the Government will invest in private companies. Does that summarise it?

Stephen Boyle: It does. The one thing that I will add is that the Government routinely invests in private companies. Typically, its enterprise agencies have been the main conduit for such investments in recent years. Those investments are not without risk. As we see reported in the agencies' accounts, many investments will come to fruition and others will lead to losses. What we have seen in recent years that is different is the Government itself taking a more direct role, distinct from the enterprise agencies. That is an important distinction, because there is therefore more need for the Government to take that final step, beyond giving advice and guidance to accountable officers of public bodies, to create a more rounded framework that captures the extent of the financial capacity available for such investments through to the outcomes that it anticipates the investments having.

Graham Simpson: You have mentioned some high-profile cases—Prestwick Airport, Ferguson Marine and BiFab. Without getting into the politics of it, but purely dealing with money and value for money, could things have been done differently for the taxpayer in any of those cases?

Stephen Boyle: We have not specifically undertaken a review of the detail of each and every level of investment. However, from last year's report, I recall the judgment made by Caroline Gardner, particularly in respect of Ferguson Marine, that it was unlikely to deliver value for money. I am also in receipt of an invitation from the Rural Economy and Connectivity Committee to progress further work in that area in the round. That is under active consideration, and I refer to that in this report.

We have reported previously on the steps that led to the Government intervention in Prestwick Airport. We have seen that significant sums of public money have been invested in Prestwick Airport and, similarly, in BiFab and that the valuation of those investments, as the Government has reported in its accounts, is very insignificant. In itself, that leads us down the path towards the judgment that the outcomes have not been as originally envisaged. We will follow that up with our own work, Mr Simpson. In due course, we will be definitive about those circumstances and we will capture that in value-for-money judgments.

Graham Simpson: There is another committee inquiry into BiFab, so we will not stray into that. Dealing purely with what you look at, the Government invested a significant sum of money into BiFab, which has now gone into administration. That £50 million could, presumably, just be lost. Could the Government have taken a different approach?

Stephen Boyle: You are right that there are committee interests elsewhere and that there will be reviews of the circumstances that led to that situation. However, as we capture in the report, the facts are pretty stark: more than £50 million of Scottish Government money was invested in BiFab and the valuation of that has now been captured at zero. That is all the more reason for our saying that reflections and a lessons-learned exercise, which ought to be undertaken by the Government on that investment, are needed to inform any subsequent investments that it chooses to make in private companies. We touched on the inevitability that more opportunities will come its way, and it is therefore urgent that that level of framework is progressed, so that the Government is better placed to secure the value of future investments.

Graham Simpson: Convener, I have one more area to explore, which is that, in the report, the Auditor General refers to some of these interventions falling outside the accounting boundary of the consolidated accounts. Why is that? Can anything be done to fix that?

Stephen Boyle: I will start and I will then invite Michael Oliphant to supplement that. Fundamentally, it is for the Government to decide on the accounting boundary. I appreciate that the committee has considered the matter a number of times over the years. As and when it creates new organisations, the Government determines whether the income, expenditure, assets and liabilities of that organisation will flow through to the consolidated accounts. There are some high-profile examples that are not within the accounting boundary, such as Caledonian Maritime Assets Ltd and the assets that it owns on behalf of Caledonian MacBrayne.

10:15

We have seen some progress in relation to such new organisations in recent times. For example, I appreciate that the committee has a very direct interest in Ferguson Marine (Port Glasgow) Holdings Ltd, which we touched on in the report and which is the Scottish Government company that has been created following the Government's ownership of the Ferguson Marine yard. That will fall within the Government accounting boundary. We understand that an order being laid in respect of that is imminent to reflect that I will also become responsible for the appointment of the external auditors of that organisation. That is welcome; it supports our call for transparency and, indeed, reflects my own ability to prepare audit reports and to report to Parliament thereafter.

I will pause for a second to see whether Michael Oliphant wishes to add anything about the overall arrangements for how that will take place.

Michael Oliphant (Audit Scotland): The only point to add is that it comes down to the classification of the body—that is, whether it is a central Government body—which is determined by the Office for National Statistics. The Scottish Government will determine the actual status of the body as it is created. However, the bodies that we are talking about—Ferguson Marine and Prestwick Airport—are commercial entities and therefore would not fall under that category and would fall outwith the consolidated accounts boundary. However, it is important to note that those organisations are obviously audited separately. Their financial statements will be audited and available under the Companies Act 2006 in normal circumstances.

The Convener: Your report states that the Scottish Government will have to learn lessons from its experience of recent financial interventions in private companies. Does the Scottish Government accept that there are lessons to be learned, and what are those lessons?

Stephen Boyle: I should say that we have, as we always do, cleared the report with the Government in terms of its factual accuracy and judgments. It will be for the Government to fully explain in due course any steps that it plans to take in respect of the lessons to be learned and the interventions that it has made.

I would probably refer back to what we consider to be the missing steps in an overall framework, recognising the progress on giving guidance to accountable officers but bearing in mind that that guidance came to fruition after some of the initial interventions had taken place. We think that those steps need to be taken; in particular, the Government needs to set out, at the point of intervention, the risk tolerance, the available financial capacity for those investments and what the outcomes need to be, so that they are clear. That supports public transparency and parliamentary scrutiny of the value of the investments taking place.

Ultimately, it is difficult to get away from the fact that many tens and hundreds of millions of pounds of public money have been invested in these organisations and it is now recorded at a next-to-nil value. There is therefore a need to follow through on the recommendations of both Parliament and the various committee inquiries that are taking place, and for our own work to follow thereafter. However, it is certainly a line of questioning that I am sure that the committee may wish to explore further with the Scottish Government.

The Convener: In relation to the first point that you made about the process, when you referred to officers, did you mean decisions being made by ministers and Government without reference to Scottish Enterprise?

Stephen Boyle: Not directly. Caroline Gardner made the recommendation for a framework to support interventions in private companies, and we are saying that the Scottish Government response to that has been to enhance the extent of guidance that it has in the Scottish public finance manual, which sets out the range of financial arrangements for public bodies in Scotland under its remit. That is important and welcome, but there is a gap between that and a wider framework.

We are therefore not necessarily drawing a distinction between the Government's role and that of the enterprise agencies in those interventions. However, there is an important point about why those interventions that carry more risk on the face of it have been led by the Government directly rather than the enterprise agencies.

The Convener: Are you saying that the riskier ones rest with the Government, and the less risky ones rest with Scottish Enterprise?

Stephen Boyle: That is what we have seen, but we think that there is insufficient guidance or clarity for Parliament and accountable officers across public bodies to understand where such an intervention might fall—in being a Government-led intervention or an enterprise agency economic support activity. All that ambiguity is unhelpful when it comes to supporting public understanding and scrutiny.

The Convener: I think that it is quite obvious to Parliament where the interventions do fall; perhaps the pertinent question is about where they should fall.

Colin Beattie (Midlothian North and Musselburgh) (SNP): I want to look at some issues around the European social fund and the European regional development fund. I realise that the suspension of funds in countries is not unusual; it seems to be part and parcel of how things work. However, you have stated that there are

"serious deficiencies in the management and control system"

for the European social fund, and I am trying to get an idea of the financial and reputational risks in that. What is your assessment of the situation?

Stephen Boyle: Good morning, Mr Beattie. I will start, and I will then invite Tarryn Wilson-Jones to update the committee on our understanding of the progress of discussions between the Scottish Government and the European Commission, which oversees the economic funds.

You are right. It is quite a long tale about the value of the funds, the level of compliance of the Scottish Government and its partners, and the levels of control and arrangements that the European Commission expects bodies in receipt of grant to operate. To cut a long story short, what we have seen and have captured in the report is that European auditors reviewed the level of compliance with the rules and found deficiencies in the extent to which those checks and balances were undertaken before moneys were paid out and then reclaimed by the Scottish Government. That led—

Colin Beattie: Sorry to interrupt, Auditor General. My concern is that you have stated that there were “serious deficiencies”.

Stephen Boyle: That terminology is drawn from European Commission auditors’ judgments. In essence, they are saying that the Scottish Government and its partners have not followed the rules that the European Commission has outlined. Some of those rules are very specific and detailed, and are potentially quite onerous on public bodies, but they are nonetheless the rules of the European Commission, which expects them to be followed in order for funds to be received.

When the Commission auditors came out, as they do, for their sample checking and evaluation, they found the Government and its partners not to be in compliance. We refer to one specific example of non-compliance: the treatment of and verification checks on staff costs and a misinterpretation of European Union rules. That has led to the suspension of the scheme, cash-flow implications for the Scottish Government and its partners, and potential penalties that the Commission may choose to apply to the Scottish Government as it reclaims the amount of the moneys that have been spent. Not all of what the penalties might mean is yet clear.

I will pause for a moment so that Tarryn Wilson-Jones can give our most up-to-date understanding of the circumstances.

Tarryn Wilson-Jones (Audit Scotland): Our understanding is that the Scottish Government expects the suspensions to be lifted imminently and awaits formal confirmation from the European Commission. That would mean that the flow of funds to Scotland would start again. As the Auditor General has said, the financial risk remains, because both schemes have been in suspension and there is therefore a risk of a penalty being applied by the European Commission, as we have said in our report.

Colin Beattie: The report states that the Scottish Government is

“hopeful that the suspensions will be lifted before the end of March”.

How confident are we that that will happen?

Tarryn Wilson-Jones: Reasonably confident. We understand that the Scottish Government expects to hear imminently that the suspension has been lifted.

Colin Beattie: Is Audit Scotland satisfied with the Scottish Government’s assessment that that will happen. From the information that you have, do you believe that that is a reasonable conclusion to draw?

Tarryn Wilson-Jones: Yes.

Stephen Boyle: The only thing that I would add is that, although the indication that the suspension will be lifted is welcome, the extent of the financial penalty that the European Commission might choose to apply to the Scottish Government’s claim process is not clear. From our experience of previous suspensions or Commission auditors’ judgments of non-compliance with the rules, we can say that there will be a penalty. There is a long drawn-out process of discussion by which the exact quantum of the penalty is established, which can extend over many months and, indeed, years of negotiation and to and fro.

What we expect to see in the Scottish Government’s 2020-21 consolidated accounts is some reference to that—a provision or a contingent liability that, where possible, quantifies the extent of financial penalty and the expectation that the flow of funds will resume following the lifting of the suspension.

Colin Beattie: Have the “serious deficiencies” that apparently exist been resolved?

Stephen Boyle: Tarryn Wilson-Jones might want to say a bit more about that in a second. First, I will say that the Scottish Government has taken the issue quite seriously. A lot of money is at stake, so it is important and welcome that it is doing so. It invested in leadership and controls and in its internal audit activity in this area, as well as in the guidance that it provides to its partner organisations.

Ultimately, the proof will be at the discretion of the European Commission and the judgment that its auditors make. However, all indications are that, as Tarryn Wilson-Jones mentioned, the Government is satisfied that it can resume claims to the Commission, because the situation has been resolved to its satisfaction.

Colin Beattie: So, even if there must still be a long discussion about whether there is any penalty, the suspension can be lifted.

Stephen Boyle: That is correct. The lifting of the suspension allows for claims to resume, but it does not do away with the fact that there was a suspension in the first place, and financial penalties will come by virtue of there having been a suspension. There will be negotiations about the extent of the penalty that the Commission ultimately applies.

Colin Beattie: You said that some of the rules are fairly onerous to abide by—we have heard that in the past in relation to some EU regulations. Do you feel that there have been any failings on the part of the Government in that regard? I do not mean just that deficiencies have been pointed out; I am thinking about whether those deficiencies are reasonable deficiencies that have come about because of the complexity of the rules, as opposed to casual indifference.

Stephen Boyle: We agree with the point that you are making. The rules are complex to follow but, ultimately, in order to receive grant, as the Scottish Government chose to do, there is an expectation that the grant-giving body—the Commission, in this case—can set the rules that it expects to be followed. The question whether the rules are onerous is almost academic. They were what they were and the Commission required them to be followed, and it is the judgment of its auditors that they were not followed at the time.

It is undoubtedly welcome that the Government has taken the issue seriously and has invested in leadership and additional training and clarification about exactly what needs to be done for the suspension to be lifted, as we anticipate that it will be. Of course, we will track what that means in terms of any penalties that the Commission levies on the Scottish Government in due course.

Colin Beattie: Your report notes that the publication of the Scottish Government's third medium-term financial strategy has been delayed as a result of the pandemic and will be published at the same time as the budget. Your predecessor was critical of the previous medium-term financial strategy, and Audit Scotland's report on it said that it was

"a missed opportunity and a step backwards for the Scottish Government's financial reporting."

That report also listed a number of areas that the strategy did not cover, such as

"indicative spending plans or priorities"

and

"detail on how the Scottish Government would address a possible £1 billion shortfall"

if that were to materialise. Have you any sense of whether the Scottish Government has responded to those criticisms? Will whatever comes out at the time of the Scottish budget address them?

10:30

Stephen Boyle: I will start and then I will invite Michael Oliphant to describe our understanding of the up-to-date position.

I should say that we have not seen a draft of the medium-term financial strategy, nor do we yet have a clear indication of its content. Particularly in light of the pandemic, certain points that we touch on in our report—ranging from what we saw in the first iteration of the strategy to what we would regard as the elements missing from the last version—provide all the more reason for clarity and transparency in the version that will be considered at the end of January.

We consider that an important point. Part of the reason for the Parliament having the ability to scrutinise the strategy is to enable the public to have an understanding of it. That is especially so given the volatility in public spending and the difficult spending choices that we expect that the Government will have to make both in 2021-22 and in the years beyond. That is all the more reason why the gaps ought to be filled in the version that we will see at the end of this month.

I ask Michael Oliphant to say whether he has seen or heard anything further in his own discussions with the Government.

Michael Oliphant: I do not have much to add. As the Auditor General has pointed out, we have not yet seen a draft of the strategy. However, we expect to see a very different financial strategy as regards the financial outlook that it will present. The Covid-19 pandemic has created a vastly different environment for doing so.

We would want to see reasonable progress on the gaps that were identified in last year's report. One of the areas that we highlighted was on making the step of linking planned spend to outcomes. That will be difficult to achieve, but we would want to see some progress having been made in that direction. We know that the Scottish Government is certainly keen to get there. As for whether it will do so through the strategy, we will just have to wait and see when it is published.

Colin Beattie: Given the situation that we are in with the pandemic and so on, would you expect to see a draft of the strategy prior to its being published? We are now well into January and the strategy is due to be published with the budget, so if you are to see a draft, it will have to be fairly soon.

Stephen Boyle: For clarity, we would probably not expect to see such a draft. It is not one that we have asked the Government to provide to us, nor has it been in touch with a request for us to offer comment. That pattern broadly follows how things have worked in previous years. Given the primacy of Parliament, we would expect that the medium-term financial strategy would be considered by it first, alongside the draft budget. As Michael Oliphant has said, and as we set out in our report, it is our ambition that the next version of the medium-term financial strategy is more comprehensive than the previous one. We will reserve our judgment until we read it, which will be along with everyone else.

Colin Beattie: So the bottom line is that we will just have to wait and see.

Stephen Boyle: It would appear so.

Gail Ross (Caithness, Sutherland and Ross) (SNP): Good morning to the Auditor General and our other witnesses. I want to go into the subject of whole-sector accounts. As you will know, the committee has previously raised the issue of changing the timetable for producing accounts so that they cover the whole devolved public sector, including total assets, investments and liabilities, borrowing and public sector pension liabilities. Your report notes that

"Progress in finalising the draft account for audit has been delayed"

by the Covid pandemic, which is entirely understandable. However, I believe that a draft report, on which Audit Scotland contributed comments, was issued to the Scottish Government's audit and assurance committee in July 2019. Are you aware of any progress on that having been made prior to the pandemic?

Stephen Boyle: We have not seen the progress that we had expected or hoped would have been made on the public consolidated accounts for Scotland. As you say and as was touched on in the report, there are some legitimate reasons for that, as the Government has been absorbing many pressures and has not prioritised the production of the public consolidated accounts during the course of the pandemic.

We re-emphasised in the report the importance of the public consolidated accounts and the need to fill what feels like the remaining gap in the suite of public financial reporting for Scotland. Mr Simpson asked about the accounting boundary that public bodies may fall in or outside of; in many respects, the production of this version of the accounts would do away with such questions in that it would capture all public bodies and all public income and expenditure. It feels like there is ever more need that, when it is able to divert the necessary resources to do so, the Scottish Government should be able to assert clearly and publicly, with sufficient audit arrangements, the assets, liabilities and income and expenditure of all public bodies in Scotland and to set out clearly the clear sweep of what its owned and owed.

There is some allowance to be made for the impact that the pandemic has had, but there is clearly a need for progress to allow that level of transparency and support parliamentary scrutiny.

Gail Ross: We all understand why that would not have been done due to the pandemic, but is there any reason why it would not have at least been started or progressed before last March?

Stephen Boyle: It was started. We mention in the report that we had engaged with the Government about the need for a robust set of public consolidated accounts that are clear and transparent and have the appropriate audit arrangements. As we mentioned, the Scottish Government finance team that is leading on that has interacted with its audit and assurance committee to take its views.

This is complex and we recognise that it involves drawing on many different sources of public accounts that work to different accounting frameworks and so on and distilling all that down to a single set of accounts, but it is not insurmountable. The challenge is that that flows through to a final set of usable documents, and that is ever more important for all the reasons that we know about.

Gail Ross: I look forward to seeing that at some point.

You have said in your report and just now that the pandemic and the withdrawal from the European Union make it even more important to have a comprehensive and transparent assessment of the state of our public finances. Your report states:

"The Scottish Government should now finalise the format and report publicly when it will produce a draft public consolidated account for audit."

What response have you had from the Scottish Government to that call?

Stephen Boyle: I will check whether Michael Oliphant wants to come in on the latest progress of those discussions. From the conversations that I have had, the Scottish Government recognises the point and is committed to doing that but, as we repeated in the report and indeed as Michael has put in his annual audit report, that needs to happen. I will pause for a second to let Michael update us on the latest position.

Michael Oliphant: We have not yet had a formal response from the Scottish Government on whether it takes on board that recommendation.

We still understand that it plans to produce or develop further the public consolidated accounts. As the Auditor General mentioned, it is a very technically complex exercise that has largely been paused because of the pandemic, but even before that we would have liked to have seen more progress than there has been.

One of the immediate challenges will be to bring the numbers that the Scottish Government has up to date. As we mention at paragraph 43, those numbers were based on 2017-18 financial information, so one of the first things that the Scottish Government will do when it returns to this will be to bring it up to date. There might be challenges with that. That is certainly one of the things that we will be keen to understand from the Government over the coming weeks—whether it accepts the recommendation and, if so, what the expected timetable is for producing a public account for us to audit.

Gail Ross: Finally, on the national performance framework, the report comments on the limited information that there is, unfortunately, about Scottish Government performance against spending, with users being directed to other publications and the national performance framework. Again, the committee has raised that issue regularly with the Scottish Government. Why has so little progress been made on that? What are the benefits of the national performance framework, if it does not link to Government spending?

Stephen Boyle: You are right, Ms Ross. Not for the first time in a section 22 report, we make that judgment on the need for a stronger performance report in the Scottish Government consolidated accounts, which would allow the user to see not just the amounts in totality that have been spent against budget but the outputs that flow from that and, more importantly, the outcomes. We give appropriate credit in this year's report in saying that the performance report has evolved with greater clarity and connection to the national performance framework. However, that is not yet the case to the extent that a user of the accounts is able to track the benefits of public expenditure and how it is contributing directly to the national performance framework outcomes. We are also not yet seeing in the performance report sufficient analysis or commentary on a portfolio basis—it tends to be done as a totality. If anything, I would say that, given the extent to which there are links to multiple other sources in the performance report, it is questionable whether a user of this set of accounts would go to the effort of tracking that. We are ambitious and hopeful that a more creative way can be found in the performance report of the Scottish Government consolidated accounts to distil the impact and outcome of public expenditure more straightforwardly and transparently. There are signs of progress, but our assessment is that there is quite a bit more to do.

The Convener: Alex, do you have a question?

Alex Neil (Airdrie and Shotts) (SNP): Yes, I have a couple of questions, the first of which might be more for the Auditor General's report on the current financial year than it is for the report on last year.

The National Audit Office recently produced a report about the cost of personal protective equipment. It concluded that the cost of PPE had been about £12 billion, but that the same amount and quality of PPE would normally have cost £2 billion. The reason for the £10 billion difference was that preparations for the pandemic, including storage of PPE at the right level, had not been carried out as was recommended in a report a number of years ago.

Has the Auditor General been able to establish how much extra PPE cost the Scottish Government? I presume that we get most of it via UK Government deals. How much extra have we had to fork out because the UK as a whole was not prepared for the pandemic?

Stephen Boyle: I am very familiar with the report that the National Audit Office produced, and with some of its quite stark judgments on expenditure and value for money.

On Audit Scotland's activity, I draw your attention to three upcoming reports. The first will be our national health service in Scotland overview report, in which we will comment on the Scottish Government's expenditure on PPE and, more generally, on the activities that the NHS has undertaken in the course of the pandemic. That will be published in the middle of February.

Our interest in PPE is not confined to that, though. We will also be tracking and reporting on other activity. One thing that will be tracked is the activity that NHS National Services Scotland has undertaken during 2020-21.

10:45

The committee might recall that we also have separate follow-up activity in which we will take forward the judgments that we reach in the NHS overview report through to a separate extended piece of work on PPE arrangements in Scotland in the round. That will come later in 2021.

You are right that the main judgments are about our being very conscious of the extent of spend. The NAO identified in judgments that it reached significant disparity, which made quite uncomfortable reading for everybody.

Alex Neil: So, is it hoped that we will know about the impact on Scotland by next month?

Stephen Boyle: That is when we will publish the first of the three reports.

Alex Neil: That is great. Thank you.

My second question is on governance, and an issue that you have probably not looked into too much. An issue is emerging in Scotland whereby a significant number of third-party organisations and non-governmental bodies—I am not referring to quangos, but to what are supposed to be independent organisations, some in the third sector and some in other sectors—are now relying on getting 50 per cent or more of their annual budget from the Scottish Government. That raises a number of issues, both for the Government and for those organisations, because some of them have almost become extensions of the Government when, in fact, they should not.

The relationship between the state—as represented by the Scottish Government, in this case—and a so-called independent organisation begins to get very blurred if the organisation relies on a large percentage of its annual funding every year, especially when it is more than 50 per cent, coming from the Scottish Government. It also raises obvious issues of governance for the Government itself. Will you be looking into that?

Stephen Boyle: I am not sure that we have specific work planned on the wider arrangements, although we have done a number of activities around that. I think that what Alex Neil has described is our following of the public pound, and the extent to which moneys have been spent appropriately where activity is funded by Government, but not delivered directly at its own hand.

The governance question is interesting. I recognise that many public bodies receive a substantial minority or a small majority of their funding directly from central Government or local authorities. That is not entirely unusual, particularly—as you mentioned—for our third sector charity organisations that provide services that might previously have been, or typically are, provided by public bodies.

Equally, I recognise the point about the effect that being reliant on a single provider of public funds, and variability in that funding, can have on an organisation and its sustainability.

From an audit perspective, transparency is what is important; we expect appropriate disclosure and accounts from related parties. A key component is the extent of financial reliance and what that means being clear to the user of the accounts. It is equally important that an organisation's governance—the board of directors—and auditors are aware of that and can think about what, if anything, that might mean for the organisation's being a going concern.

We follow the public pound absolutely; that is an inherent part of our audit work on all the 200-plus public bodies that we audit each year. As and when there are material concerns, the auditor will raise that, and I will think about how best to bring the matter to Parliament's attention.

Alex Neil: My final question is about the fiscal framework that is up for renegotiation between the UK Government and the Scottish Government later this year. In your report for the last financial year—including the lessons learned so far from aspects of handling of the pandemic—are particular areas in which there is room for improvement mentioned?

I realise that you cannot comment on policy, but what about process? We heard earlier about the time that it is taking for new help to get to businesses after initial announcements in London and—sometimes simultaneous—announcements in Edinburgh. During the Covid pandemic, the turnaround time for getting money out to businesses has become a big issue. I suspect that some of that is to do with the process that is governed by the fiscal framework. Are there areas in which you think the fiscal framework needs to be made to work better?

Stephen Boyle: You are right that I cannot comment on policy. I recall that, in one of the first meetings that I had with the committee as Auditor General, when the topic was very live a few months ago, I said publicly that the extent of the powers that are available to Scotland relative to those of the UK is not a matter for me, as Auditor General, to comment on.

However, I acknowledge the point that Alex Neil has made. As the planned negotiation to review the fiscal framework takes place between the UK Government and the Scottish Government, both Governments will want to reflect on the success or otherwise of the arrangements over the past three years. They will want to do that especially for what has happened during the past few months in terms of communication flow between the Governments, clarity on Barnett consequentials, flow of funds, what are and what are not new funding announcements, and whether that is clear between the two Governments and to Parliament. That is needed especially when so many users of public services are so reliant on funding that comes from Government. I expect that all those things will feature as part of the negotiations and discussions between the two Governments.

Alex Neil: Will you feed in on points of process? I realise that you cannot cover policy, but will you cover operational matters that you think need to be on the agenda in those negotiations?

Stephen Boyle: We have had no such invitation, and that is not something on which I am sighted, at this stage. We would, of course, be happy to make known our views and to contribute, if that is wanted. I would point to output on the fiscal framework that we have produced in recent years. We produced at the end of August a report about the impact of the pandemic on public finances, which we will update in February. All that work would be a helpful contribution to the discussions.

Alex Neil: You should follow my example, Auditor General. Do not wait for an invitation: just barge in and give them your point of view.

The Convener: That will be welcome advice for you, Auditor General.

Graham Simpson has a supplementary question on that.

Graham Simpson: My supplementary is really on Alex Neil's first line of questioning about funding of outside organisations and following the public pound. Is the amount of money that the Scottish Government gives to all the outside organisations listed anywhere? Is it easy to find that out?

Stephen Boyle: I will start, then invite the rest of the team to come in, if there is a particular source that can best describe that.

My recollection is that that is not a straightforward thing to do. Although tracking the flow of funds is clear, we should bear it in mind that, as well as providing services itself, much of the Government's responsibility is for disbursing funds to the public bodies that lie within its remit—health boards and other central Government organisations—and for funding local authorities. It can be quite a challenging exercise to collate all the information on that. I do not know off the top of my head whether there is a comprehensive source. Perhaps Michael Oliphant or Tarryn Wilson-Jones can bring something to the committee's attention.

Michael Oliphant: I am not aware that there is a source such as Mr Simpson asks about. The key point is that the Scottish budget is the starting point for funding to executive agencies and other bodies that then pass one-off funds or on-going funding to partner organisations, and so on. A good example is funding of local authorities, which pass on grant funding to organisations in their area. You can see how that quite quickly creates a web effect, in terms of following the public pound. I am certainly not aware of a central source that describes all that.

Graham Simpson: Do you think that it should be easy to find out that information? The point that Alex Neil made is that if an organisation ultimately relies on the Government for half of its funding, that can affect how it behaves. Surely we need to know that information.

Stephen Boyle: You are right—that is an important point. That is maybe something that we can come back to the committee on.

We have seen welcome developments in public reporting and transparency, whereby public bodies itemise all expenditure over a certain amount—it could be £10,000 or £50,000, depending on the size of the body. I think that I am interpreting Graham Simpson correctly in saying that his interest is in the relationship that exists. Expenditure of £10,000 or £20,000 might not be material to the Scottish Government, but it might be of huge significance to the public body recipient and would therefore influence its decisions.

The point is that—this takes me back to the importance of transparency—information needs to be set out clearly in the accounts both of organisations that are grant recipients and of the related parties. Also, the grant-giving bodies—public bodies, the Government, local authorities and so forth—need to be satisfied that the terms of grants that are made are fulfilled by public bodies. It is important that there is not just disclosure, but proper application of funds in the way that was intended.

The question is one for us to take away, Mr Simpson. We will come back to the committee in writing, if we can direct you to any further material on that question.

Graham Simpson: Okay. Thank you.

The Convener: I have a couple of questions. The first is on sponsored bodies—a subject that has been of interest and concern to the committee for some time. Your consolidated accounts report comments on sponsorship of bodies, and says that greater engagement on shared issues and risks between the Government and its public bodies is needed. We have discovered in evidence over the past year that those relationships can, in some instances, be very weak. We discovered, for example, when we were taking evidence on the Scottish Social Services Council, which is based in Dundee, that the sponsoring civil servant had never set foot inside its building. Do you think that the arrangements are working effectively? Does the Government understand that there is a problem in that respect? Have you have heard whether it intends to do anything about it?

Stephen Boyle: I am familiar with the range of examples of sponsorship that the committee has considered in recent years. They tend to be the poorer examples that might be typified in some reports that we have produced.

We captured in the report and in some of last year’s reporting that the Government recognises that it has an issue with consistency in sponsorship arrangements across its agencies and non-departmental public bodies. It has been taking steps on training and experience sharing between sponsoring departments and public bodies, and organised a range of events to share learning.

However, we understand that progress has, as it has in many other things, been interrupted by the pandemic; the Government has not been able to make the progress that it intended to make. I think that the answer to the question is that the Government is not yet in a place where it will be able to demonstrate with consistency that there are effective sponsorship arrangements. However, we know that work on that is still in hand.

I will pause and ask Michael Oliphant to update us on steps that we think have been taken subsequent to our report having been published.

Michael Oliphant: The Government had planned to do a couple of things in the past year, but it certainly has plans for this year for sponsorship training to provide sponsors and public bodies with greater awareness of governance and accountability responsibilities, and of risk management.

There is an issue in relation to the process, procedures and structures around flow of information, but the key thing that the Government needs to focus on is the relationships that exist between the sponsoring department and the public bodies, because that is often where issues arise.

I sound a note of caution on that; it might take a wee bit of time for improvements to be seen. However, I have certainly witnessed that the Government has a sharper and almost renewed focus on improving sponsorship arrangements. Part of that involves sponsors themselves taking greater responsibility for the relationships that exist.

11:00

The Convener: When you say “sponsors”, do you mean the civil servants in charge?

Michael Oliphant: Yes, that is correct.

The Convener: The situation does not seem satisfactory. You are telling me that the weakness is in the relationships between highly paid civil servants and the chief executives of these organisations. It is not satisfactory for the taxpayer if those people cannot create good relationships, because that has a knock-on effect on the efficiency of public spending and the implementation of public policy.

Stephen Boyle: I recognise the point that you make. It is not a universal set of circumstances across public bodies with regard to the sponsorship arrangements. For the most part, the vast majority of the arrangements work effectively, with public bodies delivering what is expected of them and having an appropriate level of support and challenge from their sponsorship team. Clearly, that has not been the experience across the board, and we have seen some poor examples of sponsorship not working as intended—you referenced one in your introductory comment.

We think that the Government is taking steps to address that. We have seen that the Government takes the issue seriously, and we have seen appropriate disclosures in its accounts about the need to do more around that in order to deliver consistency in effective sponsorship arrangements between itself and the public bodies that it sponsors.

The issue is undoubtedly part of our work and I know that it remains of interest to the committee. We will continue to report on it and seek evidence that the Government is re-engaging its activities in the area, as the pandemic eases, which we hope that it will do.

The Convener: I accept that we see the worst of it because, when you identify a problem, you issue a section 22 report that we scrutinise. However, there is no escaping the fact that, in the case of the SSSC, £5 million was wasted on an information technology system, and we identified that more effective sponsorship could have perhaps prevented a large part of that wastage. Significant sums of public money are at stake and are put at risk by weak relationships. Anyway, we have put that on the public record now, so I hope that it will be noted.

Your report indicates that the Scottish Government’s consolidated accounts show an overspend of £699 million. However, you go on to note that the Scottish Administration accounts, which include the accounts from other bodies such as the national health service, report an underspend of £122 million. Can you explain, for the record, how that situation arises and what it means?

Stephen Boyle: I will start and then Michael Oliphant can talk about the work that he and the team undertook to analyse those amounts.

As I touched on in my introductory remarks, one of the key judgments in the section 22 report concerned the disclosure of the Government’s recognition that it had a constructive obligation, in terms of accounting standards, with regard to the amounts that it spent during 2020-21 on business support grants—the £912 million that it recognised, which then led to an overspend in its accounts, netted off, of £669 million.

With regard to the underspends in the Scottish Administration accounts, we particularly reference pension costs as a factor. Given the scale of pension costs—which represent many billions of pounds for teachers and NHS staff in particular—it is difficult to predict with a sufficient degree of accuracy what the level of spend will be, because it can vary by many millions of pounds, depending on the number of leavers, joiners and deaths in service. At a Scottish Administration level, that led to the underspend of more than £100 million, which we capture the report.

There are significant sums at play. Overall, there is an underspend, but, unusually, there is an overspend in the consolidated accounts for this year, as we have reported. That is not by virtue of actual spend, but by virtue of what is required of the Government in its disclosure under the accounting standards.

Michael Oliphant: The key point to add is that that is to do with how the budget legislation is constructed. The Parliament approves the budget at the Scottish Administration level. As members know, the budget can be revised a couple of times a year, through the autumn and spring budget revisions. The spring revision is the last revision of the year and is the one against which the outturn figures are compared.

The Scottish Administration budget is at a level higher than the consolidated accounts budget, because of the individual accounts that sit between them—NHS and teacher pensions are an example of that. As the Auditor General mentioned, although there was an overspend at the consolidated accounts level due to the unique circumstances around business support grants at the end of the financial year, there was an underspend at the overall Scottish Administration level, which is the budget that the Parliament approves.

The Convener: Can Michael Oliphant set out the principal overspends and underspends of the consolidated accounts, please?

Michael Oliphant: The total budget for the consolidated accounts—

The Convener: What is the Government overspending and underspending on?

Michael Oliphant: The largest underspend in the consolidated accounts was in the transport, infrastructure and connectivity portfolio, in which there was an underspend of £232 million. The largest overspend, as has been described, was in the communities and local government portfolio, in which there was an overspend of £886 million.

The Convener: That is because of pensions.

Michael Oliphant: No; that is because of the business support grants being put through.

The details of the overspends and underspends are outlined in exhibit 1, which you will find under paragraph 7 of our report. That shows the total net overspend against the consolidated accounts budget of £669 million for the year.

The Convener: There is an underspend on the NHS. Is that correct?

Michael Oliphant: That is correct. The health and sport portfolio was underspent by £22 million.

The Convener: I do not expect that we will see that next year, given the pandemic.

Stephen Boyle: That remains to be seen, and we will track it closely. However, I think that we will clearly see in the 2020-21 set of accounts a significant uplift in the totality of the budget. On the latest information that we have, the Scottish Government has received an additional £8.6 billion in consequentials. We will capture whether that translates into overspends or underspends in our audit work this year.

The Convener: Thank you. Bill Bowman has a supplementary question.

Bill Bowman (North East Scotland) (Con): I have a couple of quick questions for the Auditor General. First, you mentioned the constructive obligation. Did the Government have that in the accounts, or did you raise the matter with it?

Secondly, we have been speaking about offsets, overspends and underspends. I know that, at times, there is reluctance to allow netting. Is it clear that all the numbers can be netted and that resource under one heading can be transferred to meet a requirement for more resource under another heading?

Stephen Boyle: I will start, and I will bring in Michael Oliphant to supplement my remarks.

The constructive obligation was identified during our audit work, and it is reported in Michael Oliphant's annual audit report as a significant audit adjustment of more than £900 million. It was appropriately considered and discussed by the Scottish Government's audit and assurance committee when it examined the annual report and accounts.

Although that is a hugely significant sum, the adjustment is not one that the Scottish Government was alone in making to its accounts—the Welsh Government and the UK Department for Business, Innovation and Skills also made similar adjustments to their accounts, largely because of the timing of when this all came about.

We are satisfied that it was not an audit adjustment that could have been foreseen by Government, and we are content with the extent of the communication and engagement that we had that led to the—

Bill Bowman: I suppose that that shows another benefit of being audited, although one might wonder why you were sharp enough to see the issue but the Government accountants perhaps were not.

Stephen Boyle: To be fair, I do not think that that is the judgment that we have reached. We exchanged papers and had a range of discussions on the judgment as to why it was, in our view, a necessary audit adjustment to make. It was the interaction of the budget legislation with the accounting standards that allowed us to get to that point.

On your second question about whether the netting-off is appropriately disclosed, yes, we think that it is—

Bill Bowman: I was asking about the netting itself, not about its disclosure.

Stephen Boyle: The example that springs to mind from recent years—the committee will probably be familiar with it—is the Scottish Police Authority. That organisation has overspent its budget for many years, and that has then been accounted for through additional allocation of cash from the Scottish Government. That is appropriate. The budget is managed in its totality, as opposed to being managed through the portfolio arrangements, with funds flowing as necessary from underspends elsewhere in the portfolio. We are satisfied that that has been managed appropriately—and disclosed correctly.

Do you have anything to add to support my answers, Michael?

Michael Oliphant: There are flexibilities in the Scottish budget—how they apply are outlined in the written agreement between the Scottish Government and the Scottish Parliament. As I mentioned, there is an opportunity in the autumn and spring budget revisions—in this financial year, we had a summer budget revision, too—for the Government to make changes to the budget and to transfer allocations from one portfolio to another, or from one budget line to another, and to get Parliament's approval on that. The spring budget revision is the last opportunity that the Government has in a financial year to make changes to the budget. The Government must then record the underspends and the overspends against the budget lines that were approved by Parliament at that time.

Bill Bowman: Okay—thank you.

The Convener: As members have no further questions, I thank the Auditor General and his colleagues very much for their evidence.

11:13

Meeting continued in private until 11:35.

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