OFFICIAL REPORT
AITHISG OIFIGEIL

Public Audit Committee

Thursday 24 February 2022

Session 6

The Scottish Parliament
Pàrlamaid na h-Alba

Thursday 24 February 2022

CONTENTS

PUBLIC AUDIT COMMITTEE
6th Meeting 2022, Session 6

CONVENER

*Richard Leonard (Central Scotland) (Lab)

DEPUTY CONVENER

*Sharon Dowey (South Scotland) (Con)

COMMITTEE MEMBERS

*Colin Beattie (Midlothian North and Musselburgh) (SNP)
*Willie Coffey (Kilmarnock and Irvine Valley) (SNP)
*Craig Hoy (South Scotland) (Con)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Stephen Boyle (Auditor General for Scotland)
Joanne Brown (Grant Thornton UK LLP)
Colin Cook (Scottish Government)
Graeme Greenhill (Audit Scotland)
John-Paul Marks (Scottish Government)
Jackie McAllister (Scottish Government)
Alyson Stafford (Scottish Government)

CLERK TO THE COMMITTEE

Lynn Russell

LOCATION

Committee Room 4

Scottish Parliament

Public Audit Committee

Thursday 24 February 2022

[The Convener opened the meeting at 09:00]

Decision on Taking Business in Private

The Convener (Richard Leonard): Good morning and welcome to the sixth meeting in 2022 of the Public Audit Committee. Before we begin, I remind members, witnesses and staff who are present that social distancing measures remain in place in the Parliament's committee rooms. In addition, face coverings must be worn if you are entering, leaving or moving around the room, but you can take your face masks off when you are at the table.

Agenda item 1 is a decision on taking business in private. Do members agree to take items 4 and 5 in private?

Members *indicated agreement.*

Section 22 Report: "The 2020/21 audit of Scottish Government Consolidated Accounts"

09:00

The Convener: The first principal item of business this morning is agenda item 2, which is consideration of Audit Scotland's section 22 report "The 2020/21 audit of Scottish Government Consolidated Accounts". I welcome our witnesses to the meeting, particularly our newish permanent secretary, John-Paul Marks, in what I hope will be the first of a number of appearances before the committee in this parliamentary session. He is joined in the room by Jackie McAllister, who is chief financial officer, and Colin Cook, who is director of economic development, and, virtually, by Lesley Fraser, who is the director general corporate, and Alyson Stafford, who is director general Scottish exchequer, Scottish Government.

As I have said, I welcome John-Paul Marks to his first meeting, in his new role, with a Scottish Parliament committee—in this case, the Public Audit Committee—and I invite him to make a short opening statement.

John-Paul Marks (Scottish Government): Thank you, convener and committee members, and good morning, everyone.

I want to start by saying a big "Thanks" to my team for their support over the past few weeks. As you have suggested, convener, I started this job back at the very beginning of January, so it is lovely to meet the committee early on. I look forward to working with you in the future.

I will make three key points about the 2020-21 consolidated accounts. First, the budget scale-up for the Scottish Government and the team was unprecedented, and reflected the pandemic context that the team faced. The budget was up 27 per cent, or £10 billion, on the previous year, and that huge scale-up enabled Scotland to deliver essential support at a critical time. Of course, that will, to an extent, continue this year.

This week, we published "Coronavirus (COVID-19): Scotland's Strategic Framework update—February 2022", which sets out the next steps with regard to the pandemic. Nonetheless, I point out that there were three in-year budget revisions in 2020-21 and more than £8 billion of additional consequential funding, which is the highest consequential funding there has ever been. I want to credit the team for successfully balancing the books at year end with the resource variance within 1 per cent, which is an important achievement. There were some capital underspends from financial transactions, but with the carry forward that money has been protected in this year's budget.

My first impression, therefore, is that the foundations—the accounting basis—of the accounts are robust. I am grateful to Stephen Boyle and his team for their input and, ultimately, their unqualified opinion, confirming that the accounts give a true and fair view, follow accounting standards and are lawful.

To an extent, the trends will continue in 2021-22, but the in-year consequentials have been about half of what they were in 2020-21. Having joined in early January, in the middle of the omicron peak, I have found the response from the national health service, resilience partnerships and local government to be exceptional. Of course, we continue to remain vigilant to the challenge, given that admissions to hospital are slightly up in recent data and the number of people in hospital is still at a level that puts us in the medium-risk range.

I agree with Audit Scotland's judgment that there are areas on which we should continue to focus. We will come on to fraud and error control. I also highlight strengthening of governance, where we have opportunities; the focus on delivery and performance, which I am very determined to lead on; and our support for private sector companies. On that last point, we are learning from our experience over recent years and are developing a framework for that in guidance that we hope to publish shortly.

As for the future, we are working on our spending review to set a multiyear plan for the Parliament. From my perspective, that is a great opportunity. Obviously we intend and hope that the plan will be strategic, prioritised and, ultimately, effective in achieving the outcomes in our national performance framework at year end. You will see in the next few weeks and months a lot of focus on, for example, child poverty and the delivery plan for the national strategy on economic transformation. It has been good to see progress being made in January on ScotWind, green free ports and other initiatives that will help us to make progress in the years ahead.

I will pause there, convener. I hope that that introduction has been helpful.

The Convener: Thank you very much. If you feel the need, as you might, to bring in any of your colleagues over the next hour or so, please do so. Similarly, if Lesley Fraser or Alyson Stafford, who are online, wish to come in at any point, they should put an R in the chat function, and we will make sure that they are called to give their evidence.

I want to begin with a short question before I hand over to the rest of the committee. You mentioned governance as an issue and an area in which more work might be required. On 27 January, Michael Oliphant, the audit director in Audit Scotland, told the committee about concerns about "overambition". He said that target dates and scores could sometimes be "overambitious" and that, as a result, there could be an implementation gap, which is something on which the Auditor General for Scotland has previously reflected.

Will you reflect on the part of the Audit Scotland report on the consolidated accounts? Will you look at the need for more clarity on the action that has been taken in order to allow us to understand better how risk management is being carried out and how risks are being addressed by the Scottish Government?

John-Paul Marks: There is always an opportunity for big organisations to focus on that. We start by looking at whether the right strategy is in place and whether we are clear about the factors that determine what success will look like. Our national performance framework does that very well on a long-term basis, and is integrated into our accounts.

I agree with you, convener; I think that Audit Scotland's advice on the matter is valuable with regard to what will happen in the short-to-medium term and with regard to our capacity to provide evidence that we are shifting the dial on the outcomes that we all care about. For example, we now have quarterly information on drug death rates, and significant investment—around £50 million a year over five years—is going into action on that. Of course, we all want the drug death rate to come down and we want to see the data reflect that investment, so we have a team that is very focused on that delivery plan.

The same is true for child poverty. As you will see when we publish our delivery plan on that and bring forward the national strategy on economic transformation, we are trying to be very clear about what we are trying to achieve strategically and what the indicators for success along the way will be.

Since arriving, I have put in place what we call the delivery executive; every Thursday, we meet the executive team to talk about the key priorities and the outcomes that we are seeking to achieve. We talk about the short, medium and long-term activities that we are delivering to achieve those outcomes and, to an extent, our confidence that those are translating successfully. We are very happy to work with Audit Scotland on developing the annual report and accounts to include more of that reporting. At the moment, I am impressed by how the national performance framework integrates nicely into the accounts, but we can build on that in the years ahead.

The Convener: Thank you. In Parliament there is a lot of debate around inputs but there is not necessarily sufficient concentration on the outcomes, so that is very helpful.

Sharon Dowey (South Scotland) (Con): Good morning, everybody. Paragraph 71 of the report mentions that

“Over the last year, there were several changes to the Scottish Government’s Corporate Board.”

Paragraph 72 says that the

“level of change will continue into next year”

and mentions that the recruitment campaigns for the posts of

“DG Economy and DG Net Zero were unsuccessful in identifying appointable candidates. These have been filled on an interim basis and will be re-advertised in early 2022.”

Our papers also note that four non-executive directors will reach the end of their terms in 2022. There is a lot of change and uncertainty there, so how does the Scottish Government intend to ensure stability and certainty within its leadership group? What plans are in place to manage its governance arrangements during that period?

John-Paul Marks: That is a really important question. I guess that my arrival is the start of the stability that you mentioned. I have been working with Ronnie Hinds, our lead non-executive director; I meet him very regularly. In order to provide a bit more stability, we have been able to extend end dates for some of the corporate board non-executives, and we have recruited three additional non-executive directors, who will shortly be announced. I signed off on those appointments; it was nice for me to be able to do that early in my tenure. Their experience and leadership will make a fabulous contribution to the corporate board. I have met all the non-executives; we have great diversity of capability, which supports the team. The non-execs are integrated into boards such as our boards on child poverty and constitutional reform, so we have good governance there. Audit Scotland has been fair in recognising the strengths in our governance, but we want, nonetheless, to continue to improve those strengths.

I consider Elinor Mitchell and Roy Brannen to be fabulous directors general. Roy Brannen brings to my team a great depth of complex infrastructure and major projects experience. To go back to the convener’s initial question around delivery, it is a great match to have a DG like Roy—and his skill set—around the table, when we are focused on things such as ScotRail coming into public ownership, and how we actually translate the 2045 net zero ambition into a road map that gives us confidence that we are on track.

Elinor Mitchell has an accountancy background; she has been an interim DG before, in social care, and has great depth of experience in human resources. She is bringing operational delivery and clarity to the organisation of our economic portfolio, so that we are clear about what it takes to deliver underlying improvement in our growth rate.

We will fill the non-executive director roles, but I want, with the stability of having those two individuals in my executive team, to complete the spending review first, then turn to the recruitment process later in the year.

Sharon Dowey: Thank you.

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): Good morning. I have a question on the Scottish Government’s investment and financial support that have been provided to private companies, as is mentioned in the Auditor General’s report. As an Ayrshire MSP, one of the significant ones for me is Glasgow Prestwick Airport Ltd. Could you give us a brief outline of why that investment was made? What would the implications have been, had that investment not been made in Prestwick airport?

John-Paul Marks: That is a pretty complicated question about a counterfactual that is hard to make a judgment on, but I understand why you have asked it. I had a conversation with the sponsor team yesterday. The new board was appointed just before Christmas, in October last year, so I am looking forward to visiting Prestwick and sitting down with the new chair to talk about Prestwick’s current position and its long-term future.

I recognise that just over 200 people are directly recruited at the airport and that it supports a supply chain of thousands of jobs in the area, so I absolutely understand why the decision was made—for an asset that was, at that time, in distress—to protect jobs, protect industry and support the local community.

09:15

I cannot sit here and provide a value-for-money judgment on a counterfactual about something that happened in the past, before I arrived, but I can absolutely confirm that I will be sitting down with the chair and team to understand the current position. I expect that we will do periodic reviews of all such investments, over time. We will, of course, keep the committee up to date on value-for-money judgments and we will advise ministers on their choices.

Willie Coffey: We know that there are about 300 jobs linked directly to the airport and about 1,400 spin-off jobs associated with the wider Ayrshire economy. We know that the airport is pivotal to the Ayrshire local authorities in terms of taking the Ayrshire Growth Deal forward and in relation to their hopes and aspirations for the possible spaceport in Ayrshire.

I will just ask you again—and, perhaps, your officials, who have been in post for longer than you have, Mr Marks—had the Scottish Government not made that investment, would the airport still be functioning?

John-Paul Marks: I absolutely recognise your points. I will ask Colin Cook to come in. I am just checking my latest numbers—there are 238 directly recruited jobs and 4,000 indirect jobs in the supply chain. It is an important asset, so you can absolutely understand why the Government made that choice at that time.

As I said, I will be sitting down with the board to talk about what will happen in the future. Colin—do you want to say anything about what might have happened if the Government had not stepped in?

Colin Cook (Scottish Government): As you said, permanent secretary, it is impossible to speculate on what might have happened. We should focus on the fact that the airport has developed a strong niche; it has an operating function, with a specialism in fuel and specialist cargo, so it is a robust model.

As you know, over the past few years we have had some fairly credible expressions of interest in taking on the airport. I think that its reputation is getting stronger, so we are looking forward to a very positive future for the airport.

Willie Coffey: It is hugely important for us in Ayrshire, but from a financial perspective, the committee and the Auditor General are asking about the financial implications of longer-term support, in the absence of a buyer. Can you say anything about progress in that regard?

Colin Cook: The Cabinet Secretary for Finance and the Economy made a statement to Parliament back in January repeating that our long-term aim, as it has been from the start, is to return the airport to the private sector. That remains our aim and we are in a positive place. As you know, there is a debt that is payable to the Scottish Government that, legally at least, will remain payable at a point in the future.

There is a strong working relationship between the Government, Transport Scotland and the airport and we are open minded about how we find a bidder, how the debt is structured, and how the debt might be restructured in the future. We want to do what is best for Ayrshire, as you have been pointing out, Mr Coffey, and to make sure that the airport continues to add value and to support well-paid good jobs and an infrastructure in the area.

The Convener: There has also been considerable public interest in another one of the Government's financial arrangements—the one with the Gupta Family Group Alliance. The Audit Scotland report focuses on the Lochaber aluminium smelter deal. What is the Scottish Government's total financial exposure in relation to that deal?

John-Paul Marks: As you can imagine, I have been getting into the GFG position in relation to Lochaber. We just talked about Prestwick, and I am also looking at Ferguson Marine and Liberty Steel to reflect on all our private investments.

It is important to my leadership to visit those sites, meet the teams and understand their impacts in communities. We are trying to ensure that we have consolidated the capabilities for managing those investments in a single division, and we are developing our framework, advice and guidance on how they are managed and how we would make those decisions in the future. We have had good input from Audit Scotland. We will seek to publish that framework at the end of March and we will get all that to the committee.

In relation to the latest financial exposure on Lochaber, in the 2020-21 accounts, we disclose a provisional figure in relation to the guarantee increasing from £33 million in the 2018-19 accounts to £37 million in 2019-20 and then £161 million in 2020-21. Colin Cook and I can reflect a bit more on what made that change happen, given the accounting treatment.

The Convener: Mr Cook, do you want to come in?

Colin Cook: I am happy to. It is worth starting, as we did in the discussion on Prestwick, by saying that this is a critical strategic asset. It is the last remaining aluminium smelter in the United Kingdom, and it is a valuable and important part of employment in the west Highlands. I might defer to the CFO when it comes to the technicalities of the accounting, but I am the director in the Scottish Government responsible for this, so perhaps I can give a bit of context to explain the movement in those figures.

Very close to the end of the financial year, Greensill Capital (UK) Ltd, the main provider of finance to the GFG Alliance in general, went into administration. Inevitably, that put pressure on the GFG Alliance and triggered a global refinancing and restructuring within the group. It was within the context of something that happened towards the end of the financial year that we worked with Deloitte, who is our adviser on the matter, on whether the provision in the accounts was at the right level. It also worth saying that ministers have no role in setting that level.

Despite the fact that there was no contractual default or anything like that at the end of March 2021, we decided to take a prudent approach and classify the guarantee as credit impaired. As I said, I might defer to the CFO, but that is stage 3 of the International Financial Reporting Standards methodology, and previously it had been classified as stage 2, which is about a significant increase in credit risk.

In summary, the figure has moved, but the provision has been determined very cautiously as if a default has occurred and asset recoveries are at the lower end of the spectrum. No such default has occurred, however, and our central planning assumption is that any exposure from the guarantee would be covered by the security package that the Government enjoys over the Lochaber asset. That security package is very strong, because it includes significant land holdings and the smelter, so we are in a strong position there.

The Convener: On 27 January, we took evidence from the Auditor General, who described the deal between the Scottish Government and the GFG Alliance as a “complex transaction”. He said that

“there is an increasing likelihood that the guarantee will be called upon.”—[*Official Report, Public Audit Committee,* 27 January; c 9.]

Is that a strong position?

Colin Cook: It is worth repeating that the level of provision or the provision that is made does not imply that a loss has occurred, nor does it imply that a loss will occur, and it certainly does not impact on the Scottish Government’s spending or budget, and that remains the case.

Of course, the GFG Alliance is going through a global restructuring and is dealing with some well-known financial issues. However, as regards the Lochaber asset, as I have said, we believe that the value of the provision is more than covered by the security package that is in place, when it comes to protecting the public finances. That includes the smelter, the hydro and some extensive land holdings. The value of those assets in the accounts of the GFG Alliance is in excess of the level of the guarantee that we provided, so I think that we are in as robust a position as we can be, from a financial point of view, and—I repeat—because we have protected valuable jobs and a valuable strategic asset in the west Highlands.

The Convener: I do not think that anybody disputes that, Mr Cook, and I will call on Jackie McAllister in a second, but the facts of the matter are that, in the past couple of weeks, the GFG Alliance has been brought to book by Her Majesty’s Revenue and Customs and it is the subject of a Serious Fraud Office investigation. As you said earlier, permanent secretary, Greensill Capital has collapsed, and there are question marks around the GFG Alliance’s governance structure. Given that the Scottish Government is almost a partner in the enterprise, as it is party to a deal with the GFG Alliance, what contingency plans are you making?

Colin Cook: We have planned, and we continue to plan, on a contingency basis. You will be aware of a statement that was made in Parliament in respect of the Liberty Steel transaction, which was a direct result of the contingency planning that was carried out by the Scottish Government.

It is worth saying that although HMRC has lodged winding-up petitions against four organisations in the GFG Alliance in England, the Scottish plants are not part of that. It is a complicated group, and undoubtedly there are arrangements across the group, so loans might well be made from one part to another. Therefore, there is always the potential for HMRC’s actions to spill over into the assets in Scotland, but that is not the case just now.

My team works closely with local management at the Scottish plants. In respect of Lochaber, we have regular meetings about the guarantee, so we keep a close watch on what is happening. Minister Ivan McKee visited the sites recently, and I understand that he was impressed by the plans and the operational plan. We are keeping a close eye on it. Of course, the GFG Alliance is a major international group, and of course it is having some difficulties—it is in the middle of a global restructuring. We will take the action that is required to protect jobs and the organisations going forward.

The Convener: Jackie McAllister wants to come in.

Jackie McAllister (Scottish Government): I will just come in briefly to build on the accounting treatment and Audit Scotland’s comments on it.

To be clear, the provision that Colin Cook was talking about is an expected credit loss. It is a requirement under the accounting standards for all organisations to assess credit risk. Essentially, a set of underlying credit risk scenarios are run to come up with that calculation, and they include the credit strength of the organisation and associated organisations. That calculation has driven the increase from £37 million to £161 million. Audit Scotland confirmed that it considered that to be a reasonable provision, and a reasonable expected credit loss. Clearly, we will continue to keep it under review.

The Convener: I will move on in a second, but I underline the fact that it is a quadrupling, within the space of a year, of the assessment of the exposure to risk. If that was my personal financial situation, I would be alarmed at such an increase in my expected or assessed exposure to financial risk. Is the Scottish Government not alarmed by the quadrupling of that exposure?

Jackie McAllister: At this point, there is no call on the Scottish Government guarantee. No debt is owed to the Scottish Government, so all the fees that are due with respect to the guarantee are up to date. I reiterate that a comprehensive security package is also in place.

09:30

Colin Cook: It is also worth pointing out that that level of provision can move. If the global credit position of the GFG Alliance were to improve, that would open up scope and suggest that the level of provision might well change in future.

The Convener: Colin Beattie would like to come in.

Colin Beattie (Midlothian North and Musselburgh) (SNP): When Colin Cook referred to the value of the assets, he talked about their book value. Are we relying on that rather than their market value?

Colin Cook: I quoted the most recent figure that has been quoted, which was the £438 million that the GFG Alliance valued the assets at in its 2019 accounts. I do not have a more up-to-date figure for the asset value based on current market conditions.

Colin Beattie: So we are basing this on the book value of the assets according to the company.

Colin Cook: Yes, according to the GFG Alliance in 2019. It gives us a fair degree of certainty that that is sufficient to cover the Scottish Government's exposure to the process.

Colin Beattie: How often will you revisit the matter to ensure that the value of the assets has not been impaired?

Colin Cook: At our quarterly guarantee meetings, we review management accounts and business performance and look at progress against the business plan. All of that informs the value of assets, but that value comes from the land, the smelter and the hydro. It is a complicated picture, but we can keep it under review.

Colin Beattie: Okay.

The Convener: To move things along, I invite Craig Hoy to ask some questions.

Craig Hoy (South Scotland) (Con): I want to look at the transparency of reporting on the record amounts of money that were spent on the Covid pandemic last year and the year before. At the beginning of the meeting, you summarised the situation, and the fact is that record amounts of money—£10.7 billion more—were pumped in in 2020-21, with £8.6 billion of Barnett consequentials from the UK Government and a budget underspend of £580 million. Looking at those figures, do you agree with the Auditor General that there should be greater transparency in the Government's financial reporting of Covid-related expenditure?

John-Paul Marks: I am happy to sit down with Stephen Boyle and his team and talk about what would improve transparency in our annual report and accounts. As I have said, my first impression is that we are in a robust place with regard to the fundamental quality, prudence and professionalism that is going into the annual reporting, and which, to an extent, has been covered in the Auditor General's opinion.

In the 2020-21 accounts, there were three in-year budget revisions, and there were statements to Parliament on and explanations of all those changes. Since my arrival, I have noted that the First Minister makes a statement to Parliament on our latest position on Covid pretty much every week, setting out the latest data and highlighting the business support and other investments that we have been seeking to make to maximise value for money in our response. On Monday, we published our strategic framework, which sets out the latest position in detail.

As for the further work that we can do on transparency, I go back to the conversation that we had at the beginning of the meeting. We want to build on the national performance framework and integrate it with our accounts to give us a good record of how delivery is translating into outcomes. However, Jackie McAllister might want to say a bit more about the conversations about transparency that we have had to date, because I know that there are wider public sector accounts to consider and that we are looking at a staged approach. However, we can do more to put more data in and to make more of a contribution to Parliament and the committee so that you can see where spend is happening.

Do you want to build on that, Jackie?

Jackie McAllister: Absolutely. I reinforce the permanent secretary's comment that we agree on the need for transparency and recognise the public's interest in the matter. Indeed, he has set out a number of ways in which we sought to do that through 2020-21. We enhanced the accounts with additional disclosures, and additional data sets are already in the public domain.

We have also continued to think about how we can be more transparent. This week, in fact, the Finance and Public Administration Committee received the spring budget revision guide, which again provides additional transparency on the Covid budget that has been allocated and spent. We also agree with Audit Scotland's view in its "Following the pandemic pound" publication that this is a complex area with many different challenges with tracking, depending on the type of Covid funding and spend, but we are continuing to look at how we can improve things.

Craig Hoy: Looking at the overall levels of public expenditure in Scotland, including non-Covid moneys, I would suggest that we have seen record amounts of money and perhaps more complex arrangements than we have ever seen in the history of devolution. We have record spending, the levelling up agenda and huge Covid disbursements through local authorities as well as the upcoming health and social care levy. Given that that set of spending arrangements is perhaps more complex than we have ever seen since this Parliament was created, would you welcome and possibly encourage greater UK-level oversight and scrutiny of spending in Scotland?

John-Paul Marks: That is a complicated question. It would have been easier to answer had it not been for the last bit.

We are continually building the impact of the Scottish Government in Scotland. A good example of that is social security; yesterday, I had an excellent session with David Wallace of Social Security Scotland and the team. The financial outturn there is now building as we take over the adult disability payment and, indeed, the child payment, the doubling of which is going to have a good impact on child poverty on Scotland.

Under devolution and with, say, health and education, we are seeing our capacity to make an impact grow year by year by year. In that time, the pandemic has radically changed the dynamic with, as we have highlighted, the significant in-year consequentials both in these accounts and this year. However, we expect those consequentials to be less in the year ahead.

We have very close relationships with Her Majesty's Treasury, with an almost constant dialogue going on around Barnett consequentials. Alyson Stafford, who is online, can say a bit about the fiscal framework review and the conversation that is happening in that respect between Ms Forbes and the Chief Secretary to the Treasury on the long-term fiscal framework for Scotland.

In direct answer to your question, I do not think that there is appetite in the Scottish Government for increased oversight by the UK Government of our devolved powers and budget responsibilities. We do not think that that would be necessary. However, we are absolutely working in partnership with the UK Government, with some good collaboration on, for example, green free ports. That process, which was announced recently, means a helpful additional £52 million investment for two ports in Scotland. There have also been good conversations involving the First Minister, Ms Forbes and Mr Gove at the Department for Levelling Up, Housing and Communities in agreeing what the shared prosperity fund and levelling up will mean and how our local communities can take advantage of them. Instead of this being a question of oversight by one over another, I think that my interest is in creating the environment in which the teams can work in partnership and ensuring that, whatever we do, we try to get the best outcomes for Scotland.

Alyson Stafford can say a bit more about the fiscal framework review, if that would be helpful, as that is part of the next step with regard to what the fiscal powers could look and be like in future.

Alyson Stafford (Scottish Government): As the permanent secretary says, the review of the fiscal framework is particularly active for us at the moment.

I understand Mr Hoy's question; there is a lot of complexity. It is a complexity that we have been handling over a number of years, because we have been going through some of the fastest, deepest devolution of fiscal powers of any country in the Organisation for Economic Co-operation and Development, so we have been creating that fiscal institutional landscape as well: the first tax legislation for 300 years; the establishment of Revenue Scotland; and the establishment of the Scottish Fiscal Commission, which generates the forecasts of what we build into our budgets so that they are robust.

The fiscal framework means that we are already operating in one of the most heavily regulated environments. However, it is right and proper that the framework is due for review. The Scottish Government and the Treasury have jointly agreed to commission an independent report on the block grant adjustment arrangements and they will be looking for stakeholder input into that, prior to a broader review of the fiscal framework itself.

That is timely—we have gone forward with the powers that have already come to us in Scotland and it is essential to comprehensively consider the operation of the current framework to ensure that the Scottish Government and Parliament have the necessary powers to manage the risks and the opportunities that we face within our devolved responsibilities in order to support the on-going economic recovery, which is so vital after the impact of Covid.

We also work closely with the Finance and Public Constitution Committee in the Parliament on this and we are making considerable progress with Treasury colleagues. The finance secretary, Kate Forbes, met the chief secretary at a joint exchequer meeting on 3 February and discussed the scope of the review. Clearly, some good steps are being taken and we are happy to keep the committee advised on that.

Craig Hoy: If I can just return to transparency around Covid-related spending, Mr Marks, could you say what plans the Scottish Government has to be more open and to make clear links between the budgets, the funding arrangements and the spending on the ground in relation to Covid?

John-Paul Marks: That is something that we have sought to do throughout the annual report and accounts. For each portfolio, the cabinet secretary and director general have been clear on the inputs in terms of financial spend and the budget and the outputs in terms of activity and the outcomes. I see that as being a good discipline in the annual report and accounts, but I hear the desire for it to be more detailed and, as Jackie McAllister reflected, we want to maximise the transparency. We are here to serve Parliament—to serve the Scottish people—and we want people to have confidence that they are getting value for money from the investment.

As Alyson Stafford said, we continue to see the maturity of our tax system and our social security system and, as per the Audit Scotland report this morning, as we emerge from the worst of the pandemic, we want to demonstrate—as per our spending review, which we hope to announce in May—that we have the right multiyear strategic plans for the Parliament, which will deliver the right outcomes as per the framework. Those need to be prioritised and deliver the right results and we will try to make sure that that is reflected in the spending review announcement and in our annual report and accounts and reporting as we go forward.

Craig Hoy: You mentioned that there were three quite significant in-year budget changes in 2021. Can you give the committee a flavour of how such changes are monitored and reported, particularly in relation to that Covid-related expenditure?

John-Paul Marks: A good recent example of an in-year change due to a consequential was the one on the cost of living. The announcement by the Chancellor of the Exchequer was followed very quickly by an announcement by our ministers and we made clear to Parliament how that consequential would be spent. In the case of the cost of living consequential, that was precisely done and the explanation of the spend was communicated in relation to the council tax bands that are allocated through local government. That money will be tracked and reported against.

That is the discipline that we should apply through our in-year budget changes when we receive consequentials. As part of the delivery executive, each week, we talk about finance risk, delivery and performance. Each month, we get the refreshed outturn on spend by portfolio area, which we are able to track quite precisely.

09:45

Jackie McAllister: It is important to note that budget management is dynamic in any year, which was particularly the case in 2021. The Covid funding announcements were not happening in isolation from other changes in our budgets. In each of the three budget revision exercises, we were aggregating together all those adjustments and presenting them to Parliament, because it was important that we had taut and realistic budgets for Parliament to hold us accountable for. Of course, with each of the budget revisions, there would have been a really transparent description of those budget changes.

However, therein lie some of the challenges that we alluded to earlier. As we know, the UK Government made announcements throughout the year, some of which generated consequentials. However, the process of those consequentials being confirmed happens at a much later stage, for example through the supplementary estimate that happens in January or—as we have seen this year—February. Sometimes the amounts that come through are different from what we had been planning for, so there is a bid for reconciliation. We are also subject to possibly negative consequentials in other areas. We therefore get a net figure from the UK Government, which we have to manage.

In addition, and particularly linked to Covid, a lot of our schemes were demand led. Therefore, although we would have made announcements, we would then have determined the requirement based on the demand for those schemes, and our budgets may well have been adjusted at a later stage.

In thinking about how we can be transparent, we are trying to manage all those factors. However, I come back to the point that I made earlier, which is that we are fully committed to being as transparent as we can.

Craig Hoy: Will you give the committee some flavour of the underlying reasons for the underspend of £580 million? How much of that is available through the Scotland reserve?

John-Paul Marks: We were reflecting on that this week. As I said in the opening statement, in relation to the resource budget, I was impressed by the low level of variance below 1 per cent. Nonetheless, as you said, there was the capital underspend and total underspend of £580 million less, which was 1.1 per cent of the £50 billion baseline.

The breakdown of that is that £320 million related to transport infrastructure and connectivity investments. As was true down south and in countries and economies around the world, lockdowns had a significant impact on the capacity of capital projects to stick to timetables that had been set pre-pandemic. That was the main challenge.

As Jackie McAllister said, we also received a late consequential, which we were able to carry forward. The reassuring element of the flexibility in the fiscal framework is, as Alyson Stafford described, that we were able to carry forward all that underspend to make sure that the pounds were not lost to, ultimately, the Scottish people. We can make sure that that money is still invested.

Nonetheless, those in-year movements in budget and the accounting challenge that they present for the team are complicated, hence the fiscal framework review and the importance of having partnership dialogue with the UK Government upstream to understand its planning on initiatives that are coming down the tracks so that we are also able to plan in partnership and be ready to receive new moneys.

Sharon Dowey: Paragraphs 41 and 43 of the report say that the Scottish Government should

“clearly outline its plans for future investment in private companies to ensure there is greater transparency over financial support provided and the value of public funds committed”

and that it has committed to develop

“a framework to outline its principles and approach for decisions about future investment in private companies.”

When will that framework be published?

John-Paul Marks: The intention is to publish it at the end of March. We are finalising the framework based on inputs and advice from Audit Scotland, which have been really appreciated. We will put it to our ministers with the intent to publish at the end of March.

I reviewed the framework with Colin Cook and the team this week. It is a helpful addition. It builds on the conversations that we had about Lochaber and Prestwick. In the year ahead, I want to get out and about, meet the executives of those teams—a new chief executive of Ferguson Marine has just been put in place—and understand their asset position now, the level of risk and their future plans.

The framework seeks to build on our existing guidance, take the lessons from those investments and ensure that we continue to refine the framework accordingly. That works well. It breaks things down into what the right principles are, what the right accounting officer tests are and what the key considerations should be. That relates to the question that was asked earlier about the counterfactual—the business case for a last-resort investment choice—but also to our long-term strategic intent, which is to realise value for money. It is all set out in the framework and the intent is to publish that at the end of March.

Sharon Dowey: I am a bit worried about the word “intent”. That the intent is to publish the framework at the end of March does not mean that it will be published then.

John-Paul Marks: The only reason I say that is that the framework is getting finalised. We will share the advice with ministers. It might mean that somebody wants to refine it further but, from my perspective, the end of March is feasible.

Sharon Dowey: I know that you just started in January, but the report says that the initial recommendation was made in 2018. Why has it taken so long for the framework that you intend to publish at the end of March to be produced?

John-Paul Marks: I am not sure that I can take any credit for starting in January and getting it published in March.

The bottom line is that the pandemic, as colleagues will appreciate, has hugely disrupted everything. I saw that even in my handover with my predecessor and, from 5 January, in people working flat out—all night and weekends—to manage our response to the omicron peak. It has been an unprecedented disruption, as it has been to everyone’s personal lives and to society. That included the framework.

Colin Cook: We have always followed the guidance in the Scottish public finance manual. The framework is an iteration of that guidance and we will continue to develop new iterations of it as we go forward. We have been working with Audit Scotland on it over the past year. We had very useful meetings with Audit Scotland in September and November. We now have a new framework that we can recommend should be published. I am pretty confident that it will happen.

We have always followed the SPFM. We will continue to follow it and continue to build on it.

Sharon Dowey: Audit Scotland does the audits and we have found that the recommendations do not seem to be implemented quickly. That recommendation was made in 2018. I know that we have had the pandemic, but we did not have it in 2018 or 2019. It would help Audit Scotland if we were a wee bit more timely about trying to action the recommendations that the auditors make from their audits.

Are the principles being applied in current decision-making processes in the Scottish Government? I am thinking about ScotRail with that question.

Colin Cook: Yes. As I said, we have always followed the principles in the SPFM. The framework represents an iteration and improvement of those principles and we will continue to follow them. As the permanent secretary said, the overarching principle is about there being a clear policy rationale, a commercial outcome and a comprehensive business case. The framework now gives more information, detail and specificity about what should be in a comprehensive business case.

When we make decisions about investments in business, we do and will follow the principles that are described in the SPFM and the framework.

Sharon Dowey: Thank you.

The Convener: Permanent secretary, we cannot hold you individually accountable for this either, but one of the other things that the committee, the Auditor General and the Auditor General's predecessor have waited for for a long time is the publication of whole public sector consolidated accounts. We understand that they will be produced in two stages, and I think that the stage 1 account is due to be published this spring. Will you bring the committee up to date on what progress is being made on that? Do you expect that target date to be met?

John-Paul Marks: On the previous point, I have had really good introductory meetings with Stephen Boyle and Audit Scotland, and I am completely committed to ensuring that, when we get recommendations, we are clear about them, we have a good debate about them if we have a challenge, and we then get on with it. That is a fair challenge for us. Let us ensure that we get that right.

Jackie McAllister is our resident expert on public sector accounts, and she can say a bit more about them. As you said, a plan for a staged approach has been developed with Audit Scotland. I have challenged the team to explain to me what that means, and my understanding is that that will enable us to see a wider set of expenditure that relates to Scotland's overall public administration—to things such as Audit Scotland and the Scottish Parliament's non-ministerial public bodies. It is a matter of bringing that together so that it is more visible. The aim is for that to be delivered in the spring and from there, going into the summer, to develop what the wider output could be.

My only caution is that it should be ensured that that will add value and that it will not create significant additional data-collection burdens on, for example, the NHS, local government or others. I want to be confident that we are doing the work with the right intent, because it will help transparency, the tracking of overall spend, and our understanding of value for money in Scotland.

Jackie McAllister can say a bit more about the timetable and certainty.

The Convener: Is there a cast-iron guarantee that those accounts will be published, or are you now caveating that? I am bound to say to you that your predecessor sat before this committee's equivalent in 2016 and gave an undertaking to provide whole public sector Scottish Government consolidated accounts, and we are still waiting in 2022.

John-Paul Marks: I ask that I am able to reserve a bit of judgment, so that I can provide the committee and our ministers with advice on doing that in a way that is proportionate, will add value and can be done without creating significant additional administrative burdens on other public bodies. That said, our absolute intent is first to get stage 1 done and then to move to a stage 2 that fulfils that commitment in a proportionate way or a way that adds value.

Jackie, do want to say a bit more about that, as you are our expert?

Jackie McAllister: I am very happy to do that.

To build on what the permanent secretary said, we remain committed to producing those accounts. Taking a staged approach allows us to share the accounts with Audit Scotland and the committee, get feedback, and evolve the work in a way that is meaningful and adds value, as the permanent secretary has set out.

We are on track to deliver stage 1 in the spring. We will share that draft with Audit Scotland very shortly, and we intend to undertake stage 2 in the summer.

10:00

My only caveat brings us back to the permanent secretary's point about not creating additional burdens. We are planning to use data and information capture that is already happening with the UK Government's whole of Government accounts, so we would not be asking entities to do something that they are not doing already. However, we are aware that the UK Government's 2020-21 whole of Government accounts are not yet live or open. That might inhibit us as we get nearer the time, but we will keep an eye on things. The intent, though, is absolutely there, and the work is being undertaken.

I am afraid to say that the 2016 recommendation precedes me, too, but I must point to the pandemic in a slightly different way. As this is a consolidated set of accounts, we must have the underlying accounts prepared and completed, and unfortunately the elongated timelines for the completion of those accounts have impacted on our timeline and on our ability to do the whole of public sector accounts. Even with a deadline of the end of September for the Scottish Government's consolidated accounts, that would be challenging, but we are working to the end of December, which runs us straight into the next year end and the next accounting period.

That said, we are very confident with our staged approach. Indeed, we would welcome the committee's feedback on that in due course.

The Convener: I am sure that we will reflect on your evidence on that subject and we will decide what we think the next steps should be.

Permanent secretary, you have mentioned the national performance framework a few times. What plans do you have to improve performance reporting in the consolidated accounts?

John-Paul Marks: As you said, convener, I alluded to that issue earlier. The national performance framework is particularly powerful in Scotland, is respected elsewhere and is seen as best practice. It is powerful in that it works for public bodies, agencies and local government, and the fact that it is transparent with clear evidence creates a good set of strategic accountabilities. As you will know, it is integrated with the annual report and accounts, and each portfolio area director is clear about what their activities relate to with regard to achieving those outcomes.

However, there is one area that was mentioned earlier that I want to work on. The teams are already addressing this, but we want to make progress with the short to medium-term indicators so that we can track activity against outcomes and see progress. As and when that is developed and it is feasible to include more of that in the annual report and accounts, I will absolutely be encouraging the teams to do so.

The Convener: Thank you very much.

I also wanted to ask you about one quite specific area. At our previous evidence session on this report, on 27 January, we took evidence from the Auditor General on the overspend in the Crown Office and Procurator Fiscal Service, which arose as a result of special payments of £40.2 million in connection with the acquisition and administration of Rangers Football Club. We are interested not only in the impact of that overspend on the service itself, but in the decision making around those payments, particularly the role of the Lord Advocate in that respect. At the previous evidence session, we were told that there were two cases still outstanding. The Audit Scotland report tells us that the Scottish Government authorised the overspend. Can you tell us who did so?

John-Paul Marks: I am not sure whether Jackie McAllister knows off the top of her head, but the best thing that we can do is to check in order to give you certainty. With regard to the annual report and accounts, any overspend is ultimately signed off by the accounting officer, the principal accounting officer and ministers. However, if there is a specific point that you are alluding to, we can take that away, if we cannot say now.

Jackie, do you want to add anything?

Jackie McAllister: In the first instance, the accountable officer would be having a conversation with the Crown Office on the budget and, in particular, looking at the extent to which it could manage the pressure within the budget. Where it was clear that it would go above that, the accountable officer would give advice to ministers—in essence, the Cabinet would sign off on budget changes.

John-Paul Marks: I have just checked the detail. For the financial year 2020-21, as you say, the Crown Office and Procurator Fiscal Service charged £27.9 million to the accounts, including a provision for £14.96 million. As Jackie McAllister said, that will have gone through the usual due diligence, involving the accountable officer and then ministerial approval. I am happy to come back to the committee with more detail on that, if that would be helpful.

The Convener: I think that it would be helpful. I know that other processes are under way, but there is an important aspect to the issue for the Public Audit Committee, which is about the decision-making process. The Lord Advocate admitted liability in court, which therefore had financial consequences. If you could get back to us on that, that would be very helpful.

I will move on. Colin Beattie has a series of questions.

Colin Beattie: First, I want to go back to the intervention that I made earlier about the smelter, just for clarification in my mind. You are relying on a 2019 book value to cover the Scottish Government's potential liability. Book value is not necessarily market value and it is certainly not forced sale value. Normally, as a matter of prudence, when the Scottish Government is in the position of a lender and, if you like, a guarantor, it would look at forced sale value to ensure that, in the worst case, it would be covered. Has that forced sale value been calculated? If so, does it still cover the potential liability of the Scottish Government?

Colin Cook: I am not aware of our having calculated the value in the way that you describe. I will check and get back to the committee if we have done so. I will also get back to the committee with any plans that we can put in place to do exactly what you have just described.

Colin Beattie: Clearly, the issue is that book value, and to an extent market value, will assume that the smelter is a going concern, and it will be valued accordingly, whereas the forced sale value will simply be the value of the land and buildings but without the business attached. That is the critical value to ensure that we have cover.

I will move on—

Jackie McAllister: I will just make one clarification, if that is okay. The number that Colin Cook referred to earlier is the estimate of the value of the security. That is not directly linked to the number that is reflected in the balance sheet in the accounts, which is the expected credit loss against the guarantee. I just wanted to clarify that they are very different numbers.

Colin Beattie: Okay. I was taking the book value as the book value, but you are saying that there is a bit more behind it. Nevertheless, the important thing is the forced sale value, to ensure that we have cover.

John-Paul Marks: Yes, and as I said earlier, with regards to all those investments, my plan through the year is to visit each of the sites and to do that review. As you say, we should of course include the asset position and the longer-term plan. I want to discuss that with each of those executives and their boards, meet the teams in the community and properly get under the detail of each of them. I hope that we can have a good dialogue with the committee about each of their futures. If individual members would like to meet to talk about those, I am happy to do so.

Colin Beattie: I am sure that there will be an appetite for that when the time comes.

I want to move on to fraud and irregularities around Covid-19 expenditure. Obviously, the two big business support schemes totalled nearly £1.6 billion. They responded quickly to Covid-19. Obviously, there was a need to get money to the right place at the right time very quickly, which opens up a higher-risk element.

I notice that the Scottish Government estimates that fraud and error will account for 1 to 2 per cent of those payments, involving approximately £16 million to £32 million. How does that equate to the figures that we see coming from Westminster, which are obviously on a bigger scale? We see estimates from there of £15 billion or more. Have we been better at it? Given that Westminster has had that experience, why are we better? Why is the figure not proportionately as high here?

John-Paul Marks: That is a fair question. Your description of the provision for fraud being 1 to 2 per cent is precisely right. That figure is based on benchmarking from previous schemes. The range of financial risk is £16 million to £32 million. Colin Cook will be able to say more about our process for assuring the outturn. From my perspective, early reflection suggests that we are at the lower end of that. So far, we have identified actual fraud cases of less than £1 million.

To address your point, the response was fast but it was also done in partnership with local government and using existing capabilities and footprints. We had authenticated identities for the people who would be in receipt of those moneys and we used existing systems.

Scotland benefited from things such as the furlough scheme and from the trust and protect approach taken to universal credit. As you say, those schemes and at that scale had their own particular design. There has been a fraud loss, but because we were able to work with local government, using existing infrastructure and their delivery expertise, we think that we have kept the exposure on those grants to identified cases of less than £1 million so far.

Colin Cook may want to say more.

Colin Cook: Throughout the pandemic, we have taken into account the need to be as tight as possible and to ensure that we minimise the risk of fraud. Initial judgements were taken about the key, pivotal enterprises that we needed to support. We worked with Scottish Enterprise, VisitScotland and organisations that had established relationships. That minimises the risk of fraud.

As the permanent secretary said, we then moved on to the provision of a much wider range of far smaller grants, working largely through local authorities and leading eventually to the strategic framework business fund. Those grants were based on non-domestic rates. Local authorities already have a system in place for those. They have mechanisms for tying businesses to particular properties and they have tried and tested mechanisms for reducing error and fraud. They were able to bring those to bear, which has been absolutely critical to minimising fraud, as the permanent secretary said.

As we moved into other areas, we took decisions on a case-by-case basis. The taxi fund was administered by local authorities because they license taxis and therefore have an established relationship with that organisation. We used a different approach when it came to mobile close contact services.

I know that this goes beyond the financial year that we are discussing, but we have continued evolving our approach. The Scottish Government has appointed a head of counter-fraud. He has looked at the funds that we operate and has assessed them as adequate. We have put a fraud control checklist in place, so that policy people who are thinking about or designing new support schemes can work through that checklist from the beginning and can design fraud control into the system from the beginning, based on our latest expertise and the intelligence that we have picked up in the past few years.

Colin Beattie: I am still a wee bit worried about the differences north and south of the border. Did we approach it very differently up here, as opposed to how it was done down south? Did they not use local authorities as the obvious avenue to manage a great deal of Covid-19 payments? I am worried that there may be a hidden amount somewhere that will jump out at us.

10:15

Colin Cook: I do not think that I can—and nor would I want to—put myself in the position of speculating on the decisions that were taken by the UK Government. We focused on the approach to be taken in Scotland, and we believed that working with local authorities was the best way of doing that. The evidence so far seems to suggest that that was the right thing to do, and the local authorities with their existing systems, their intelligence and the people working on the ground in those areas have brought great benefit to the Scottish economy.

Colin Beattie: I would be very pleased if we have managed to keep fraud down to this level. I just have a niggling worry.

Colin, you partly answered my next question when you talked about controls, counter-fraud checklists and so on. I was going to ask you about the action that the Scottish Government has been taking to reduce and manage error and fraud, and perhaps you can give us a bit more detail on that.

Colin Cook: Yes. As I said, the Scottish Government has appointed a head of counter-fraud, who has assessed the funds, has worked with local authorities and, indeed, has looked at our controls on the business side and found them to be adequate. The counter-fraud checklist that I mentioned allows us to bake that learning into the assessment of future funds. Its prompts include checking that a business is actually in the sector that it is claiming to be in and other such things that lead to fraud. For example, it covers cases of people applying more than once for a particular grant with a different bank account, and it goes as far as organised crime groups impersonating genuine businesses. What has been important is that, working with our head of counter-fraud and Audit Scotland, we have raised those matters and have made the policy makers and people who decide on the shape and operation of a fund aware of them upfront, so that we can plan for them.

Colin Beattie: How much has the Scottish Government actually recovered with regard to fraudulent payments and payments made in error? Do we have a figure for that?

Colin Cook: We do not have a figure for that, because it is for individual delivery partners to determine how and when they take legal action to recover such payments. As a result, we do not have data on the number of cases of suspected fraud that they are currently pursuing.

Mind you—and perhaps this will add to the degree of confidence that you have been looking for, Mr Beattie—there is clear data to indicate a high rate of pre-payment fraud detection in local authorities. Moreover, the ratio of applications to awards is low, which indicates a high number of rejected applications. That suggests that the system is working extremely effectively.

Colin Beattie: I am a bit concerned that we do not seem to have a grip on recovery. Is that not quite important? You are making estimates of how much the fraud and errors amount to, but you have no idea about recovery. I would have thought it a simple matter of calling the councils and getting the figures from them.

John-Paul Marks: We are happy to take that away. In a case that related to us, we would seek recovery either legally or through a civil case, and our delivery partners will be doing the same. However, I will take away the challenge and see whether we can confirm how many of the just under a million fraud cases to date are being pursued and how much money has been collected so far.

Colin Beattie: How much reassurance can you give us that your partners are vigorously pursuing that if you are not currently looking at it?

Colin Cook: I can assure you that we are continuing to ensure with local delivery partners that they have the resources available to pursue those actions, should they choose to do so.

Colin Beattie: Surely we need to know how effective that is and what the outcomes are.

Colin Cook: As the permanent secretary has said, I am sure that there is action that we can take to improve our data collection, and we can return to the committee if and when that happens.

Colin Beattie: The logical extension of that is that until you know the whole picture, you cannot know whether all the estimates that you are making are particularly accurate.

John-Paul Marks: I think that we are talking about different things. We are confirming cases of fraud that have been identified and confirmed to us, and you are making a fair point about the amount of money that has been recovered. We will take action to confirm that for you.

Colin Beattie: Local authorities are confirming to you the number of cases and so on, but you do not have information on what they are doing about them. You say that the authorities are pursuing cases vigorously, but you have no evidence to show that.

Colin Cook: As we were suggesting, we can do more to collect and collate information. There is a lot of on-going work between the responsible team in the Scottish Government—we have a dedicated team, division and directorate that are focused on that action—and our local authority delivery partners. There is no current information that suggests that there is a large amount of undetected fraud, and there are no other factors that introduce any significant uncertainty. However, we will continue to work with local authorities to see what we can do to improve the flow of information and intelligence back from them.

Colin Beattie: Data is always king. Getting data, including in the right format and so on, is always a problem—that problem comes before the committee all the time. It does not seem difficult to get data relating to this issue. I would have hoped that the Government would have plans to report fraud and error, and could report on the amounts recovered. That seems pretty basic to me.

I have a final question to wind up. What lessons have we learned in relation to not only fraud and error but the processes that have been put in place? Have we learned anything from the situation?

John-Paul Marks: You made the point in your opening question that money got out the door quickly, got to the right sectors and delivered the support that was needed at a critical time. That was not without challenge and a lot of heavy lifting, and local government played a huge part in making that happen.

On the fraud and error point, I completely agree with your challenge to show you the data on recovery against the identified cases to date. Nonetheless, the exposure of 1 to 2 per cent of provision in the accounts is quite encouraging, given the volume of investment and the context in which it was provided—as you said, that had to be done at pace, given the crisis—and the picture relating to some of our comparators elsewhere.

We have certainly learned important lessons around ensuring that we tailor such schemes. As you said, data is key. It is not just about tracking the spend, but about tracking its receipt, and there has been debate about that.

We are happy to come back to the committee to talk more generally about the learning from Covid as, I hope, the strategic framework embeds and we move on a bit.

Colin Beattie: The committee would certainly be interested in a bit more data around what has happened in terms of recovery and so on. Looking at the big figures south of the border niggles me—I wonder whether we are missing something.

John-Paul Marks: We will take back that fair challenge to the team. We will ask it to think again, on due diligence, the assurance levels and sampling, and whether we are confident about those aspects.

Colin Cook: Local authorities, and the publication of their accounts, will be a critical element of that. For example, you would expect them to publish the number of fraud cases in the schemes that they have administered as part of that process. That will give us an opportunity to consider that aspect.

The Convener: We are coming to the last lap, permanent secretary. Sharon Dowey has a couple of questions to put to you, and then Willie Coffey will come back in before we finish.

Sharon Dowey: During 2021, the Scottish Government commissioned an external consultant to conduct a review of its relationships with public bodies. The review considered the current delivery of sponsorship arrangements in the Government, including how it should organise and manage its relationships with public bodies. It also considered how sponsors and public bodies can effectively manage risk and, importantly, the escalation of issues when challenges arise. What improvements has the consultant advised should be made? Has the Government accepted all the findings?

John-Paul Marks: That is a really important piece of work. I am conscious that, as we discussed earlier, capturing the footprint of the public sector in terms of public sector accounts is critical, as is the leadership and sponsorship of public bodies.

So far, I have been able to meet Social Security Scotland, Food Standards Scotland, Transport Scotland, the Scottish Prison Service, Education Scotland and Revenue Scotland—there are many more still to meet. The intent is to ensure that we have the best sponsorship arrangements in place.

We have received that report and it is fair to say that we accept that all the recommendations are helpful. From my perspective, the next step is a session with my whole executive team, which I am bringing together to walk through each of the recommendations and talk about the assurance process that we will expect each of the DG portfolios to use to confirm that the recommendations are in place. The process will ensure that roles and responsibilities are clear; a full business case is in place before a new public body is established; we seek to use shared services to avoid duplication if it is a small public body; we have well-developed performance frameworks; and ministers meet the chair or chief executive regularly. Those are some of the recommendations that we have received.

From my early meetings, it is clear that best practice is in place. We have some great public bodies in Scotland and good relationships, but consistency is what matters and we want to give that assurance back. We will have that focus session and get the assurance in, and then I hope that we can confirm later to the committee that that has been established and that best practice is working well.

Sharon Dowey: Is the report available?

John-Paul Marks: Yes; it will be published at the end of February.

Sharon Dowey: We will see it then.

John-Paul Marks: We will get a copy to the committee, yes.

Sharon Dowey: You have explained how you will implement the recommendations, but I ask for timescales so that we know when they will be implemented and that we do not end up getting a report further down the line about—

John-Paul Marks: One hundred per cent. From my perspective, the objective is the ET session. For me to feel confident in my principal accounting officer role, I will want to know that the recommendations are embedded consistently. My expectation is therefore that, through this calendar year, all the recommendations will be established as best practice, and each DG will assure me of that. That is a broad planning assumption around a window of time for us to get that done and assured properly. If we need a specific milestone for a complex recommendation or two, we can put that in place.

Sharon Dowey: Thank you.

The Convener: For the final question or two, I hand over to Willie Coffey.

Willie Coffey: My question is on the European structural and investment funds issue that is also covered in the Auditor General's report. We know that the UK Government committed to replacing those funds, which came from the European Union, and that an estimated £183 million a year is coming to Scotland.

First, has that sum been confirmed yet? Secondly, and importantly for the committee, what is to be the role of the committee, the Scottish Parliament and Audit Scotland in scrutinising that spend and accounting for it in Scotland? We did that previously but, as far as I know, none of us is aware of where the scrutiny function will lie for that funding. It might fall under the shared prosperity or levelling up funds and so on, but we do not know yet. We do not even know whether the Scottish Parliament will have the same role in scrutinising the spend that we had previously. I would be obliged if you could clarify any of that for the committee.

John-Paul Marks: Your final point demonstrates one of the complexities of the UK internal market legislation and the common frameworks, and precisely how the shared prosperity fund will work in Scotland, Northern Ireland and Wales.

10:30

My ambition—going back to our earlier conversation about partnership—is to settle on a co-design/co-delivery model that enables us to ensure that the shared prosperity fund investments and the levelling up agenda in Scotland align with our existing programmes. That will mean that we do not have duplication, that the process works well for communities and partners on the ground and that it is optimised to deliver best value. However, we do not have that agreed detail yet. There are clear conversations at senior ministerial level about it, and there is still that opportunity to get to that co-design/co-delivery position, so that we have co-ordination and can optimise the process.

If we can get to that point, there is a role for this committee with regard to how the Scottish Government is engaging with that model, and you can have oversight of our involvement. We will absolutely keep the committee up to date as issues around the shared prosperity fund and the levelling up agenda are finalised.

On the accounts, there is a small write-off and provision in respect of European structural funding already expended that will not, or may not, be reimbursed to the Scottish Government by the European Commission—there is a £16 million write-off and a £28.7 million provision. Colin Cook can say a bit more about the detail of that, but we think that we have gone through the right accounting process to make that transparent.

Willie Coffey: Is the Scottish Government making it clear to our UK Government colleagues that it is our wish that that scrutiny function remains in Scotland, where it previously was?

John-Paul Marks: You can rest assured, 100 per cent, that that has been made extremely clear, consistently and at every level.

Willie Coffey: Has there been a response to that yet?

John-Paul Marks: There are regular discussions going on, and that dialogue has yet to conclude.

Willie Coffey: Mr Gove is downstairs at the moment. Could we invite him up to give us that clarification? [*Laughter.*]

John-Paul Marks: I think that there is a shared ambition around what the shared prosperity fund and the levelling up agenda should seek to ultimately achieve—reduce poverty, improve skills, secure prosperity and so on. As you say, the question is how to do that. Oversight matters, and, from a Scottish Government perspective, we would prefer to direct that investment and align it with our existing strategies and plans, in partnership with local government in Scotland. I do not think that that is how it is going to work, so the question is whether we can design a co-design/co-delivery operating model that ensures that we get the best possible partnership working to get the best value for money.

The Convener: Just to conclude, I think that you undertook to give us some information in writing about fraud, payment and recovery, decision making relating to the Crown Office and Procurator Fiscal Service overspend and so on. That would be helpful. When we survey the *Official Report* of the meeting, we might find that there are other areas that we want to follow up with you, too.

Thank you for your time this morning and for your thoughtful contributions. I also thank your team: Lesley Fraser and Alyson Stafford, who joined us online; and Jackie McAllister and Colin Cook, who joined us in the committee room.

With that, I suspend the meeting to allow for a change of witnesses.

10:33

Meeting suspended.

10:36

On resuming—

Section 22 Report: "The 2020/21 audit of Scottish Canals"

The Convener: Agenda item 3 is a review of the section 22 report arising from the 2020-21 audit of Scottish Canals. I welcome our witnesses for this part of the meeting. The Auditor General for Scotland, Stephen Boyle, is joining us in the committee room. Graeme Greenhill, who is senior manager in performance audit and best value at Audit Scotland, and Joanne Brown, who is a partner with Grant Thornton UK LLP, are online. I think that Grant Thornton UK LLP carried out the audit on the ground with Scottish Canals.

I invite the Auditor General to give an opening statement.

Stephen Boyle (Auditor General for Scotland): Thank you, convener, and good morning to the committee.

I prepared the report under section 22 of the Public Finance and Accountability (Scotland) Act 2000, to draw Parliament's attention to challenges that Scottish Canals has had in valuing its assets during 2020-21 and the resultant disclaimer of opinion that was issued by its external auditors.

By way of background, I note that on 1 April 2020, the status of Scottish Canals changed from public corporation to non-departmental public body. That change came with a requirement to follow Her Majesty's Treasury's accounting guide, including the methodology that is to be used to value canal infrastructure and inland waterways.

Although the required valuations for investment properties and land and buildings were conducted, auditors found that Scottish Canals did not get valuations for about £51 million-worth of specialist assets. Those assets included dredging equipment, lock gates and canal basin widening works. A subsequent valuation that was aimed at estimating the cost of replacing those assets in their current condition and for existing use raised concerns about the accuracy of Scottish Canals' fixed asset register, among other valuation flaws. That meant that auditors had to issue a disclaimer of opinion on the accuracy of Scottish Canals' financial statements, because insufficient audit evidence was available to conclude on the overall valuation of the canal infrastructure and inland waterways. That remains a very unusual step for an auditor to take.

Scottish Canals will now, during 2022, undertake a new valuation of the canal infrastructure estate in its entirety. A key part of that work will require Scottish Canals to review its fixed asset register to ensure that all assets are appropriately recorded and categorised. That will be a substantial piece of work, but it is necessary in order to provide sufficient evidence to support future judgments and estimates of asset valuations. It is also needed to support the preparation of Scottish Canals' medium-term financial strategy and delivery of its asset management strategy. The Scottish Canals board now needs to assure itself that the organisation has sufficient skills and capacity to deliver that complex project, and that it provides appropriate support and challenge to ensure that the project is delivered according to plan.

As you have noted, convener, I am joined by Joanne Brown, who is a partner with Grant Thornton and is the external auditor of Scottish Canals, and Graeme Greenhill, who is a senior manager at Audit Scotland. We will seek to answer the committee's questions among the three of us.

The Convener: Thanks, Auditor General. As usual, feel free to call on Joanne Brown and Graeme Greenhill as appropriate. If they wish to come in at any point, they should put an R in the chat box function and we will ensure that they are called.

Sharon Dowey will ask the first question.

Sharon Dowey: Page 3 of the report states:

> "Scottish Canals consists of a board comprising a chair, a vice chair and between one and four members appointed by Scottish ministers. As such, it operates on a day-to-day basis independently from the Scottish Government, but for which Scottish ministers are ultimately accountable to the Scottish Parliament. Scottish Canals' chief executive, as accountable officer for the organisation, is also personally accountable to the Scottish Parliament for ensuring its resources are used economically, efficiently and effectively."

What support, if any, did the Scottish Government provide to the board of Scottish Canals when the organisation's status was changed from public corporation to non-departmental public body? Was it the level of support that you expected?

Stephen Boyle: The overall accountability is clear: the accountability for preparing an annual report and set of accounts rests with the organisation and the accountable officer. As you know, the "Scottish Public Finance Manual" sets out personal accountability through this committee of the Scottish Parliament.

The change of status was not sprung on Scottish Canals as a new requirement. Let us look at the chronology. In its annual audit report on the audit concluding in 2019, Grant Thornton noted that the change was pending. The change stemmed from a decision that was made by the Office for National Statistics, which, having reviewed the functions, operation and status of Scottish Canals, deemed it to be more adequately described as a non-departmental public body than as a public corporation. Therefore, there was awareness of the project going back nearly two years.

As I said, responsibility rests with the accountable officer and board of Scottish Canals to reflect that change in its accounts. However, as you would expect, there is always interaction with the sponsoring body. Joanne Brown might wish to say more about those conversations.

The Convener: Joanne—do you want to come in?

Joanne Brown (Grant Thornton UK LLP): Thanks. I apologise—I was stuck on mute.

Representatives from the sponsor team in Transport Scotland routinely attend the Scottish Canals board. The board discussed on a number of occasions the organisation's change in status to NDPB. As I understand it, when the change was first announced, which I think was around September 2019, a number of discussions took place with the sponsor team. As the audit matters arose during the audit later on last year, there were further conversations with Transport Scotland, in its sponsor role.

Sharon Dowey: Was the issue a lack of understanding on the board or a lack of guidance from the Scottish Government? If the board knew in 2019 that the change was going to happen, why did it not take action?

Joanne Brown: From an external audit perspective, it was known that Scottish Canals becoming an NDPB would, under the FReM, require a change in how Scottish Canals accounted. We had a number of discussions with Scottish Canals' management and, later on, shared a paper with them outlining some of the issues that they would need to consider in changing to accounting under the FReM. There was a lack of understanding in Scottish Canals about the need to get the £51 million-worth of specialist assets valued to comply with the FReM, so when the organisation picked up the change to accounting under the FReM, that balance was missed.

Sharon Dowey: Okay, thank you.

The Convener: For clarity, FReM is "The Government Financial Reporting Manual". I just want everyone to be clear about that.

10:45

Craig Hoy: Good morning, Mr Boyle. Thank you for joining us on what I understand is a busy morning.

I am looking for clarification. Your report provides information on Scottish Canals' financial performance for 2020-21. However, it is not clear from the report whether you have any specific concerns about Scottish Canals' financial performance, or the information that you set out is in the report in order to provide the broader context of the overall situation. Will you clarify your position on that?

Stephen Boyle: It is, largely, the latter rather than the former. In preparing the section 22 report, the principal objective was to draw Parliament's attention to the challenges that Scottish Canals has had in valuing its specialist infrastructure assets and the resultant disclaimer of opinion. As I touched on in my opening statement, that is a very unusual move and there are important steps that Scottish Canals needs to take in the current financial year to resolve the matter.

Nonetheless, we draw attention to the overall financial position of Scottish Canals and, as the report mentions, the need for it to develop a medium-term financial strategy. The nature of Scottish Canals' activity is management of Scotland's inland waterways. For many years, the organisation has been involved in regeneration activity, which influences its income arrangements. In valuing its estate, it is important that Scottish Canals captures what that means for its revenue projections and for its call on Government grants, as part of a medium-term financial strategy.

We provide the information largely as context, but the matters are not entirely unrelated.

The Convener: Thank you. Colin Beattie has a couple of questions.

Colin Beattie: Looking at the big picture, is there a governance issue?

Stephen Boyle: The principal conclusion that we reached was that Scottish Canals needs to take some significant steps in the current year to resolve the issue that led to the disclaimer of opinion. I do not wish to labour the point, but that was a very unusual step for the auditors to take. I say that knowing that in the past couple of weeks the committee received another report that had a similar disclaimer of opinion. However, it has been many years since an auditor has taken that step because of insufficient evidence.

We note in the report, and I mentioned in my opening remarks, that the board of Scottish Canals will want to assure itself that the issue can be resolved during the current financial year. However, it is also true that there were two years or so before the accounts were signed off in which steps could have been taken. We know that the organisation has—like all others—as the committee has already heard, been dealing with the effects of the Covid-19 pandemic and that there have been changes in personnel in Scottish Canals that have interrupted its progress. What we are saying in the report that we have published is that there is a real need for the board of Scottish Canals to track, monitor and be assured on progress.

Joanne might want to say a bit more about the timeline for this year's audit, the signing off of the accounts and the steps that the board will be following in the course of the year.

Joanne Brown: Thanks—

Colin Beattie: [*Inaudible*.]—there is something I want to ask. I was going to ask what the role of the external auditors was, because they must have been advising the board all the way along. Were they ignored? Did they not give sufficient advice, guidance or clarification? Perhaps Joanne Brown can give us a bit more information on that.

Stephen Boyle: I am sure that Joanne will want to say a bit more about the role that she and Grant Thornton have played. However, I will just say that it is not the auditors' role to provide advice to the board of Scottish Canals, but to provide an independent audit. As you will know, the public audit model in Scotland is to provide assurance and to support public bodies to improve, but it is ultimately the responsibility of the accountable officer and the board to ensure that the accounts are well prepared.

Colin Beattie: That is true, but I would be surprised if the external auditors did not have a role in providing the information that the board needed to enable it to comply with whatever was required in relation to the assets.

Stephen Boyle: I accept that point. As Joanne Brown mentioned, the Grant Thornton external audit report on the 2018-19 audit identified a significant task that was pending. I think that it is safe to draw the conclusion that it was not an event or a requirement that emerged late on during the current year, and that conversations will have taken place regularly with the auditors. I heard Joanne say a few moments ago that they prepared a paper on the matter. It is probably best for Joanne to set out how Grant Thornton has discussed the requirement with Scottish Canals.

Joanne Brown: I will pick up on that last point before I comment on the project plan that Scottish Canals has developed to address the issues. As the Auditor General set out, in our 2019-20 external audit report, we highlighted a management action plan in which we noted the risk to Scottish Canals in the transition to accounting as an NDPB and what that would mean, given the significant work that was involved in restating the financial statements. There was a management response, which was captured in that report.

We raised the matter as a significant audit risk in our 2020-21 external audit plan, which we presented to the organisation's audit committee—again, setting out the work that was required to restate the financial statements, and the impact on the financial statements of Scottish Canals due to its change of status.

As I mentioned, in December 2020 we shared with management a paper that set out the various accounting requirements under the FReM and where we recommended that management pay particular attention in undertaking and drafting the financial statements for the year ahead.

As the Auditor General outlined, many things are, to be honest, management decisions. We are there to independently audit the set of accounts and the decisions and judgments that are made by management. However, from an external audit perspective, the subject routinely came up in conversations with the accountable officer and finance team throughout the year and throughout the audit work.

Scottish Canals has started to produce an indicative timeline and a project plan that sets out the various activities that it needs to undertake during the current year in order to resolve the issues on which we have reported. They include updating the fixed asset register and consideration of the nature of the assets that are held and how they will be subjected to valuation. That timeline takes Scottish Canals through to December 2022, when it anticipates that audited accounts will be signed.

That is an indicative timeline, at the moment. The board is still to have sight of the plan and to sign it off. We will work closely with Scottish Canals on that, as we go through our planning for the audit this year. As you would expect, we will stay close to the actions that Scottish Canals is taking to rectify the issues that have been identified.

Colin Beattie: Auditor General, turning to a slightly different aspect, I note that the report makes it clear that the cost of running Scottish Canals exceeds the funding and income. Paragraph 11 says that, in 2020-21, the income was £18.8 million and the outgoings were £22.7 million, so there was a net negative of £3.9 million. What are your views on the financial sustainability of Scottish Canals?

Stephen Boyle: One of the requirements of external auditors of public bodies in Scotland is to express a judgment on their financial sustainability and their financial management, governance and leadership arrangements, as well as any opinion on the financial statements.

Building on my response to Mr Hoy, I note that we have not identified core financial sustainability issues with the business of Scottish Canals. The main thrust of the report that we are discussing today is based on the valuation concerns and the need to tackle them. However, we make the connection that the business of Scottish Canals is to maintain Scotland's inland waterways, which requires considerable on-going maintenance investment. The organisation has played an important role in the regeneration of Scotland's canals.

Scottish Canals is in the process of updating its medium-term financial strategy. That will be the key judgment point, first for the board of Scottish Canals, which will make its own assessment of its financial sustainability, and the audit perspective will follow on from that. We are not raising a red flag about the financial sustainability of Scottish Canals today but, like any public body, Scottish Canals should keep that under close review.

Colin Beattie: The report also states that there is a £70 million maintenance backlog. That is a heck of a lot for an organisation of this size and with the resources that it has. How on earth did the backlog reach that level?

Stephen Boyle: Joanne Brown may want to say more about the background to that. Having a maintenance backlog is not unique to Scottish Canals. That is a regular feature for public bodies that manage large, complex asset bases. How they keep those assets up to date and in the expected condition is by prioritisation. Valuations and reviews of maintenance requirements have arrived at that figure as the cost of returning all assets to their ideal condition.

Scottish Canals will have to make a choice, just as it has made one about prioritising its investment in past years. Whether it invests £70 million, or more, will depend both on the financial strategy that it produces and on its delivery of the estates or asset management strategy that accompanies that.

Joanne Brown will give the background and to talk about decisions made in the years preceding this report.

Joanne Brown: Scottish Canals has had an asset management plan in place for some time. That plan has typically spanned 10 to 12 years and is reviewed and considered annually.

As the Auditor General said, that asset management plan considers the historic nature of the assets. It also considers them according to risk, according to priority and according to the information that comes from inspection of those assets. Scottish Canals recognises the need to take decisions about how to invest in canal infrastructure, based on funding and on the sums that it can afford to put back into maintenance. There are judgments within the plan.

Scottish Canals must balance its longer-term asset management plan with possible one-off instances of asset failure in year, when there is a need to go in and repair that asset. The maintenance backlog is recognised in the asset management plan and as a risk on the corporate risk register. Scottish Canals continues talking to the sponsor team about how that can be funded in future.

The Convener: I want to probe the fact that we are sitting with a report that has a disclaimer attached to the audit opinion. Paragraph 3 of the report says:

> "Scottish Canals had not obtained a valuation for around £51 million of specialist operational assets which had been capitalised between 2012 and 2021."

Would you have expected a public corporation—as Scottish Canals was during that period—to have had those assets valued?

Stephen Boyle: We say in the report that £51 million of specialist operational assets did not have a valuation. Joanne Brown will take the committee through subsequent valuations that were obtained during the year and about some of the concerns that Grant Thornton had about the material that was presented and about how that related to information that was stored in the fixed asset register.

Part of the background to this is that the requirement on Scottish Canals for valuation evolved as it moved from being a public corporation into being a non-departmental body, with the additional obligations that that brought for how it recorded its assets and disclosed them in its financial report and accounts.

I am sure that Joanne Brown will have more to say on this, but what we have today is a disclaimer of audit opinion because the auditor was unable to obtain the necessary evidence to sign off the accounts. Joanne can take the committee through what went before.

11:00

Joanne Brown: I am happy to pick up on those points. Because, as a public corporation, Scottish Canals was accounting primarily under Companies Act 2006 requirements, it was not required to have a physical valuation of the assets and the capital spend. Those assets were held at historical cost and then depreciated over their useful life.

However, under the FReM, the accounting treatment changed, and the organisation was required to have a valuation done. It identified and commissioned a valuer for land and buildings prior to our audit, and those assets account for circa £8 million of the balance on the balance sheet. However, it did not request a valuation for the £51 million of what were determined as specialist assets, and when that came to light during our external audit year-end work in May and June, we had conversations with management on the need for the valuation in order to demonstrate compliance with accounting requirements.

When we started to look at the detail of the underlying records for the £51 million, coupled with the valuation that Scottish Canals subsequently got in October, we had concerns about the suitability of the audit evidence and the management's records. The descriptions in the fixed asset register made it quite difficult to understand the exact asset, and it is quite important in accounting terms for us to know whether an asset is a new one that is being brought in or an existing one that has been repaired or enhanced. Moreover, the fixed asset register had been set up in such a way that you would not have been able to tell whether old assets had effectively been written out of the register.

We also had some concerns about potential duplication and double counting between the valuation of the specialist assets and what was recorded in the fixed asset register. For example, a number of investment properties were subject to valuation. Although we were comfortable with those valuations, some of the balance that made up the £51 million contributed to the investment property, and we were unclear whether that was effectively a double count.

The asset register held a number of assets as a component of assets, which were then wrapped up into individual assets that the valuer sought to value last October and November. Within those assets, however, there were different types of assets, which raised an audit challenge with regard to whether the useful life of those individual components was the correct allocation and whether, therefore, the valuation basis was correct. The 51 specialist assets included infrastructure assets—bridges, roads, towpaths and so on—and specialist engineering such as rock piles and sea gates, but there was also a land element, which had a different valuation basis. As a result, the records that Scottish Canals had to support the valuation and to show the individual assets were lacking. There was also a challenge with regard to the subsequent valuation that it received in October or November, which obviously came later than our audit work.

Therefore, a number of factors with regard to the fixed assets and the subsequent valuation caused us concern. As the Auditor General has said, a disclaimer opinion is very unusual—I have signed only two, which you have seen—but we had to issue a disclaimer, because when we looked at the balances in the financial statements where these transactions would hit, we were unable to say whether they were materially or otherwise misstated. Capital could have been incorrectly treated and should have been expenditure instead; if the useful lives were incorrect, that would have an impact on depreciation; and there was an impact on revaluation reserves. The impact of the £51 million hit a number of the financial statement line items, which led us to think that this was pervasive across the accounts and to issue the disclaimer.

The Convener: Thank you. That was really helpful.

I understand that Scottish Canals changed its status from being a public corporation to being a non-departmental public body, which led to a change in its accounting requirements, but does Scottish Natural Heritage or Scottish Water have a fixed asset register? Will ScotRail need to have a fixed asset register in the future? Where does Scottish Canals sit in the spectrum of organisations in that regard?

Stephen Boyle: Any public body that manages assets should have a fixed asset register, as it is a core component in managing the maintenance and recording of assets. As Joanne Brown touched on, the register does not record just the overall asset that you can see; an asset is often subdivided into components—the different items that make up the asset—which may have different useful lives. That ought to link clearly and transparently to depreciation of the asset, the management of it and the associated financial reporting that is disclosed in respect of it.

It is usual and expected that that information will be recorded and kept up to date in a fixed asset register, and that those records will be accurate.

The Convener: There are other circumstances in which a valuation might be applied prior to a change of ownership. That has happened in the past. With ScotRail, for example, where the ownership of the franchise is changing, would you expect some kind of fixed asset register to be provided on the transfer date, so that the Scottish Government, in taking on the assets, would know what Abellio was handing over to it?

Stephen Boyle: In that context, yes. As you know, we have not yet done any work on that. The auditors—whether the outgoing or the incoming auditors—will look at opening balances, in order to be satisfied with the disclosures that are being inherited. Building on the discussion that we had earlier, the same applies to the incoming board and the accountable officers, who will also want such an assurance. Whether that is provided by external auditors or internal auditors, they will want to be clear about the assets and the liabilities that the organisation is inheriting.

As far as Scottish Canals is concerned, a fixed asset register is a vital component of the organisation, given what it does in maintaining Scotland’s inland waterways. It is a key feature of its work. That is why it is so important that there is a focus on resolving the issues that we have reported on today, that that work is done over the course of this year and that the reporting on that goes ahead as intended, at the end of December.

The Convener: The value of the canal network in its entirety has never been disclosed in accounts produced by Scottish Canals. What is the reason for that? Is that because the network consists of old, Victorian structures that have never been properly assessed since they were built centuries ago, or is there another reason? Why is that?

Stephen Boyle: The situation is largely as you described it. Before Scottish Canals became a non-departmental public body, it was not required to have valuations of the sort that it now requires to have, as an NDPB. There has been a change of status. Joanne Brown might want to say a bit more about the valuation methodologies that Scottish Canals has now that it has moved to a depreciated replacement cost and existing use model, and the requirements on it in that regard.

I do not wish to understate the significance of the work that requires to be done. In the report, we make the judgment that Scottish Canals must do a significant piece of work this year to resolve the valuation concerns that we talk about in the report. Therefore, there is all the more reason for there to be good governance and oversight of the project over the course of this year.

I will hand over to Joanne Brown to talk about the present and previous valuation arrangements.

The Convener: That would be helpful.

Joanne Brown: When Scottish Canals came into existence in 2012, there was an asset register agreement between British Waterways and Scottish Canals, which involved the assets transferring to Scottish Canals with a nil net book value. In effect, the canal network and the canal assets were recognised as a heritage or historic monument type of asset that could not be subject to valuation and were therefore held at a residual nil value.

Over time, Scottish Canals has invested in the canal network and undertaken a number of repairs. As part of the repairs, the canal network has been enhanced. It has been challenging for Scottish Canals to think through some issues—for example, some of the spend this year in the specialist asset category was to enhance a reservoir, but the reservoir is not held on the Scottish Canals books and does not have a value attributed to it. The conversations are about whether the reservoir or the piece of work that was done at the reservoir should be valued and about what that means in valuation terms.

Scottish Canals is discussing with the sponsor team the challenge about how to put a value on a canal network—a canal is not quite the same as a trunk road and is not used in the same way. Ultimately, does the Scottish Government want a value to be attributed to the whole canal network and to have it on the Scottish Government's books? Scottish Canals needs to have that on-going conversation so that it understands why it would want to have capital assets and hold them in the proposed way. Once Scottish Canals better understands the nature of the capital asset, it will be better placed to determine the valuation of it.

Over time, all the work is being capitalised. If that approach continues, it will inadvertently give the whole canal network a value. I am not sure that that is necessarily the intention, and Scottish Canals management are looking further at that.

The Convener: There are still quite a few unanswered questions and we will need to consider how best to respond to them. Willie Coffey has questions to raise.

Willie Coffey: The transition of Scottish Canals from a public body to an NDPB seems to have brought about many or most of the issues. Paragraph 10 of the report says that the decision to change the status from public body to NDPB resulted from a review by the Office for National Statistics. Did no one think that that would put a bit of a millstone around the neck of Scottish Canals? Joanne Brown described the substantial change in requirements. Being one type of body or the other makes a substantial difference to how the assets are accounted for. Did nobody think about that before the decision was made about changing the organisation's status?

Stephen Boyle: That is an interesting point. Graeme Greenhill can provide additional context and background. From the work of the committee's predecessor, Mr Coffey might recall decisions that the Office for National Statistics made about other capital projects. Graeme Greenhill might say a bit more about the Aberdeen western peripheral route; the special purpose vehicle that went around that was a consequence of a call that the Office for National Statistics made.

The ONS makes its own decisions. Across the UK, it makes judgments on the status and activity of public bodies and it determines into which categories they best fall. The ONS judged that, by way of its relationship with the Government, Scottish Canals was better described as a non-departmental public body than a public corporation, but the knock-on implications of that were significant, as we see today. Joanne Brown described the complexities of the various valuation arrangements and what then fell on Scottish Canals.

Decisions that might initially appear to be relatively innocuous can have serious repercussions. It is worth hearing from Graeme Greenhill about how that has been dealt with previously.

Graeme Greenhill (Audit Scotland): It is not entirely uncommon for a body's status to change as a result of ONS reviews, but it is fairly unusual. It tends to involve arm's-length bodies that are at the boundaries of the public sector and have features of a trading nature.

One recent example, which Willie Coffey might remember the committee's predecessor considering, was the special purpose vehicle that was set up to deliver the Aberdeen western peripheral route, which was part of the non-profit-distributing programme. The ONS was responsible for classifying, under guidance that Eurostat—the European statistical body—prepared, whether the privately financed projects were under public sector control or private sector control.

11:15

Back in 2015, the ONS concluded that, because the public sector in effect had a veto over key aspects of projects and a share of the project surpluses, NPD projects fell under the public sector. That led to the Scottish Government halting NPD as a method of delivering private finance projects. It changed the way in which it was going to do private finance projects and introduced the mutual investment model to avoid having that kind of ONS review resulting in a special purpose vehicle being regarded as being under public sector control.

The ONS tends not to think much about the implications of its decisions in the way that Mr Coffey outlined. It tends to look at the wider picture and at where public bodies sit within national accounting boundaries.

Willie Coffey: Auditor General, I am still reading the report. That status change was made only in April 2020. We might argue that Scottish Canals would struggle to be able to deliver the extent of the fixed asset register re-evaluation in that timeframe. The more important question is whether Scottish Canals is getting on with that now. Are you confident that the organisation is aware of what must be done and of the demands that you have outlined in the FReM and that Joanne Brown described to us? Does the organisation have the skills and capacity to do the work now and as quickly as possible?

Stephen Boyle: I can address both those points.

Although the status change happened in April 2020, there was an awareness of the implications of that change for at least a year beforehand. That might have allowed some of the circumstances that we are reporting today to have been avoided.

You asked whether we can assure you that all the necessary work will be carried out over the course of this year. Unfortunately, we cannot do that yet. Joanne Brown will want to say more about what she has seen. We know that this is a complex task. Scottish Canals recognises that there is complex work to do and has arrangements in progress to tackle the issue.

We have said a couple of times that the board of Scottish Canals will want to assure itself that the necessary skills are in place to tackle and deliver the project. Joanne already said that we will track and monitor that through our external audit work and will consider further public reporting as necessary. I will hand over to her to say more about how Scottish Canals is tackling that and what its intentions are this year.

The Convener: I think that Joanne Brown has frozen. I do not think that we can fix that. Auditor General, do you want to say anything else?

Stephen Boyle: We know that Scottish Canals is making plans to tackle the issue. That is a significant task, as we have said a number of times here and in the report. It must be carefully managed, with the right resources and level of expertise. Scottish Canals may not have that expertise in house and may need to bring in experts in the necessary subject matter to provide support for the valuation process. It is a big and complex project. Scottish Canals will want support from the Scottish Government and the sponsor team to deliver it, to manage it and to report transparently throughout the year. As I have said, we will continue to monitor it through our audit work and through Joanne Brown's team.

The Convener: Thank you. We are out of time. I thank the Auditor General for providing us with a useful insight into the report. I thank Joanne Brown, who joined us online, and Graeme Greenhill for their evidence, which has given us a lot of food for thought.

The meeting will now move into private session.

11:20

Meeting continued in public until 11:42.

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