The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

PUBLIC AUDIT COMMITTEE

Wednesday 1 April 2015

Session 4

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CONTENTS

PUBLIC AUDIT COMMITTEE
7th Meeting 2015, Session 4

CONVENER

*Paul Martin (Glasgow Provan) (Lab)

DEPUTY CONVENER

*Mary Scanlon (Highlands and Islands) (Con)

COMMITTEE MEMBERS

*Colin Beattie (Midlothian North and Musselburgh) (SNP)
*Nigel Don (Angus North and Mearns) (SNP)
*Colin Keir (Edinburgh Western) (SNP)
*Stuart McMillan (West Scotland) (SNP)
*Tavish Scott (Shetland Islands) (LD)
*Drew Smith (Glasgow) (Lab)
*David Torrance (Kirkcaldy) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Gemma Diamond (Audit Scotland)
Russell Frith (Audit Scotland)
Caroline Gardner (Auditor General for Scotland)
Fraser McKinlay (Audit Scotland)
Graham Sharp (Accounts Commission)
Gordon Smail (Audit Scotland)
Mark Taylor (Audit Scotland)
Pauline Weetman (Accounts Commission)

CLERK TO THE COMMITTEE

Jane Williams

LOCATION

The Adam Smith Room (CR5)

Scottish Parliament

Public Audit Committee

Wednesday 1 April 2015

[The Convener opened the meeting at 09:31]

Decision on Taking Business in Private

The Convener (Paul Martin): Good morning. I welcome members of the press and public to the 7th meeting of the Public Audit Committee in 2015. I ask all those present to ensure that their electronic items are switched to flight mode so that they do not affect the work of the committee.

Do members agree to take items 5 and 6 in private?

Members *indicated agreement.*

Accounts Commission Report

"Borrowing and treasury management in councils"

09:31

The Convener: Agenda item 2 is a briefing on the Accounts Commission report entitled "Borrowing and treasury management in councils". I welcome from the Accounts Commission Graham Sharp and Pauline Weetman; and from Audit Scotland Fraser McKinlay, director and controller of audit, and Gemma Diamond, senior manager. Graham Sharp, from the Accounts Commission, would like to make a brief opening statement.

Graham Sharp (Accounts Commission): Thank you, convener. The report that we are here to discuss today on behalf of the Accounts Commission looks at borrowing and treasury management in councils.

Borrowing is a major source of funding for councils to invest in infrastructure projects, such as schools and roads, that are essential for the provision of key public services. At the same time, in today's environment councils have on-going challenges in relation to reducing public spending.

The report looks at how councils are demonstrating affordability in making decisions to borrow, and at the different positions that councils are in as a result of historical borrowing and policy decisions. The report focuses on long-term borrowing. We did not evaluate day-to-day cash, investment and borrowing transactions or look at other forms of debt, such as public-private partnerships.

The report is aimed at councillors as the key audience. It considers the clarity and purpose of treasury management reports that are presented to them, which are often very technical in nature. It also considers the skills and expertise that councillors need in order to perform their key scrutiny role.

During 2014, we looked at treasury management reports relating to 12 councils to get an indication of the clarity, content and variation of financial policy among councils. We interviewed officers and councillors from six of the 12 councils to get a more detailed insight. The report provides a summary of the main themes and conclusions arising from that work and identifies what more needs to be done. The messages and recommendations in the report apply to all councils, and our expectation is that financial officers, along with councillors, will review the report, assess themselves against it and implement the relevant recommendations.

I now turn to what we found. Borrowing by Scottish councils is £12.1 billion, or around 82 per cent of councils' total debt. Councils take on debt to invest in capital assets such as schools and roads. As I noted, our focus for this audit was on the borrowing element. We looked at councils' borrowing since the introduction of the prudential code 10 years ago. The prudential code is a framework to support councils and help them show effective control over levels of, and decisions relating to, capital investment activity, including borrowing. We found that just over half of councils have higher levels of borrowing now than they had 10 years ago.

Councils are following relevant codes and regulations, and they are clearly demonstrating short-term affordability of borrowing and other debt. However, we have found it difficult to identify how officers analyse long-term affordability and communicate that to councillors through strategies and reports for councils. For example, councils have information on capital investment requirements for up to 10 years and on the timing and cost of repaying borrowing, and they also have forecasts of future interest rates, but there was no analysis bringing those together with budget scenarios to assess affordability in the longer term.

Treasury management is a professionally run function in councils. There are signs of more joint working and of integration of activity with the capital investment function, which is a positive step. We see potential issues in the future around the transfer and succession of skills and experience in that area and suggest that councils might wish to plan for that together.

Councils have a range of governance and scrutiny arrangements, which is fine. The detailed arrangements are not for us to prescribe, but they need to be consistent across each council to enable councillors to build up knowledge and experience in this technical area. Councillors need to ask, and to be equipped to ask, more questions of officers about the affordability of borrowing and other financing options, particularly in the longer term, and about performance based on prudential and other indicators as reflected in year-end reports. Reports for councillors could be improved. They can be very technical documents and they should be written with councillors and the general public in mind.

I will quickly summarise our recommendations. The report makes recommendations that are aimed at: helping councils develop treasury management strategies to present a wider, more integrated strategic view of borrowing and treasury management; encouraging councils to be more open about, and to report on, longer-term affordability; and helping councillors to scrutinise treasury management activity.

The first main recommendation is that councils should prepare the treasury management strategy with councillors as the key audience, and that they should present a wider, strategic view of borrowing and treasury management. That should also cover how the borrowing strategy is informed by corporate priorities and capital investment needs.

Secondly, councils need to create more detailed and longer-term borrowing and treasury management analysis that is informed by their financial strategies. It should include scenario planning, the analysis of capital financing options and the use of prudential indicators over a longer period than the minimum three-year requirement in the prudential code. Year-end reports should provide an overall assessment of performance and treasury activity.

Finally, councillors and officers should review governance arrangements to ensure that they provide councillors with a wider strategic view of borrowing and treasury management and that councillors have access to all relevant treasury management reports. They should also ensure that training for councillors provides the appropriate level and balance of treasury management knowledge and scrutiny skills. We have provided a short guide and scrutiny questions for councillors to assist that process, published separately from the report.

My colleagues and I are happy to answer any questions that the committee has on the report.

The Convener: Thank you, Mr Sharp.

I refer the witnesses to page 31 of the report, which states:

> "Council governance structures are in place but not all meet code requirements".

Will you elaborate on that?

Gemma Diamond (Audit Scotland): We found that councils were all generally following the principles of the code but, sometimes, the requirement for everything to be approved by the full council was not being followed. The full council might approve the minutes of another meeting where the treasury management strategy was approved, so the strategy was not going to full council to be approved.

The Convener: How many councils did you find in that position?

Gemma Diamond: Two of the six that we looked at.

The Convener: So only six councils were looked at in this assessment.

Gemma Diamond: That is right. We looked at six councils in detail.

The Convener: In percentage terms, therefore, the figure could be even higher.

Gemma Diamond: We do not have any evidence for other councils, so I am not able to comment on that.

The Convener: Should that part of the code not be pursued to ensure that the requirements are met?

Gemma Diamond: The councils all consider that they are meeting the general spirit of the code's requirements, because the full council would have the opportunity to see the strategy and would approve the minutes of the committee at which the strategy had been approved. Certainly the strategy is available to all members, but that approach does not follow the exact requirement in the code that the full council approve the treasury management strategy.

Fraser McKinlay (Audit Scotland): As Gemma Diamond said, we took a sample, which is what we often do in our work. However, if it would help the committee, we could see whether we could find out that specific information for all 32 local authorities.

The Convener: Correct me if I am wrong but I believe that in your opening remarks, Mr Sharp, you said that councils were meeting those requirements—I am sure that you referred to the code of practice. Does that comment apply to everything except the point that is made in the paragraph from which I just quoted?

Graham Sharp: In my opening remarks, I said that, in material terms, councils are meeting the code. The more significant point that I think we are trying to get across in that paragraph is that we believe that the code does not go far enough in a number of respects, particularly with regard to maturity of borrowing and looking far enough into the future.

Mary Scanlon (Highlands and Islands) (Con): On page 5, the report says:

> "Overall borrowing has remained at around £12 billion for the last three years, with total assets of £39 billion."

In fact, that point is made quite often throughout the report. Does that mean that you are quite content with borrowing sitting at around a third of the level of assets? At what point should we as committee members be concerned about the level of borrowing in relation to assets?

Graham Sharp: There are a couple of levels to that question that need to be dealt with. First of all, we are talking about total figures, and I would be neither content nor discontent on the basis of aggregated figures. What matters are specific councils' financial plans and strategies and how they justify the borrowing and other debt that they have taken on in terms of sustainability, and that sort of thing is not captured in aggregated figures.

Secondly, we have included the asset figure to give a feeling of scale. Because borrowings are serviced and repaid from future revenues, we really need to look at future projections. The situation is not quite the same as that in companies, where you can have asset cover for properties that are realisable in the market, for example. Clearly, the assets that councils have are largely infrastructure ones that provide services instead of generating an economic rent, so we have to look at individual councils and their plans.

Mary Scanlon: I am an economist, not an accountant, but I note that you constantly mention £12 billion of borrowing against £39 billion of assets. The way I read that comment, it seems to be providing a bit of comfort; it is as if you are saying, "We've only got £12.8 in borrowing, so we don't need to worry." If the figure for borrowing was £30 billion or even £38 billion against £39 billion in assets, would that be a cause for concern? Would you still be looking only at individual councils and what they are doing?

Graham Sharp: As I said, I would assess that on the basis of individual councils' specific plans and borrowings, not on the aggregated figures.

Fraser McKinlay: I do not suppose that using those numbers is designed to give comfort or otherwise; rather, it is designed to give a sense of scale. Similarly, with reference to some of the conversations that we have had with the committee in the past about levels of reserves, it is not right for us or the Accounts Commission to come up with a magic number for what is good or bad, or worrying or not worrying. As Graham Sharp explained, we make the point so strongly in the report because it is important that the levels of borrowing are understood in the context of a council's long-term financial plans. That is the bit that we think could be strengthened.

09:45

Mary Scanlon: On the financial plans for individual councils, the histogram in exhibit 4 on page 13 shows that East Lothian and West Lothian have probably more than doubled their borrowing in the past 10 years. We also see significant increases in Edinburgh and South Lanarkshire. In the rest of the councils, there has been very little decrease, as Mr Sharp said. Is there any particular reason why those four councils have seen a fairly dramatic increase in borrowing?

Fraser McKinlay: I will kick off; if we do not have the detail, I will be happy to come back to the committee because, as you say, the numbers are striking.

From other audit work that we have done in the City of Edinburgh, I know that one of the specific reasons for the increase in borrowing there was the trams. Gemma Diamond might be able to help with the reasons in East Lothian and West Lothian.

Gemma Diamond: I do not have the detail on it all. It essentially depends on the council's asset management plan and capital investment plan over the period. Exhibit 4 shows that the councils all had different plans over that time. For example, West Lothian has had significant investment in its assets and has used borrowing as a means of funding that investment.

Colin Beattie (Midlothian North and Musselburgh) (SNP): Who is ultimately responsible for borrowing by councils?

Graham Sharp: I believe that the councils themselves are legally responsible for their borrowing.

Colin Beattie: The councils are responsible, not the Government.

Graham Sharp: Correct.

Colin Beattie: Councils are completely independent.

Graham Sharp: They are.

Colin Beattie: Thank you.

Paragraph 16 states that 17 of the 32 councils increased their borrowing, but paragraph 18 says:

> "fewer councils are borrowing now than ten years ago".

The level of debt seems to be bouncing along within the same sort of margin. However, we have just heard Mary Scanlon say that some councils have substantially increased their borrowing. Presumably, that means that some councils have decreased their borrowing.

Graham Sharp: Yes. You can see from the histogram that some councils have reduced their borrowing. There is a timescale issue between those two paragraphs. Gemma Diamond might be able to expand on that.

However, that is one of the reasons why you need to look at borrowing on a council-by-council basis. Each council is in a different position when they come to look at their future requirements for services and what that means for their infrastructure investment. They are also in a different position when it comes to the condition of their existing estate, their financial options and the revenues that they might look to in future. Some councils might have particular revenue sources that are specific to them.

All those things go together, in terms of cycle and the absolute position, to determine what is reasonable. That is why you see different patterns in different councils as well as different levels. I do not know whether Gemma Diamond wants to add anything.

Gemma Diamond: No.

Colin Beattie: That takes us to paragraph 27 and the differences in debt position at the local level. The report says:

> "These differences are likely to increase over time as councils' choices reflect local priorities."

Could you expand on that?

Gemma Diamond: Since the prudential code was introduced, we have found a level of variability in what councils have chosen to do and how they have chosen to fund investment in their assets. We can see that that variation will continue.

Councils have very different strategies in terms of whether or not they are going to borrow and they are starting to use new debt models, such as tax incremental financing, growth accelerator models and city deals. Councils are starting to look into those as ways of investing in their assets, and we see that variation continuing over time.

Graham Sharp: The report is about the borrowing element. Non-borrowing options may be used more in the future, so differences in the borrowing levels will follow.

Colin Beattie: An important aspect is the quality of councils' borrowing. There is an assumption that it is all Public Works Loan Board borrowing, but councils have Bermudan interest rate swaps and suchlike, which are rather more exotic and carry higher risks for councils. There is no mention of that in the report.

Gemma Diamond: At the moment, councils are borrowing largely from the PWLB, as that offers the best interest rates. Historically, councils have used borrowing options but, at the moment, it is PWLB borrowing.

Colin Beattie: You say that short-term borrowing is increasing, which is a bit of a concern if it is not linked to longer-term planning.

Graham Sharp: In principle, I agree with that. If you look at the figures, you will see that one effect of the increase in short-term borrowing has been an evening out of the maturities, which is, in principle, a good thing. However, over the past few years, borrowing has been driven by the interest rates that have been available, particularly from the PWLB.

Colin Beattie: Are there indications that the borrowing is short term and that there is lending out on the market to make a return?

Graham Sharp: I am not aware that we have come across that.

Gemma Diamond: No, we have not come across that.

Colin Beattie: I have heard that it has been happening.

Drew Smith (Glasgow) (Lab): I have two related questions on the role of councillors, which was a major focus of your report. In terms of the balance, are your concerns about all councillors or particularly about councillors who are involved in executive decision making or who scrutinise accounts? Is your concern about decision making over borrowing or about scrutiny of the accounts? I suspect that it is about both.

Graham Sharp: I will make a general comment and then ask others to come in. In general, compared with 10 or six years ago, finance cannot be put in a separate box so that we can get on with the business of the council while the financing issues are dealt with separately. Because of the economic conditions that everyone faces, particularly in the public sector, the assessment of borrowing sustainability, debt sustainability and financial decisions in general must be much more integrated with strategy in providing services—especially future services. To that extent, all councillors need to be much more aware than they were years ago of the financial position and the issues that it raises.

Pauline Weetman (Accounts Commission): In our scrutiny guidance, we provided questions that we believe all councillors are capable of asking. We are trying to encourage councillors not to be afraid of the terminology and the jargon, and we have provided straightforward questions that they can ask in scrutinising what they are borrowing, whether they are getting the best deal, how long it will take to repay the borrowing and what the implications are for their future revenue streams if they commit those to interest payments and repayment of borrowing. Any councillor should have the confidence to understand those questions. We are telling them not to be afraid of asking those questions because they are legitimate questions for a councillor to ask in a scrutiny role—or in any role.

Drew Smith: Are there any examples of best practice, where the information is communicated clearly and there is a culture of greater scrutiny of it? That takes me on to my next question. Later in the report you mention the use of external advisers on borrowing. Is there any issue around information being prepared externally for officials? Do councillors understand that they are receiving information from an external source or are reports prepared by council officials, who might have a better idea of how to communicate the information to their elected members?

Gemma Diamond: We saw a lot of variation in the quality and content of borrowing and treasury management strategies. We found that the Scottish Borders Council strategy told a better story for members about why the council was borrowing and in explaining what that meant.

All 32 councils have external advisers for borrowing and treasury management advice. We found that all the officials in the borrowing and treasury management departments were appropriately qualified—they had financial qualifications or the treasury management qualification. Although they were taking advice, they were certainly writing their own reports to members.

Drew Smith: That is quite reassuring. You mentioned that Capita is the contractor for 28 of the 32 local authorities. On one level, someone who is engaged in such a contract has a vested interest in local authorities' borrowing, because that is the basis of their contract. Is the increase in the use of advisers a replacement of expertise that previously existed in local authorities or is it a reflection of a greater scrutiny and reporting burden being placed on councils? Have they taken external advice for that reason or is that just good practice?

Gemma Diamond: All councils recognise the need for specialist advice in the area. That advice comes from the treasury management advisers in the market, who can give them the best advice about what is happening in the financial markets.

Councils in England and Wales take external advice. We see that practice as a means for councils to ensure that they have the best information that they can get on which to make their decisions.

Graham Sharp: The area is technical. One would expect councils to have their own expertise to understand their financial requirements and know the options to meet those requirements. However, councils would not necessarily be able to replicate external advisers' knowledge of what is out there in the market. The important point is that councils represent, if you like, a smart client who is sufficiently knowledgeable to challenge external advisers' advice if it does not seem suitable for their circumstances.

Drew Smith: You have made recommendations for council officers and councillors to take forward. Do you have any comments on the Government's role or recommendations for the Government, given the committee's interest in public sector borrowing in general?

Graham Sharp: As we said, borrowing and other debt issues are individual councils' responsibility and they must be held to account for that. That is done, council by council, primarily through the financial audit cycle and the risk reviews that are part of that, and through individual reports as required. There is not a specific role for the Government to intervene in that process.

Fraser McKinlay: I absolutely agree. There are—I guess that we might come on to this later—important principles of transparency and long-term planning and ensuring that the process is clearly reported and integrated into what councils are trying to do with the money. Let us remember that borrowing is not an end in itself. The commission has—correctly—focused the recommendations on councils, but there are principles that apply to other parts of the public sector.

Nigel Don (Angus North and Mearns) (SNP): I will follow straight on from what was just said. Exhibit 5 on page 15 tells me about maturity dates—as I think has been said, they are maybe becoming less skewed, which is in principle a good thing—but it does not tell me the one thing that I absolutely have to know, which is what the interest rates are. You have not told me that—it is not there. Who is auditing the results?

10:00

Graham Sharp: That is down to the individual council audits. To aggregate all the interest payments would not be a terribly useful statistic for this report, because one would need to look at the discretionary spend council by council that is available to cover that. We would get into a complex and—

Nigel Don: I am entirely with you on that, but that was not my point. You are entitled to that interpretation but—forgive me—that was not where I was going. You have told us about making sure that councillors are in a position to ask the right questions, but I am slightly concerned about whether most councillors—I was one—are capable of understanding the answers. Nonetheless, getting the right questions is a good start.

We finish up with the councils being responsible for what they do, as you said. I am very concerned about who will make sure that councils have a strategy. Somewhere in the report you talk about five to 10 years as being long term, but I am afraid that I do not think that that is long term. I expect my local council to be running in 30 years' time. The fact that it has debts that will be protected in 30 years' time is something that somebody, somewhere really should be worrying about. People are well capable of fooling themselves, so I would be really concerned if the scrutiny was done just by the council internally. Most people will not fool themselves, of course. However, my concern is about who is worrying about the scrutiny overall if the Accounts Commission is not doing it.

Graham Sharp: One of the report's main messages is that we are not satisfied that councils are looking far enough into the future. I think that the timescale of five to 10 years links with how councils look at things in the capital investment structure.

Fraser McKinlay: The points are extremely well made. The Accounts Commission asked us to do this piece of work because not an awful lot of light has been shone on it in the past, and certainly not since the code was brought in. However, councils have had a pretty decent track record up to this point of doing such work, so the issue is not on the critical list, if I can use that phrase. However, we say in the report that there are definitely things that councils can do better.

The role of audit is an interesting question, as ever. The local auditors' role would be to get assurance that the council was doing things to understand what interest rates it was paying over what period and what that meant for the sustainability of finances and in particular the impact on future revenue budgets. I do not think that it is for audit to assess whether a council is getting a good deal or whether it has taken the right interest rate or loan. That is properly a decision for management and, ultimately, councils and councillors.

However, the Accounts Commission asked us to do this work because it requires some focus. It is probably right to say that the commission will continue to look at this area and perhaps begin to look at the other forms of debt that we mentioned but did not look at specifically. I would expect a bit of a stream of work that the commission will ask us to do over the next few years.

Nigel Don: I endorse the view that you should be doing such work. If a business did what a local council does, the shareholders would be at risk. They could be left to worry about that, but this is about the public domain and public money—local people are in effect the shareholders and they cannot go bust.

I am conscious that it is eight years since I was a councillor and that, as Mr Sharp said, a lot has changed in that time. One of the changes is that very low interest rates have become the norm, which I suspect means that it is easy for councils to believe that they can borrow lots and not worry about it. I express again my concern that, among all the other issues that you look at, you should worry about that, because somebody should be looking at the result.

Graham Sharp: I can only follow Fraser McKinlay and say that the low interest rates and the ability to borrow are clearly concerns, although councils can borrow only for capital purposes and not to supplement revenue. Those concerns formed one of the reasons why we carried out the work that we did. As Fraser McKinlay said, we intend to look at the more complex areas of debt because, looking into the future, I think that there will be more of that than conventional borrowing.

Mary Scanlon: You talk about borrowing for capital purposes, but I understand that payment of borrowing charges—in other words, the interest payments—comes from revenue expenditure, so borrowing impacts on that expenditure.

Graham Sharp: Absolutely. I was making the point that the fact that councils can legally borrow only for capital purposes constrains their ability to borrow—they need to have a capital reason to do it.

Mary Scanlon: Borrowing charges are a constraint on spending.

Graham Sharp: Yes.

Tavish Scott (Shetland Islands) (LD): I want to explore paragraph 38 so that I understand it exactly. It states:

"none of the councils in our sample presented councillors with a longer-term view."

Why not?

Gemma Diamond: We found that none of the councils presented more than the minimum of three years required by the prudential code. The code requires councils to use prudential indicators to look ahead for three years, but no council went further than that. Many councils do not have a long-term financial plan in place that would inform the analysis that they would need to do on affordability.

Tavish Scott: When you refer to many councils, do you mean all of them or three? How many is it?

Gemma Diamond: We found that the capital plan is for three to five years, but the revenue plan is for two to three years.

Tavish Scott: Is that for all local authorities or just those in the sample?

Gemma Diamond: That is about the ones that we looked at. The local government overview report gives the number of councils that do not have a long-term financial plan, and I can certainly get that figure for you.

Tavish Scott: Thank you. Is that why paragraph 38 goes on to say that

"there was no analysis bringing this together with budget scenarios to assess affordability"?

Gemma Diamond: That is right. We found that councils know when they need to make repayments on their borrowing, what the interest rates are—where they are fixed—and when those will fall. However, to work out whether that is affordable, they need the revenue line, and they do not have that over the longer term.

Tavish Scott: The revenue line is not available because there is three-year budgeting by the Scottish Government to local government. Is that right?

Gemma Diamond: In the report, we explore the use of budget scenarios and forecasting using what-if scenarios to make assumptions about what revenue might be and to see what the risks are to the affordability of the borrowing.

Tavish Scott: Yes, but local authorities have a degree of certainty on budgeting over only three years—they know nothing beyond that, unless they make heroic assumptions about what central Government might give them.

Fraser McKinlay: We hear that a lot from councils, and we buy it to an extent, in that they do not have absolute certainty or clarity beyond that period, but we think that it is reasonable for them to make assumptions—not heroic ones, I hope—and to look ahead. The point has been made that, particularly in the context of the report, councils already make decisions that will have an impact well beyond the three-year period, so it is not unreasonable to expect them to make such assumptions, which of course need to be monitored and changed as they go along.

Tavish Scott: I take that point. What would a long-term financial plan be? To go back to what Nigel Don said, would it be for 10 years or for five years?

Fraser McKinlay: In past reports, we have talked about planning for up to 10 years. I absolutely take Nigel Don's point, given the context of investing and taking out loans that have a 50-year period. However, we are trying to strike a balance between what is reasonable and practical and the constraints, so we tend to talk about five to 10 years as being the medium to long term.

Tavish Scott: It would help councils if central Government set out a longer-term strategy for how much even the totality of local government funding would be. There is an argument to be had about the bun fight between councils, but would information on the totality of funding for local government not help councils with that 10-year plan?

Fraser McKinlay: There is an interesting debate to be had on that, which might come up in later sessions with the Auditor General for

Scotland today about the longevity of view that all tiers of government can take.

Tavish Scott: Quite. Is it fair to say that there is a recommendation for central Government about providing at least a degree of clarity, albeit that no central Government can bind a future one? Ministers always use the caveat, "We cannot bind the next lot." However, it would not half help local government to have that clarity.

Fraser McKinlay: As I said, there is a debate to be had, and I am sure that it will come up later today.

Tavish Scott: That is very civil service language, if I may say so.

Another point that I hear a lot from local government is that the hubcos and the Scottish Futures Trust do not provide sufficient transparency and detail on borrowing to allow officials to give elected members certainty about what it means in the longer term. Is that a fair concern that elected members have?

Graham Sharp: The report is specifically about the borrowing element of debt and does not address other debt, which includes the various schemes to which you refer, so I do not have the evidence to comment on that. The other debt schemes are clearly more complex than conventional borrowing, so the requirement to provide good information that explains exactly what they mean is even more important.

Tavish Scott: That is fair.

Stuart McMillan (West Scotland) (SNP): My first question is a point of clarification on paragraph 62, where you highlight the fact that

"Scottish Borders Council appoints non-executive members to its Audit Committee".

Are those non-executive members opposition councillors, or are they individuals who are not part of the local authority?

Gemma Diamond: I would need to check the detail on that. I am sorry that I do not have it.

Fraser McKinlay: Gemma Diamond will kick me for saying this without checking, but I am pretty sure that it is the latter. I think that, when we refer to non-executive members, we mean people who are not councillors, but we will confirm that for you.

Stuart McMillan: That was my interpretation of the paragraph. If unelected individuals provide advice and assistance—which is not necessarily a bad thing, I hasten to add—how is that fully democratically transparent?

Fraser McKinlay: That is a good question. Scottish Borders Council is not the only council that does that. A number of councils have non-councillor members from the local community sitting on their audit committees or have had them in the past.

There is a balance to be struck. It is really important that people are clear that the councillors are there to undertake the democratic scrutiny, but it can also be a good thing to have a different perspective and to bring in people from the local community with some expertise who can help. If that balance is managed carefully, it can be effective.

Graham Sharp: From a governance point of view, the decisions or recommendations of a council's audit committee come from the whole committee, which will be dominated by councillors, and any non-executive members should have been selected to serve to inform the level of debate at the committee.

Stuart McMillan: When you double-check the point and come back to the committee, will you also find out how the selection process occurs? Committees in the Parliament bring in external advisers regularly and a process takes place. External advisers provide additional assistance to our committees, and I expect that it will be the same in councils.

Fraser McKinlay: Sure. We are happy to do that.

Stuart McMillan: Paragraph 71 highlights the situation regarding the online publication of treasury reports and the

"lack of clear and accessible information".

What recommendation do you make to local authorities about how they present the information online? You suggest that they should make it a bit easier to find, but do you recommend that they should have a particular area of their websites that is easily accessible for members of the public?

Pauline Weetman: I would encourage that. I tried searching for treasury reports online and, although I am a member of the Accounts Commission, I could not find them all. It is really difficult.

Company websites always have company investor sections. We know that we can type in "investors" or "investor relations" to find that section and that all the stuff that looks rather dry to some people will be available there. I would like all councils to have a separate section on their websites for governance information and reports.

Fraser McKinlay: That would be enormously helpful. Councils perhaps also need to present slightly different views for different people with different interests. There will be people who want to find out about the borrowing and treasury management issues, but someone might also want to know how their new school is being paid for.

Graham Sharp talked earlier about things being integrated. That point is about councils understanding and telling the story, as Gemma Diamond said, about what they are borrowing money for, where it comes from, how much it costs, what it is building and what the longer-term implication is. It is about making that information easier to find and about the story about borrowing being told in a less technical and jargony way than at the moment.

10:15

Stuart McMillan: Okay—thank you. My final question relates to paragraph 73, which addresses the issue of training and support to improve councillors' understanding and attendance. I would imagine that, when there is a new intake following an election, it is quite a challenging task for the officers to put together a training plan not only for the new intake but for all the councillors. People have other commitments—for a start, they might not have expected to be elected as a councillor—so a fair amount of juggling will have to take place in the short term. The situation will be the same for anyone who is elected in a by-election.

On the question of what councils could do, the financial reports could be simplified, and the training could be delivered in smaller chunks but more regularly. Would that be advantageous?

Graham Sharp: We make the point in the report that it might be helpful for councils to recognise that some councillors may find it difficult to attend a full-day course at a particular point in time. We recommend that solutions such as breaking up the training or providing online training materials be explored.

On the training side, there has been a recent development.

Fraser McKinlay: Yes. The commission and Audit Scotland are acutely aware of the pressures on councillors. Being a councillor is a big and increasingly complex job these days, and we recognise that people cannot do everything all the time.

The good news is that, just this week, the Chartered Institute of Public Finance and Accountancy Scotland announced that it has launched a new training programme specifically for councillors on borrowing and treasury management, partly—although not exclusively—in response to the commission's report.

That programme will work in combination with what councils are doing themselves and the bit of work that we have published. Of course, councils can always ask their external auditors to help them with some of the work.

We hope that there is enough support for councillors. We need people to want to undertake that training, and we hope that, by opening up the area, which has previously been seen as a technical area that has been addressed by the director of finance, we will encourage more people to come forward.

Stuart McMillan: Is there an expectation that councillors will become experts in public finance?

Graham Sharp: No, absolutely not. As Pauline Weetman said, someone does not need to be an expert to ask basic questions about borrowing maturity, how debt will be repaid and what it will be used for, and whether it is the best option or whether there are alternatives.

Stuart McMillan: Thank you.

Colin Keir (Edinburgh Western) (SNP): You have answered quite a lot of the questions that I had for you. Mr Sharp, you mentioned earlier that the report is written with elected members and the public in mind. Councillors who are making a decision will need some fairly technical information to follow a treasury plan, and they will therefore need a bit more than the generalised information that may appear.

We heard from Gemma Diamond that, although some of the reports that go through to full council refer to a report from the local audit committee or from an officer, councillors are not given reams of report material—there is simply a reference. If the councillors get their decision making wrong, the local press is likely to come back at them and say that the councillor did not do the necessary homework to come to a decision despite the information being there in black and white.

It seems that there is a bit of a double standard, given what is available in a general public report as against the information that somebody needs to make an informed decision. How do you reconcile that?

Pauline Weetman: The full report is available to the councillors and they have it in all their minutes. I found the way in which things were explained in the Scottish Borders very helpful—the report included a good paragraph of explanation with each piece of financial information, so as well as having the three-year prudential indicators the councillors had a really clear explanation of how that affected the council. I contrasted that with another council's report, which just presented the prudential indicators and said that the prudential code was satisfied—end of story.

Some councils seemed to provide a very closed description that did not encourage any questions, but I think that the Scottish Borders Council's report was an example of how it is possible to combine detailed information with an understandable explanation.

Gemma Diamond: We found that, when it came to members asking questions, because there was not a high level of narrative in the report they had to ask a lot of questions to get clarification of the content instead of asking scrutiny questions. If a report tells the story more and explains why the prudential indicators show the trend that they are showing and what that means for the council and its strategy, that gives members more opportunity to ask scrutiny questions about that information rather than having to spend the time clarifying exactly what is in the report.

We are asking officers to think about explaining in their reports in a clear fashion exactly what they are doing, why they are doing it and what that means for the council.

Graham Sharp: I think that we are looking at the issue from both ends in the report. We are recommending that education for councillors be improved, but we are also recommending that the information that is fed to councillors be clearer for the layman. For example, to say that all of a council's borrowing meets the requirements of the prudential code conveys a rather different message from saying, "We've checked and all our borrowing is sustainable for the next three years." That is the sort of thing that one needs to get behind.

Colin Keir: In my experience as a councillor in Edinburgh, what was brought through in terms of treasury management information could be quite complicated. I assume that that was because of the size of the city's budget and all the other things that come through.

If we are trying to simplify things for people who are not qualified in treasury management, we need to pitch the training at a particular level, such that the basic minimum standard of scrutiny can be adhered to. In the past, there have been examples of officials in various authorities wanting their view to be put through in a particular manner. If officers want a decision to be made by the councillors, the councillors must understand the wording that is put in the report to make sure that, through the public sector officer jargon, they understand what the decision is. How do we break through that?

Graham Sharp: As I said, part of officials' responsibility is to make sure that they inform councillors in a clear and objective fashion, such that proper decisions can be made. That is part of the equation.

Fraser McKinlay: I think that that is the million dollar question. There is a cultural issue at the heart of the treasury management process—historically, it has been seen as something that has been done by the finance people, who do it well and run it professionally, as we say. Completely understandably, members put their trust in those people and rely on them.

We are not challenging that relationship, because it is important, but we are saying that it needs to be opened up a bit. The process needs to be less of a black box; more explanation needs to be provided in a way that councillors can understand so that they can properly challenge and ask questions about what they are being presented with.

As Pauline Weetman mentioned, reports can be written in a way that seeks to close down or minimise debate and discussion or in a way that openly seeks debate and questioning. The Accounts Commission is saying that we want councils to move in the direction of encouraging debate and questioning. It is a case of push and pull. Councillors ought to say that they want and need different information that is presented differently, and officers need to be in a position to provide that.

Pauline Weetman: Page 6 of the report has a whole list of recommendations for council officers that addresses many of the issues that you have raised. The recommendations deal with the need for officers to provide a clearer explanation of affordability, the links to capital investment and the reasons for a proposal, instead of simply making a request to borrow.

Colin Keir: Officers also need to write their reports in such a manner that they are understandable to the public.

David Torrance (Kirkcaldy) (SNP): Good morning. Do councillors really understand borrowing and treasury management in their scrutiny role? Exhibit 15 on page 37 of the report shows that the attendance of councillors at scrutiny committees is pretty low although that is a vital function within councils' committee structure.

Graham Sharp: I have to say that, looking at exhibit 15, one cannot be other than disappointed at some of the attendance figures. However, I do not know the stories behind those figures. Earlier, we touched on the fact that councils could perhaps be a bit more thoughtful about how they present training in order to improve the take-up. As we said, financial sustainability cannot be put aside until the main council business has been dealt with, with financing being done as a separate exercise. These days, it is a major constraint on the ability to provide services and it has to be centre stage, integrated with the other council decisions.

David Torrance: Exhibit 5 on page 15 shows that, in 2012-13, 60 per cent of the borrowings were to be repaid within between 10 and 50 years. Given the fact that nobody can predict councils' future budgets, is that not storing up a problem for the future?

Graham Sharp: Given that one cannot say where we will be in 50 years, I am not sure how best to answer that question. You need to look at the specifics of individual councils. If a council was struggling to meet its financial obligations and one saw that those financial obligations were going to continue and perhaps even increase for a very lengthy period, that would be of considerable concern. If, on the other hand, a council could cope reasonably well with its financial obligations looking, say, 10 years ahead, one might be a bit more sanguine about the assumption that that could continue for the following 40 years.

There is an intergenerational issue. One cannot and would not wish to supplement current funds at the cost of the future, but one must be measured about it. If we could push the three years out to 10 years, and if we were getting sensible results at that level, I think that we could be more relaxed about the following 40 years.

I do not know whether Fraser McKinlay has anything to add to that.

Fraser McKinlay: No, I have nothing to add.

The Convener: On the issue of training for councillors, has consideration ever been given to making the training that councillors get on the financial elements of the decisions that they make compulsory? There are many other jobs and roles in which people are required to undertake training as part of their contractual obligations. I say that as a former councillor.

Fraser McKinlay: That is a very good question, convener. In our recommendation on page 7 of the report, we say that council officers and councillors should consider whether the training should be mandatory, although the commission did not feel that it was appropriate for us to go as far as to say that it should be mandatory.

On a couple of levels, for all councillors—as Graham Sharp mentioned at the start of our evidence—there is a need for financial literacy and understanding that probably did not exist 10 years ago. There is a need for that at a basic level, and there is also a case for people who have specific roles on a finance committee, a policy and resources committee or an audit committee having a deeper level of understanding. We would strongly encourage councils to provide that.

The Convener: I think that there are compulsory courses in other parts of councils—for example, in dealing with licensing arrangements, which are quasi-judicial.

Fraser McKinlay: I think that that is right. That is a requirement for some of the statutory and regulatory functions, for sure. Although we are not talking about one of those functions, finance feels like such an important issue that, if you were considering making anything else mandatory, it would be pretty near the top of the list.

Graham Sharp: Yes.

The Convener: We will have a brief final question from Drew Smith.

Drew Smith: We have discussed how councillors can be encouraged to undertake training to improve their understanding of the reports that are given to them and the role of officers in improving and encouraging that. To whom are officers responsible? They have a number of different responsibilities. Do you believe that the balance is right in terms of their responsibility to the clerk, the chief executive and the administration of the council? Surely, in this aspect of their work, officers have a responsibility to the council as a whole and to the area that the council is responsible for.

Fraser McKinlay: There is a whole bunch of interesting stuff in there. For the purposes of this exercise, it is worth remembering that in every council there is a section 95 officer—a proper officer of finance—who is statutorily responsible for giving advice to the council. Regardless of the political make-up of the council or who the chief executive is, the section 95 officer role is absolutely key and, just like the chief executive as the head of paid services, they are accountable to the council and not to the administration of the day. For the purposes of this exercise, the section 95 officer is a key role.

The Convener: On behalf of the committee, I thank the panel for their evidence. I recall that there are a number of commitments to follow up the evidence in correspondence, and I am sure that that will happen.

Fraser McKinlay: Sure. I will do that.

The Convener: Thank you. We will have a brief suspension to allow a changeover of witnesses.

10:31

Meeting suspended.

10:32

On resuming—

Section 23 Report

"Update on developing financial reporting"

The Convener: Under agenda item 3, we will take evidence from Audit Scotland on the AGS report entitled "Update on developing financial reporting". I am delighted to welcome Caroline Gardner, the Auditor General for Scotland; Mark Taylor, the assistant director of Audit Scotland; and Gordon Smail, a senior manager at Audit Scotland. I understand that the Auditor General would like to make an opening statement.

Caroline Gardner (Auditor General for Scotland): The report that I bring to the committee today provides an update on the actions that the Scottish Government is taking to further develop its approach to public financial reporting. The committee might recall that I previously emphasised the importance of comprehensive, transparent and reliable financial reporting in my report of July 2013.

Scotland's public finances are on the cusp of significant change, with the introduction of new financial powers through the Scotland Act 2012 from today and the prospect of further financial devolution in the future. That is happening at a time when public services are facing considerable pressures from falling budgets and increasing demand. The quickly changing environment for public finances means that the case for financial transparency as part of a strong fiscal framework has never been stronger.

The Scotland Act 2012 and the changes that are anticipated to flow from the Smith commission agreement mean that the Scottish Government will, in the future, be responsible for raising more of its revenue and will have more responsibilities for spending. Its budget will also become more dependent on Scotland's economic performance, and the amount that it raises through taxation and spends on welfare will be more directly affected by policy decisions in Scotland.

As a result of that, the Scottish Government will have more control over and more responsibility for its finances, which will provide an opportunity for new approaches and will bring new financial risks. Transparent reporting will be more important than ever to support decision making, to safeguard public confidence and to maintain effective accountability. That position is reflected in the Smith commission's recommendation that the Scottish Parliament should expand and strengthen the independent scrutiny of the public finances.

The Smith commission also called for an updated fiscal framework to support further devolution. Maintaining and enhancing transparent financial reporting of the public finances in Scotland is an essential component in this quickly changing context.

In the light of the new financial powers for the Scottish Parliament, we think that information could be enhanced to show more clearly, for example, how the different elements of funding support total Government spending and how the performance of the economy is affecting budgets, and the financial position of the Scottish public sector as a whole. It is important to be clear that the audited accounts of the Scottish Government and other public bodies already provide a good starting point for understanding their financial position, but they do not show the overall position of the devolved Scottish public sector as a whole, including the balance between funding and spending, and the overall level of borrowing.

We think that consolidated public sector accounts that pull together information in one place on what the Scottish public sector owns and owes overall would provide a better understanding of the financial position. It would give the Scottish Parliament, taxpayers and decision makers a fuller picture of where money is spent and of the longer-term implications for the public finances. The Scottish Government recognises the need to further develop its financial reporting and is currently considering options for the future.

The next step is for the Scottish Government to set out the details of its proposals for consultation with the Parliament. We in Audit Scotland will continue to monitor progress and report publicly as the Scottish Government develops its plans. We will also continue to play our part in helping to develop a high-quality fiscal framework for Scotland that reflects the new financial powers and the related opportunities and challenges.

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

The Convener: Okay. Thank you. I will ask the first question. You referred to consolidated public accounts. Will you provide some of the history of why we do not already have consolidated accounts and say what happens in that regard in other parts of the United Kingdom and perhaps further afield?

Caroline Gardner: Certainly. I will ask colleagues to chip in but I will outline the broad picture first. Up until this point there has not been a particularly strong case for consolidated accounts for the whole of the Scottish public sector. What the Scottish Government has been doing until now, broadly, is putting forward a budget to the Parliament that sets out how to spend the bulk of the money that comes through the block grant from Westminster and some small additions from, for example, non-domestic rate income and small amounts of money from other sources. As of today that is changing quite markedly.

From today, the Parliament also has responsibilities for raising taxes, which will be done this year through the land and buildings transaction tax and the Scottish landfill tax, and from next year through the Scottish rate of income tax. The Parliament has some limited borrowing powers from this year, which will increase in the years ahead. The Smith commission set out a clear direction of travel towards more revenue being raised here in Scotland through decisions of the Government and the Parliament and having more responsibilities for borrowing and—it is likely—welfare in future. All of that means that, suddenly, the financial reporting that we have had does not give us a full enough picture to understand the implications of decisions about taxation, the balance between different types of tax, borrowing and, potentially, welfare spending. So, this is very much a moment in time when we think that consolidated accounts become necessary.

It is interesting to note that the Scottish Government already has the power to produce consolidated accounts. There has not been a strong case for using it so far but we think that that is changing quite fast just now.

Mark, do you want to add anything?

Mark Taylor (Audit Scotland): I think that this issue came up earlier, but the Scottish Government is quite clear about where accountability lies and that there is an existing set of consolidated accounts for the Scottish Government and different sets of accounts for different bodies. Given the historical situation that Caroline Gardner set out, those vehicles have been felt to be the ones to provide accountability and details on the expenditure of individual bodies. As Caroline said, we are in changing times and, as the level of responsibility increases, there is a real opportunity to bring in consolidated public accounts from here on.

The Convener: Would it have been considered good practice to do it before, though, or would it have been difficult to pull together such accounts? What has been the barrier to doing it?

Caroline Gardner: I think—

The Convener: I mean historically, going way back to when the Parliament was formed.

Caroline Gardner: Sure. As I said, back in 1999-2000, there was not a strong case for it anyway, but this is also a field that is changing quite a lot across the UK and globally. For example, the United Kingdom Government now produces whole-of-Government accounts, but it has done so only for the past five years—the fifth set was published just last week. During that period, its ability to do that work has increased and the usefulness of the accounts and of the information that is included has grown and developed.

It is not that the Scottish Government is behind the pace; it is that this is an area in which good practice is evolving quite quickly, and what makes sense for Scotland is also changing. There is clearly a cost to doing this work, but we do not think that it is significant given the benefits. The balance of what we get in return for the effort of producing the accounts is tipped markedly in favour of producing them.

Colin Beattie: As a matter of interest, to what extent is Audit Scotland working with the Scottish Government on the issue?

Caroline Gardner: We are working quite closely, as I think you would expect. We discuss our views about what good practice looks like and the Scottish Government's plans, and in our "Update on developing financial reporting" we report on its commitment to developing its financial reporting in this context.

Mark Taylor, as the person who leads the audit of the Scottish Government for me each year, is in close contact with the director general who is responsible for finance and with other colleagues about it, and he might want to give you a bit more flavour of the way we go about it.

Mark Taylor: It is fair to say that we have been in active and constant discussions about the plans and how they are developing. However, there is an important distinction between our role as auditors and the Scottish Government's role in making decisions. We put questions to it and make suggestions, and we get into engagement and discussions around that. However, ultimately, it is for the Government to decide and for us as auditors to come in at the back of that to audit how well the system is working from a whole-system perspective.

We have that engagement, but it is important to note that we do not muddle up who decides how this should work.

Colin Beattie: Given your close relationship with the Scottish Government, do you believe that it is on the path to delivering the enhanced financial reporting that you are looking for?

Caroline Gardner: That is hard for us to say, for two reasons. First, as Mark Taylor said, the Government is responsible for developing its own plans. We know that it is doing that, but we have not had detailed involvement with what those plans look like. Secondly, whatever financial reporting the Scottish Government produces needs to meet the needs of this Parliament, and we understand that there is a commitment to consult the Parliament on how far the reporting needs to go in order to do that.

What we are looking to do is to move the debate forward to help the Parliament to think through what it requires, and to set out our view, as auditors, of what good practice looks like, in order to help to inform that debate.

Colin Beattie: In your report, you quite rightly focus on the Scottish Government and its need to ensure that there is the greatest transparency. With the delegation of further powers and a much-changed relationship with organisations such as the Treasury, should greater transparency in that interlocking relationship extend to UK bodies?

Caroline Gardner: The short answer is clearly yes. There will need to be dialogue about the extent to which this Parliament needs greater insight into—and, potentially, oversight of—some of the bodies that play an important part in achieving the Scottish Government's objectives.

However, in broad terms, we are in a position in which the UK Government produces whole-of-Government accounts that include the whole of the Scottish public sector. What we do not have is an intermediate layer of information on the Scottish public sector as a whole for people in Scotland, starting with this Parliament, to use, and for the Treasury, the UK Government and people on the wider UK stage to show an interest in.

Tavish Scott: I thank Audit Scotland for pushing this agenda really hard, because it is very important. How difficult would it be to produce consolidated accounts?

Caroline Gardner: It would require effort, but we do not think that it is impossible for the Government to do it. The Scottish Government and all other public bodies already produce returns that allow consolidation to happen for the UK whole-of-Government accounts. They are funnelled through the Scottish Government to Her Majesty's Treasury, and our auditors play a part in providing assurance on them. The missing step is to pull it together for Scotland. More effort would be required to do that, but we are not starting from scratch. A lot of experience has been built up over the past five years as the UK whole-of-Government accounts have gained currency.

Tavish Scott: When you were describing that, it struck me that, if there are whole-of-UK accounts, presumably that means that we produce whole-of-Scotland accounts, otherwise how could whole-of-UK accounts be produced?

10:45

Caroline Gardner: My colleagues will keep me straight if needs be, but that is not quite the case. Each of the 200 or so bodies that make up the Scottish public sector produces its returns, which is a complicated process. That allows the transactions that go on between individual bodies and between Scottish bodies and UK bodies to be taken out. The information is then transmitted to the Treasury so that the consolidation can happen. Consolidation for Scotland does not happen. That is the additional step that would be needed. However, the information and the processes are all there already.

Tavish Scott: Broadly speaking, if we decided to have consolidated Scottish accounts, we could do that within a financial year, and it would not be an enormous accounting challenge.

Caroline Gardner: It would be doable. I would expect that, as happens at the UK level, there would be lessons to be learned on the way. I would think that improvements would need to be made to the first set.

Mark Taylor may want to talk about some of the complexities that we think would need to be worked through.

Mark Taylor: The basic building blocks are there, in that individual bodies prepare information in a broadly consistent form; the challenge would be in putting those building blocks together. Another challenge would be in presenting the right or appropriate information that reflects the Scottish context so that the accounts are not just a dry document that adds up and consolidates figures—although there would be value in that—but are instead a document that has the right commentary, disclosures and notes in it. That is where a bit more investment would need to be put in.

Inevitably, there would be technical challenges. It is not simply about adding up the numbers. One of the main challenges would be to eliminate transactions between individual parts of Government, or between one part of Government funds from another part, identify the exact amounts involved and, even more challenging, who owes who what. Although detailed information is available to all bodies about where their debts are, there are technical challenges in aggregating that up and eliminating some of the transactions. The National Audit Office has identified those challenges in putting together whole-of-Government accounts at the UK level.

Tavish Scott: As a number of us will recall, we passed the Public Finance and Accountability (Scotland) Act 2000, so we must have envisaged at the time that it would be possible to do this.

On your observation about what is not in the accounts, some schools are not going ahead or are being delayed because of an accounting procedure that is coming from Europe. Is that the sort of thing that could be tidied up by having consolidated accounts? The issue seems to relate to whether the hubcos are on or off balance sheet—that debate seems to have been going on in relation to the UK accounts for a long time. Could we clean up all that by having consolidated accounts?

Caroline Gardner: I will start off and Gordon Smail may want to come in behind me. Because we do not have Scotland whole-of-Government accounts, we do not have clear oversight of all the assets that we have across the Scottish public sector. It is important to know whether those are being maintained or whether they are being allowed to degrade in the face of financial challenges; that information could also help our thinking about how we can make the best use of assets across the public sector. There are also some key liabilities, such as the public sector pension liability for Scotland as a whole. That information appears in a number of different places; we do not pull it together to say what the position is across Scotland. We think that such insights would be very useful, not only to the Parliament but much more widely, for decision making and accountability.

Tavish Scott: I return to a point that was asked about earlier. Is Audit Scotland aware of whether the Scottish Government is looking at consolidation as part of its entirely correct approach to have more transparency and greater accountability in relation to Government accounts?

Caroline Gardner: That would be a question for the Scottish Government.

Tavish Scott: Yes, you are right.

Your conclusions on forecasting are very strong. You also make pertinent observations about the Office for Budget Responsibility being independent of Government and therefore able to provide that forecasting. Would it be essential for the new machinery that we have in Scotland—the Scottish Fiscal Commission—to be independent so that it can provide the correct check and balance, irrespective who is in government, as happens south of the border?

Caroline Gardner: Absolutely. The detail of the Scottish Fiscal Commission's remit is a policy matter for this Parliament. The principles of transparency, non-partisanship and independence that are set out in Organisation for Economic Co-operation and Development guidance are absolutely central. The proposed legislation to put the commission on a statutory footing needs to protect those principles. I know that that is a strong theme in the consultation paper, but those principles are critical, just as they are for our work.

Tavish Scott: Thank you.

Stuart McMillan: Good morning. Paragraphs 21 to 25 of the report are positive. It appears that, because of the changing financial landscape, the Scottish Government is prepared to look at improving the financial mechanisms. Is that an accurate assumption?

Caroline Gardner: Yes. We have tried in the report—as we do in all our work—to give the Scottish Government credit for what it has achieved, including its good record of financial management so far; the strong financial statements for each of the individual bodies; and the commitment to taking that work further.

In light of the speed of change, we would like the Parliament to be provided with more information on the detail of the Government's plans and how they will give effect to our recommendations in practice.

Stuart McMillan: At paragraph 28, the report highlights the situation regarding the Scottish budget documents. It states:

> "The Scottish Government's budget will become more dependent on Scotland's economic performance. The amount the Scottish Government raises through taxation and spends on welfare will be affected by its policy decisions."

I accept that those comments are accurate. However, the report goes on to highlight that the Government

> "has recognised the need to further develop its budget documents and annual accounts to reflect these new responsibilities."

A Scottish Government of whichever hue may put forward a set of proposals to improve the economic situation in Scotland. However, our budgetary process takes some six months, whereas the budget process at Westminster is altogether different, so last-minute decisions at Westminster may have an effect on Scotland. As a consequence, the budget proposals that a Scottish Government puts forward may be negated or may have an adverse impact.

How could the Scottish Government of the day try to deal with that, particularly with regard to reporting and auditing?

Caroline Gardner: I absolutely recognise the challenge, but I am not sure that we are the people to help you with the answer. We are saying that the need for such budget scrutiny by this Parliament will increase from what it has been in its first 15 years, because of the importance of the taxation and welfare decisions that will need to be taken in future.

It is clear that, in the political context in which we are now working, there are challenges in the way that our process joins up with what happens in Westminster, and in the way in which decisions about matters such as adjustments to the Barnett formula are made. All that requires a great deal of thought and attention by both Parliaments, ideally working together.

We can help you by highlighting some of the elements that we think should be there, such as good practice on fiscal responsibility, on which there is the strong commitment that this Government has made since its election in 2007.

Stuart McMillan: That is helpful—thank you.

The Convener: Drew Smith will go next.

Drew Smith: Stuart McMillan highlighted the issue of forecasting, essentially, for economic uncertainty, and the impact that changes in Scotland's economic performance would have on the money that would be available to fund public services and other things. To what extent is that the driver of the need for consolidated accounts? Is it the case that we need to know how much we are spending because there is a concern about what we will be taking in in the future?

Caroline Gardner: I do not think that it is a particularly strong driver. The Scottish Fiscal Commission, in its first report, endorsed the Government's forecasts but also recommended the development of more data and a better understanding of things such as the behavioural impact of taxation changes in terms of likely responses.

What we are saying is very much in line with the conversation that you had earlier with my colleagues from the Accounts Commission looking at the Scotland-wide level. Having an overall picture of what the current financial position looks like helps with making better decisions about tax and other spending decisions.

We know already that, in the UK, the whole-of-Government accounts are a very important input to the OBR's "Fiscal sustainability report", which is produced twice a year. The information can be used by other people to help with such decisions rather than necessarily informing decisions directly.

Mark Taylor may want to add to my comments.

Mark Taylor: As a main advantage, a whole-of-Government accounts equivalent, or Scottish public consolidated accounts, would give an overarching view that would allow you to manage longer-term financial risks. It would allow you to know, based on the decisions that you are taking today, some of the potential implications of those risks down the line, in relation to the liabilities that are carried across the whole system and where assets lie within the system.

In its report "Whole of Government Accounts 2013-14", which was published in the past week or so, the National Audit Office covers some of the uses to which whole-of-Government accounts, now that they have been available for a number of years, are increasingly put.

One of the key features of such a set of accounts is that it is pulled together in accordance with clear international financial reporting standards and audited. Others, including the Parliament, can therefore use the accounts with real trust in the information that is provided.

Stuart McMillan: On a point of order, convener. I do not usually make points of order. I did not want to interrupt the Auditor General's comments, but I simply want to put on record that at no point did I use the language that Drew Smith alleged that I used, particularly with regard to the point in question.

The Convener: We have two options here. Either Drew Smith can reconsider—

Drew Smith: I am sorry if I upset Mr McMillan, convener, but I thought that he was referring to the fact that there will be an element of variability in the Government's future revenue as a result of the decisions that it takes on raising revenue in Scotland. If that is not an accurate reflection of what he meant—

Stuart McMillan: No, it is not.

Drew Smith: —I am happy for him to clarify that for the record, if that is easier.

The Convener: I think that Stuart McMillan has clarified the point, and we can move on. If we need any more information, we can refer to the *Official Report* later.

Caroline Gardner: Gordon Smail has a point to make in response to Mr Smith's question.

Gordon Smail (Audit Scotland): It is just a very minor point to emphasise the importance of the whole-of-Government accounts and the need for them to be audited. Whatever information comes through the UK whole-of-Government accounts and whatever lies down the road for Scotland, it is important that those accounts are audited and that there is an independent checking process that forms a good basis for discussion in Parliament and which gives other people confidence.

Drew Smith: I will tread carefully here, but if I understood your response to Mr Scott correctly, Auditor General—and I hope that Mr Scott finds my rephrasing of the response that he received acceptable—you seemed to be saying that, to an extent, all the information about public bodies in

Scotland is already collected but the problem is that that happens at a UK level and is not consolidated on a Scottish basis. Thinking about the previous evidence session, I presume that that includes Scottish local authorities, whose accounts will not be examined at a Scottish level. Because the information already exists at a UK level, I am less concerned about the issue, but is there a tension between pulling this information together and scrutinising it for other purposes? After all, local government and all the bodies that we are talking about are independent. Is there a danger of accumulating information at a Scottish level that should properly be scrutinised and be a matter of concern at the local level?

Caroline Gardner: That is a really important point—I was interested in Mr Beattie's earlier question on the matter. There is no question but that local authorities in Scotland are responsible for their own finances, including borrowing and other long-term commitments that they enter into, and no one wants to blur that accountability whether for good reasons of principle or because there is a risk of spooking the people who are lending the money.

What we are saying, however, is that, in Scotland as in the UK, local authorities make a significant contribution to the delivery of the Government's policy objectives and the services for which it is responsible. If a local authority were to find that it could not meet its obligations, the strong likelihood is that the Scottish Government would need to step in not so much to service the debt but to ensure that services could continue to be provided. There is therefore a relationship between the two sets of accounts that we think needs to be recognised in the same way that it is already recognised within the UK whole-of-Government accounts. All UK local authorities are consolidated into that overall picture, and that has not caused any confusion about accountabilities or where the liability sits. What it has done is provide that bigger picture of what the liabilities are, which is what consolidated accounts would do, as well as information about, for example, maturity dates, lengths of loans and other commitments, pensions liabilities and the assets that sit alongside all of that, which gives the whole picture of the risks at the high level as well as at the level of each of the bodies that make up Scottish public services.

Drew Smith: That was helpful.

I have no objection to the Scottish Government's taking the lead to provide the same information at a Scottish level, but are you aware of any discussion that has been had with the Scotland Office on the matter? If the information is accumulated and held at a UK level by the UK Government, would it not be simpler for the Scotland Office to accumulate and consolidate the information for Scotland, instead of the devolved Administration trying to do that separately?

11:00

Caroline Gardner: Given how the devolution settlement is evolving, I think that it is entirely appropriate for the Scottish Government itself to keep ownership of the picture for Scotland and to contribute to the UK-wide picture. The technical administration is already handled by the Scottish Government, working with the Treasury. Our auditors work closely with the Government as part of that process. We are looking for a straightforward pulling together at the Scotland level. That does not happen at the moment but, as Martin Taylor said, all the building blocks are there.

Nigel Don: Good morning. I am conscious that audited consolidated accounts take time to produce. However, without worrying about how long it takes, my point is that surely Scotland is at a stage at which we are raising taxation that is to an extent variable and slightly unpredictable, and that therefore our ability as a Parliament to scrutinise our financial affairs is now somewhat time dependent. I have not heard anything about that in this morning's conversation. What are your thoughts about how quickly we can be provided with meaningful management accounting data, as opposed to getting financial accounting data a year or two later, which I think is what we have previously discussed?

Caroline Gardner: That is a really good question and one that we have been discussing among ourselves and with our colleagues in the Scottish Government. At the moment, the Scottish Government's consolidated accounts, which exclude some important parts of the public sector, are produced over the summer each year and then audited and laid before the Parliament during the autumn term. To my mind, there is no question but that if the Scottish Government were to commit to introducing consolidated public sector accounts, that process would take longer. For example, the UK whole-of-Government accounts that were published last week related to the 2013-14 financial year, and that is the quickest that the Government has ever done them. The accounts have a six-month lag, and I expect that it would take as long to publish such accounts in Scotland.

That said, as part of our thinking on the issue we have been looking at international experience. For example, the New Zealand Government publishes what are, in effect, monthly management accounts: it publishes at the end of each month its financial position as at that month. That is part of the overall financial management approach that the New Zealand Government takes. That is absolutely an aspirational goal and not something that we think that Scotland should be working for in the short term. However, I think that there is a debate to be had between the Government and the Parliament and other interested parties about what the direction of travel should be and what is a reasonable investment to be making, given all the other things that the Government needs to deliver in the context of the Scotland Act 2012, the Smith clauses and so on. There are decisions to be taken and although we are certainly not looking for perfection in this area, it seems to us that it is important to have clarity around the direction of travel at this stage.

Mark Taylor wants to add to that.

Mark Taylor: I agree with all of that. It is of course valuable to have information in consolidated public accounts about the current year, but what is much more valuable is information over a long trend period about what is happening over time. Although there is a challenge in getting the most up-to-date information out as soon as possible, the trend information has continuing value. Its real value lies in helping us to understand what is happening with pension liabilities, debt and public-private partnership and non-profit distributing commitments over the longer trend period.

The Convener: Okay. Thank you. On behalf of the committee, I thank the Auditor General for her presentation.

I suspend the meeting for five minutes.

11:03

Meeting suspended.

11:07

On resuming—

Further Devolution (Accountability and Audit Arrangements)

The Convener: Under agenda item 4, we will take evidence on the accountability and audit arrangements for the proposed further devolution of powers. Members will be aware that the committee has issued a call for evidence on the subject. The committee will hold a further evidence session on the issue in May with the Cabinet Secretary for Finance, Constitution and Economy.

We will hear evidence again today from the Auditor General, Caroline Gardner, and from her Audit Scotland colleagues Russell Frith, assistant auditor general, Fraser McKinlay, director and controller of audit, and Mark Taylor, assistant director.

I understand that the Auditor General will make a brief statement.

Caroline Gardner: Not today, thank you, convener.

The Convener: You have caught us out there.

Okay. I will ask the first question of the Auditor General. On scrutiny of UK public bodies, we know that we can now potentially seek evidence from a number of bodies such as the BBC and the Office of Gas and Electricity Markets and that they will be able to lay financial reports before the Parliament. Will you elaborate on how you think that will be progressed?

Caroline Gardner: I should say first that we are delighted to have the chance to talk to the committee as part of its inquiry into scrutiny of future powers arising from the Scotland Act 2012 and the Smith commission. We have looked closely at the Smith commission proposals that we think might have implications for us and for this committee. The bodies referred to in the Smith commission report and picked up in the draft clauses all carry out functions that can have a significant impact on and contribute to the Scottish Government's policy objectives. It is fair to say that they are a wide-ranging set of bodies that do that in different ways.

At one extreme, most of the functions of the Northern Lighthouse Board are carried out in Scotland and a fair amount of reporting about that body is already available. At the other end of the spectrum, Ofgem regulates energy companies throughout the UK, including companies that are based in Scotland but serve the whole UK and companies that are based elsewhere in the UK but serve people in Scotland. The starting point is that no single model will work; it very much needs to start from the basis of what work the bodies carry out in Scotland and what the Scottish Parliament wants more oversight of.

It is worth noting that there are UK-wide bodies, including the Security Industry Authority, whose annual reports and accounts are already laid in the Scottish Parliament, although the fact that their accounts are laid here does not mean that the committee needs to do anything with them. There is a debate to be had about what the Parliament's and the committee's interests are, which should lead to a debate about how the process might work in practice.

The Convener: Let us take the BBC as an example. When the financial reporting comes from the BBC, does it relate to the BBC licence fee revenue?

Caroline Gardner: That is a very good example to use in picking apart what the Parliament's interest is. The BBC is a UK-wide organisation that serves the people of the UK as a whole as well as the people of Scotland as a separate group within that population. I think that the BBC currently produces a management review for Scotland, which provides information about the services that it provides here but is not linked to financial information about what is spent in Scotland or the revenue that is raised from licence payers in Scotland. That is a good example of the sort of body in relation to which the Parliament may wish to have a discussion with both the body and the UK Parliament about the development of further reporting about Scotland such as you have been having with the UK Government and Her Majesty's Revenue and Customs about the reporting on the Scottish rate of income tax. That money will continue to be collected by a UK-wide body but there is a definite Scottish interest.

The Convener: Could there be some challenges in that? You talk about discussions with the BBC, but the Scotland Act 2012 makes clear the role of the Public Audit Committee in scrutinising the reports that are laid before it. Do you expect the UK Government to legislate on how the Scottish Parliament would interact with such bodies?

Caroline Gardner: There are two sets of issues to be resolved. First, given that the number of bodies that play a role in Scotland is very high, in order to make the best use of its time the committee may want to think about its priorities and which UK-wide bodies' activities in Scotland it wants to have clear oversight of.

Secondly, it will be easier for some bodies than for others to produce annual reports that contain Scotland-specific information. That would be no problem for the Northern Lighthouse Board, as most of what it does is already Scotland specific. Some parts of the BBC's activities are also clearly Scotland specific, and I think that there could be a productive dialogue about what information you want on both spend and performance to allow you to carry out your oversight. However, for a body such as Ofgem it would be much more difficult to determine what aspects of its overall business it would make sense to talk about specifically in relation to Scotland as opposed to which specific projects were being carried out that had an impact on Scotland alone. That demonstrates the range of different bodies that we are talking about and the need to be clear about what your interest is so that the information can be developed and reported in ways that allow you to use it.

Mary Scanlon: I appreciate that there is some complexity involved and that one size of auditing may not fit all. We are in preparation mode, as we have quite a few additional powers coming today and a whole load of significant powers coming down the line. The Food Standards Agency has been devolved for many years, although it becomes Food Standards Scotland as of today. Where the Forestry Commission, which is a UK-wide body, operates as a cross-border body, Audit Scotland is the auditor under statute and the agency reports directly to the Scottish ministers. Given that we have had experience of both those agencies, can you say whether the Food Standards Agency—as was—and the Forestry Commission are good examples of how bodies can fit with the further devolved powers that are coming down the line, which the convener just mentioned?

Caroline Gardner: I ask Russell Frith to talk you through how that has worked in the past, and we can then draw out what that might mean for the future.

11:15

Russell Frith (Audit Scotland): There might be some lessons from the Forestry Commission but I am not sure that it provides a perfect example partly because, since Scottish devolution, its business has been clearly divided up between England, Scotland and Wales, which have had their own management boards, committees and groups. The commission has produced separate sets of financial statements in each country and the policies that have been employed in each country have differed as devolution has gone on.

The Forestry Commission still has a lot of central functions that it is economic to provide on a GB-wide basis but the business has been clearly divided on a geographical basis whereas the business of some of the bodies that it is now proposed will lay their reports in Parliament is not so clearly separate in each of the geographical areas.

Mary Scanlon: I understand that. Would any existing body be a better fit than, say, the Forestry Commission or the Food Standards Agency? Is there any good practice that could be adopted to fit some of the new powers that are coming?

Caroline Gardner: For a body such as the BBC, the nearest parallel is probably the discussions that you have already had with HMRC about its role in collecting the Scottish rate of income tax and, in future, VAT, part of which will be assigned to Scotland.

The challenge comes for bodies such as the Office of Communications and Ofgem, which very much work on a UK-wide basis and regulate for the UK companies that serve the whole UK. We do not yet have a model for that scenario. That is where there is more thinking to do about what the committee and the Parliament need in order to receive assurance about those bodies' performance in relation to Scotland and about where there might be more difficulties in breaking down the information in ways that are meaningful to you without disproportionate cost.

Mary Scanlon: That is helpful. My final question comes from the Scottish Parliament information centre and concerns the no-detriment principle, which, in layman's terms, basically states that the Scottish or UK budget should be no larger or smaller as a consequence of tax and spending changes.

If we suppose, for example, that the Scottish Government increases the top rate of tax to 50 per cent and Scots pay less national insurance, should the Scottish Government compensate the UK Government for the fall in national insurance contributions? Alternatively if, as often happens with the higher rate of income tax, high-earning Scots shift their income from earnings to dividends or higher-rate taxpayers move elsewhere in the UK, should the UK Government compensate the Scottish Government?

It is a very muddy area. Can we really expect the no-detriment principle to continue clearly and effectively as we go forward with very different powers and economic and fiscal decisions?

Caroline Gardner: Your question highlights the challenges that will need to be addressed in working through—

Mary Scanlon: I think that "challenges" is an understatement, if I may say so.

Caroline Gardner: You will not be surprised to hear that we are clear about the challenges that are involved in the matter. The way in which they are resolved will be part of a political process. Our interest is in ensuring that the process for making adjustments to the funding formula for Scotland, whatever it looks like in the future, is transparent and clearly understood and that there is a way of providing assurance to this Parliament as well as to the UK Parliament about the funds that are received into Scotland for spending on Scottish policy objectives.

There is a lot of work to do in making that a reality. We are not the only people to say that and it is one of the areas on which the Parliament is rightly focusing at this stage.

Mary Scanlon: However, even if the system is open and transparent, can the no-detriment principle be followed in light of the two examples that I gave? I appreciate that it is challenging but, for example, how can we relate increased revenue in the rest of the UK to an increase in tax in Scotland? How can we prove that the decision to invest in England was the result of an increased tax? I cannot see it in my mind. I do not know how that can be traced effectively under the no-detriment principle.

Caroline Gardner: There are technical challenges, as you describe, but I am sure that they can be worked through if appropriate information is provided and appropriate systems are put in place. There are also political challenges, and I suspect that they might be the more difficult challenges to overcome. I am very clear that there is work to do in order to make a reality of that recommendation from Smith.

Nigel Don: It is my understanding that although the Department for Work and Pensions may well provide some of the services, it will be spending money that is, in effect, Scottish Government money on welfare payments. If I am right in that regard, how do you see the DWP reporting to us on how it spends that fraction of what will be our budget?

Caroline Gardner: The Government and the Parliament have a choice to make about how the welfare responsibilities that it is proposed be devolved to the Scottish Parliament will be administered. Broadly, there are three options. First, as you say, the DWP could continue administering the services under Scottish Government rules. Secondly, the Scottish Government could seek to set up its own body to do the work, in the way that it has done with Revenue Scotland. Thirdly, it could look at other options, such as the arrangements that are in place for councils to administer housing benefit and council tax benefit.

Each of those options would have different implications for the information that the Parliament would need and would have access to. I will ask Russell Frith to outline those implications for you.

Russell Frith: If the Parliament decided to continue with the DWP administering Scottish benefits, the HMRC arrangements that are being developed for the Scottish rate of income tax provide a good model. The UK legislation that gives effect to that could make similar arrangements for the DWP to report to the Scottish Parliament as well as to the UK Parliament, and that could be followed by similar arrangements for audit.

Nigel Don: The implication of that is that you feel that a model is available not only for the DWP, but potentially for any other UK Government department that does something for the Scottish Government that it used to do for itself and spends our money in doing so.

Russell Frith: Yes—when it spends money that the Scottish Parliament has control over.

Nigel Don: Okay.

I return to the previous discussion, which was about the risks involved in discretionary expenditure and discretionary income. In the context of the developing situation, how do you feel that those risks could be audited?

Caroline Gardner: I do not think that we would be looking to audit the risks. Our interest is in making sure that the information is available for the Government to use in making decisions and making policy, for the Parliament to use in scrutinising the Government's actions and for bodies such as the Scottish Fiscal Commission to use in its work in reporting on fiscal sustainability. That is exactly the way in which the OBR uses UK whole-of-Government accounts at the moment. It looks at issues such as the Government's commitments on public sector pensions and other long-term liabilities to estimate over the longer term—25 years and out—what they mean against changes in the population and known policy commitments. We envisage the transparent reporting that we propose being used in the same way by the Scottish Fiscal Commission as the whole process develops.

Nigel Don: That leads me inexorably to precisely the same point that came up earlier about timing and how long we will have to wait, because risk and time are inevitably intertwined. Do you feel that we are moving to a point at which information will be available soon enough to allow the right people to make the right judgments and to enable us as parliamentarians to scrutinise the risks involved in those decisions?

Caroline Gardner: It is hard for us to give you any assurance about that without knowing the detail of the Government's plans for developing its financial reporting, but I will ask Mark Taylor to talk in a bit more detail than we did earlier about what we think is needed and what we think is likely to be possible.

Mark Taylor: With regard to the timetable, there is a point about the information being made available as quickly as possible and the investment in relation to that, but there is also a point about the commentary on some of the risks that arises from not knowing. Inevitably, where there is more variability, it is certain that there is more risk involved. Enhanced financial reporting would be clearer and more open about where the uncertainty and variability lies, and we would then be able to talk about some of those issues.

Of course the committee would like more information, but at least the decision makers are clear about where the information gaps are, what is known, what is estimated and what is forecast, and—as far as possible—the reliability of all that.

Nigel Don: I am perhaps making the point for those who want to report this session, but the term “risk” is really being used to mean “uncertainty”. There is no risk of anybody falling over or going bankrupt, for example—the issue is not having the accuracy in the information that we have when the information is historical.

Caroline Gardner: That is absolutely the way in which we use the term “risk” as auditors.

Drew Smith: Auditor General, you spoke earlier about the no-detriment principle, which has drawn quite a lot of attention. In essence, it is about there being no detriment at the point of transfer, rather than relating in any way to the policy decisions that are taken—if it were to be interpreted in that way, it could easily become a no-benefit principle.

I do not expect you to comment on the politics of the debate surrounding the principle. However, in your view as an auditor, how great is the need for independent sources of information and for scrutiny of information in relation to the agreement at the point of transfer, whether that is at the point at which something is devolved or at a subsequent point when there is a policy change?

Caroline Gardner: It is always hard to talk about such issues in the abstract, because we are inevitably talking about hypotheticals and the way in which things might work through.

We are seeing in the Smith clauses a number of elements that are either different sources of revenue-raising powers for the Scottish Parliament or spending responsibilities. For each of those, there will need to be an agreed mechanism for tracing through the likely impact at the point of transfer—as you describe—on the adjustment to the Scottish block grant.

First, we need to ensure that the information that is necessary to underpin that forecast is, as expected, available and agreed on. Secondly, it must be able to be scrutinised by this Parliament and by people more widely. The transparency of that information will be a key part of building confidence, but it will also help to highlight where there may be problems that need to be addressed by developing new information sources.

I am sounding like a stuck record, as “transparency” seems to be the word of the day, but it is a key part of the process in addition to getting the technical process right and understanding what might change, what information can be used and what gaps need to be filled. Ensuring that that is aired and understood as widely as it can be will be a key aspect of the process.

Russell Frith may want to add to my comments.

Russell Frith: In some cases, there may well be a technically based agreement that can be audited through specific data, but in other cases—the land and buildings transaction tax first-year agreement is a classic example—there will be a negotiated agreement between the two Governments. The LBTT example involves a revenue stream that is very volatile over the economic cycle in accordance with house sales; one can audit what has happened in each year, but at the end of the day the agreement is made between two Governments.

Drew Smith: That is interesting. In a way, thinking about some of the politics, a lot of the facts are contested and will probably remain so into the future and at the point at which matters are transferred. As auditors, your interest will presumably be in the process rather than in the amounts that are agreed—reluctantly or enthusiastically—between either party.

Caroline Gardner: Speaking narrowly as auditors, our interest is in the amount that is agreed and how that flows through into the Scottish Government’s accounts. With regard to the stability of the fiscal framework, we have the same interest as everybody else in this Parliament in ensuring that it is robust and stable so that the Scottish Parliament and the UK Parliament can make sensible decisions moving forward for the good of the people they represent.

We all know that there are huge challenges in doing that, but it is very important that it can be done in a way that keeps the longer-term view in sight and picks up the Smith commission’s recommendation on strong intergovernmental mechanisms as a basis for proceeding properly.

11:30

Drew Smith: Yes—it is important that we read these recommendations in conjunction with some of the others.

I do not expect you to predict the future of your own work in an environment that is difficult to predict. However, I presume that you could, in theory, imagine circumstances in which you might be commenting on whether or not an amount of money that was earmarked for something was correct. The term “correct” is somewhat value laden, of course, but you may be making a judgment about the actual amounts that were transferred. Do you think that that is likely?

Caroline Gardner: It might be helpful if we use the Scottish rate of income tax as an example, given that it is the area that we have worked through the furthest.

There is now an agreement in progress among the UK Government, the Scottish Government and HMRC about how the implementation will be achieved. In future, the Scottish Fiscal Commission will comment on the forecasts for the Scottish rate of income tax proceeds in the same way as the OBR does for UK forecasts. Our formal interest will start at the point at which that sum of money is transferred from HMRC to the Scottish Government’s consolidated fund bank account. We will be auditing that in the Scottish Government’s financial statements, whatever form they take at that stage.

The memorandum of understanding that committee members have in front of them in draft form today attempts to move a bit further than that in saying that the Scottish Parliament also has an interest in ensuring that the amount that is transferred properly reflects the amount that is collected from Scottish taxpayers under the agreement that has been made. HMRC is a UK body that is audited by the NAO and will continue to be so, but we are agreeing a mechanism by which HMRC will discuss with us its audit work in so far as it relates to the Scottish rate of income tax proceeds. We will have the power to comment on its reports to this committee and to this Parliament if we think that there are issues that need to be drawn to your attention.

That model can be extended to other sources of income or expenditure that are administered by UK bodies on behalf of the Scottish Parliament. For some of the new taxes that are to be raised in Scotland, such as air passenger duty and the aggregates levy, the focus will be much more clearly on what is done by the Scottish Government, and we will therefore have a direct audit relationship.

We are looking at a more nuanced landscape and set of arrangements in future, and it is helpful to have the chance to talk to you now about your priorities and the areas of interest or uncertainty on which you may need assurance in future.

Drew Smith: The example of the BBC was used at the beginning of the session, and it is an interesting one. As a Scottish licence-fee payer, I am interested in what the BBC does in Scotland and in its Scottish output, and in the BBC's reporting on Scotland elsewhere in the UK, although that is probably—to be frank—a minority element of my interest in the BBC's overall output.

It would be difficult to see how you could audit that area separately, if we were to go down the route of having BBC Scotland lay accounts beside whatever report it made to the Scottish Parliament. I would assume that it would be an opportunity for scrutiny of BBC Scotland's work and for a degree of influence over its forward priorities rather than an accounting mechanism in reality. Is that a fair comment?

Caroline Gardner: That is a good way of framing the question. This Parliament clearly has an interest in the BBC's activities as far as they relate to Scotland specifically, and there is a debate to be had about how that process operates.

It would be possible to develop the current BBC Scotland management review further to provide the committee with more information on performance and the amount that is spent in delivering its Scottish outputs. However, given the current direction of travel, the BBC will continue to be a UK-wide institution that will report on a UK-wide level, and it will have its accounts audited by KPMG—as it currently does—with the UK Public Accounts Committee having some oversight of that process.

If you want to develop arrangements here, they will need to be negotiated with the BBC and the UK Government. In the Smith recommendations, there is a mechanism to enable the annual report and accounts to be laid in Parliament. However, the question of how that process might develop to give you the information that you need, and what your purpose in undertaking it would be, has not yet been worked through.

Drew Smith: Can I ask one final question, convener? Well, I might be cheeky and ask about two related things in one.

The Convener: Please be brief.

Drew Smith: Auditor General, is there likely to be a need for legislative change in relation to your relationships with bodies such as the National Audit Office and others that might be important to the Parliament, or are you confident that they can be dealt with through working in partnership and memoranda of understanding?

The other thing is that I want to give you an opportunity to say what you regard as the biggest risks. I take Nigel Don's point about use of the word "risk" but, from your point of view as an audit organisation, what are the biggest risks in the transfer of the powers that we are talking about?

Caroline Gardner: The honest answer to your first question, on legislation, is that it depends. If the DWP was to continue to deliver some of the Scottish Government's new responsibilities for welfare, it would be useful to have some of the arrangements enshrined in legislation, as is already the case with the Scottish rate of income tax with the requirements for both HMRC and the NAO to report to the Scottish Parliament. That is a parallel, and I can see circumstances in which it would be useful to have something in legislation. With other things, there would be no need, either because they are too small or because the committee's interest would be not in the accounts but in something else.

Your second question was about the biggest areas of uncertainty that need to be dealt with. As we discussed during the previous agenda item, the question of the new volatility and the new uncertainties that come with raising revenue and with welfare spending, both of which vary with the conditions in the economy more widely, is something that nobody in Scotland has really had to consider before, and it is why we believe that the availability of more comprehensive and transparent information is a key way of helping to manage those uncertainties.

Drew Smith: Thank you.

Tavish Scott: I would like to go back—dare I say it?—to the principle of no detriment. Given that there is no international illustration or definition of "no detriment", is it fair to say that, ultimately, the rules that will govern it can be laid down only by the fiscal agreement that will have to exist between the UK and Scottish Governments?

Caroline Gardner: That fiscal agreement has to be the starting point. As we have discussed, there will then be technical and political challenges in the way in which it operates, but I do not think that that is entirely uncharted territory. We talk about the Barnett formula, but within that there are areas that are the results of different levels of discussion and negotiation. The same is true of other strands of funding that come in. What we are discussing is on a different scale, but it is not entirely a new thing that is different from anything that we have had to deal with since 1999, when the Scottish Parliament was established.

Tavish Scott: I agree. Would it be helpful if no detriment were to be considered not in the context of a particular tax that changes on a particular date—you highlighted air passenger duty—but in the context of a fiscal cycle of three years, or whatever the agreed fiscal cycle might be?

Caroline Gardner: I am not sure that I agree that it is an either/or choice, but I absolutely agree that we need to think about the matter both at the level of individual policy measures and in relation to the big picture—not least because we know that some policy measures will interact with each other, so it might not make sense to look at each in isolation in coming up with the overall answer to how the principle of no detriment will be protected.

Tavish Scott: Another committee that Stuart McMillan and I serve on has been playing around with this for a while, and the evidence from there suggests that to consider the matter over a cycle—it would have to be agreed between Governments, which would involve Cardiff and Belfast as well—would be better, both for the reasons that you gave and for audit purposes. It strikes me that to consider the matter tax by tax would be a nightmare politically and in every other sense. In audit terms, to consider it over some kind of cycle might be a better way to achieve what is being sought—if I understand the principle correctly.

Caroline Gardner: I return to my earlier answer. What is needed are measure-by-measure agreements that contribute to a picture for the whole package. It clearly makes sense also to keep the big picture in mind over time, as it comes together more generally.

Tavish Scott: That is fine. Given your earlier answer on the importance of the independence of the Fiscal Commission, is there a logical role for that independent body, in conjunction with the OBR, to underpin the analysis? That could help the Governments not to argue about the numbers so much—although we will probably always do that—but instead to agree on the dividing point and the need to come to what will be a political agreement on a particular scenario.

Caroline Gardner: It is very clear that the OBR and the Scottish Fiscal Commission will need to work closely together on the issues in exactly the same way as Audit Scotland and the National Audit Office do. We do not want huge amounts of duplication in our respective roles, but we need to respect the fact that the UK Parliament and the Scottish Parliament have separate sets of interests that in many cases will overlap but which will not be the same. Both Parliaments need to be assured about the forecasts that the OBR and the Fiscal Commission will produce, the adjustments that are made to Government funding streams and, in our case, the annual results that come out of that in the financial statements.

Tavish Scott: That was helpful. Finally, do you think that the consolidated accounts or the whole-of-Scotland accounts that we discussed earlier are important in this context, or do they not necessarily play a significant role in how Parliament can best scrutinise the whole no-detriment principle?

Caroline Gardner: Consolidated accounts are not the whole answer, but they are a very important building block. As my colleagues have made clear, having for the whole of Scotland's public finances a set of financial statements that are prepared according to IFRS, in order to ensure that we all know the assumptions and conventions that underlie them, and which are audited in ways that give independent assurance that they say what they purport to say, will make a really strong contribution to this Parliament's scrutiny and the Scottish Fiscal Commission's ability to do its long-term financial-sustainability job.

Stuart McMillan: This is probably outwith the area that Audit Scotland considers, but I want to pose this next question so that I can reconcile myself with the answer. With regard to the intergovernmental relations that happen at the moment and which will happen as a result of the further powers that are coming to the Scottish Parliament, are you aware of all the different mechanisms that are in place, and are you content with the information transfer that happens in those IGRs?

Caroline Gardner: I am not sure that we can put our hands on our hearts and say that we are aware of all the mechanisms that are in place. We are very deliberately not part of Government; we are independent of it. We understand the parts that affect the areas in which we have a direct professional interest, and we fully respect the Smith commission recommendation that the intergovernmental mechanisms need to evolve as the Smith commission clauses come into effect.

Stuart McMillan: Does Audit Scotland have any recommendations to put on the table about what is in place at the moment?

Caroline Gardner: I am not sure that there is very much that we would want to add. The issue that, for good reason, we have stayed closest to has been the negotiations over the Scottish rate of income tax, because starting next April it will have a very direct impact on Scotland's public finances. From our perspective and from what we have seen at this committee, those negotiations have focused on the right issues and good progress is being made, but we are not party to the wider set of intergovernmental relationships that cover all the other policy and political questions that need to be managed.

Stuart McMillan: Thank you.

Mark Taylor said earlier that information should be made available as early as possible and that decision makers should know how accurate that information is. In the previous evidence session, I asked about the budget processes that are followed by the UK and Scottish Governments, and I note that in written evidence to the Finance Committee for its meeting on 25 June 2014, Professor David Heald stressed that the devolution of more taxes would require a UK-wide change and that, for example, the UK Government "budgetary timetable" would have to be changed in order to avoid gaming. As Tavish Scott has made clear, some of the issues have been raised at another committee. Does Professor Heald make a valid point in his submission? When it comes to intergovernmental relations, information sharing and the accuracy of information for decision makers, do you think that such a move would be beneficial, particularly with regard to the devolution of further powers?

Caroline Gardner: I go back to Lord Smith's very clear recommendation that the fiscal framework needs to be updated to take account of all that. The fiscal framework includes not only financial reporting, which for obvious reasons is what we have been majoring on, but the budget and scrutiny cycle, the fiscal rules that will need to be agreed and other elements. All those need to be reviewed. Our focus has been very much on financial reporting, because that is where our professional expertise lies, but I can only agree whole-heartedly with Lord Smith's conclusion that the whole picture needs to be developed over the next couple of years as the Smith commission clauses come into being.

11:45

Stuart McMillan: Obviously all the major parties have signed up to the Smith recommendations. I am not asking you to make any policy suggestions, but with regard to the further powers that are coming to the Scottish Parliament, does Audit Scotland have a view on other organisations that could have an impact on, or a regular dialogue with, the Scottish Parliament or its committees? I am thinking in particular of the Bank of England, given the borrowing powers that the Scottish Parliament is going to have.

Caroline Gardner: Sticking with our interest, which is about providing this committee and this Parliament with assurance on the way in which public money is being spent, I say that the key bodies in this respect will be HMRC, given that the Scottish rate of income tax and VAT will continue to be collected by that UK-wide body, and the DWP—although that will depend, of course, on the policy decisions on the new welfare responsibilities and whether DWP will continue to play a major role. That will be especially important, but I think that, because of universal credit, there will in any case still be a read-across.

Beyond that, I come back to the convener's opening questions; it all depends very much on what the committee's interest is. At this stage, I would not expect the Bank of England to be a particularly high priority on that list. The borrowing powers that are coming through the Scotland Act 2012 are, at the moment, very limited—although that is not to say that they are unimportant and do not need to be managed well—and the extent to which further borrowing powers will be devolved is an issue that will need to go through the legislative process. That relationship might change, but it all comes back to clarity of purpose, which will allow you to work out which bodies need to be involved and what the relationship should be.

Stuart McMillan: Thank you.

Colin Beattie: I want to build a little bit on the issue of risk management. Obviously with new powers come new risks; there is a risk to public spending if the revenues from devolved taxation come in lower than forecast, and there are risks with demand-led welfare powers. To what extent can Audit Scotland audit and report on the risk to Scottish public finances arising from the proposed new powers in areas such as taxation, borrowing and the welfare provisions?

Caroline Gardner: I do not think that we would be particularly reporting on the risks from those areas of policy; instead, we would expect the audit work that we produce to inform the Scottish Fiscal Commission's reporting on such matters. However, we can expect, especially over the transitional period, to play a role in the implementation of the new powers and readiness for them. You might recall that at the back end of last year we reported on preparations for the Scotland Act 2012; we gave a good deal of assurance on the preparations that were in hand, but we also raised some questions about the speed of implementing information technology systems. That is a good example of our oversight of the preparations that are happening during the transitional period, which is, I guess, when the risks are likely to be at their highest.

Colin Beattie: The command paper states that the fiscal rules need to be agreed by both the Scottish and the UK Governments. What is your role in monitoring adherence to those rules?

Caroline Gardner: I am not expecting that to be a significant part of my work or the work of Audit Scotland, just as it is not a significant part of the work of the Comptroller and Auditor General or the NAO in the UK. The OBR plays that role on a UK basis and, as I have said, draws on some of the information that comes out of the Government's audited accounts. I expect a parallel situation to develop here in Scotland, and that we will have a close relationship with the Scottish Fiscal Commission. From our perspective, that relationship is developing very well and will allow us to understand our work programmes and to explore areas of uncertainty or working papers behind the scenes, but the two sets of responsibilities are pretty clearly demarcated.

Colin Beattie: Obviously the Scottish Fiscal Commission has a clear role in the forecast element of tax and spending decisions, but what do you think are the priorities for ensuring an effective and independent commission?

Caroline Gardner: I think that the Government has done a very good job of establishing the Scottish Fiscal Commission early and ensuring that it was in place in good time to comment on the first Scottish tax forecasts for land and buildings transaction tax and the landfill tax. You will be aware that in the past week or so the Deputy First Minister has produced a consultation paper with proposals for putting the commission on a statutory basis as its role expands to cover the Scottish rate of income tax and the Smith proposals. That paper includes some questions about ensuring that the commission is on the strongest possible footing to do that work. We will certainly respond to the consultation paper with some suggestions for fine tuning but, as I have said, the most important challenge is to ensure that the commission has the capacity and expertise to do what it will need to do in the future, and that its independence, non-partisanship and transparency place it beyond question in what is a very political environment.

The Convener: On behalf of the committee, I thank the Auditor General and her team for their contributions. We now move into private session.

11:50

Meeting continued in private until 12:15.

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