Public Audit Committee

6th Meeting, 2023 (Session 6), Thursday, 23 February 2023

The 2021/22 audit of the Scottish Government Consolidated Accounts

Scotland's public finances: challenges and risks

Introduction

1. The Public Audit Committee took evidence from the Auditor General for Scotland (AGS) on his section 22 report on The 2021/22 audit of the Scottish Government Consolidated Accounts (published 1 December 2022) at its meeting on 19 January 2023.

2. The Committee previously took evidence from the AGS on his briefing, Scotland's public finances: challenges and risks (published 17 November 2022) at its meeting on 1 December 2022.

3. Copies of both the section 22 report and the briefing can be found in **Annexe A.**

4. The Committee will take evidence today from John-Paul Marks, Permanent Secretary to the Scottish Government on issues raised in both the briefing and the section 22 report.

5. The following correspondence is relevant to the evidence session—

- The 2021/22 audit of the Scottish Government Consolidated Accounts
    - Letter to the Auditor General for Scotland, 19 January 2023
    - Letter from the Auditor General for Scotland, 9 February 2023

- Scotland's public finances: challenges and risks
    - Letter to the Auditor General for Scotland, 16 December 2022
    - Letter to the Permanent Secretary, 16 December 2022
    - Letter from the Permanent Secretary, 22 December 2022
    - Letter from the Auditor General for Scotland, 11 January 2023

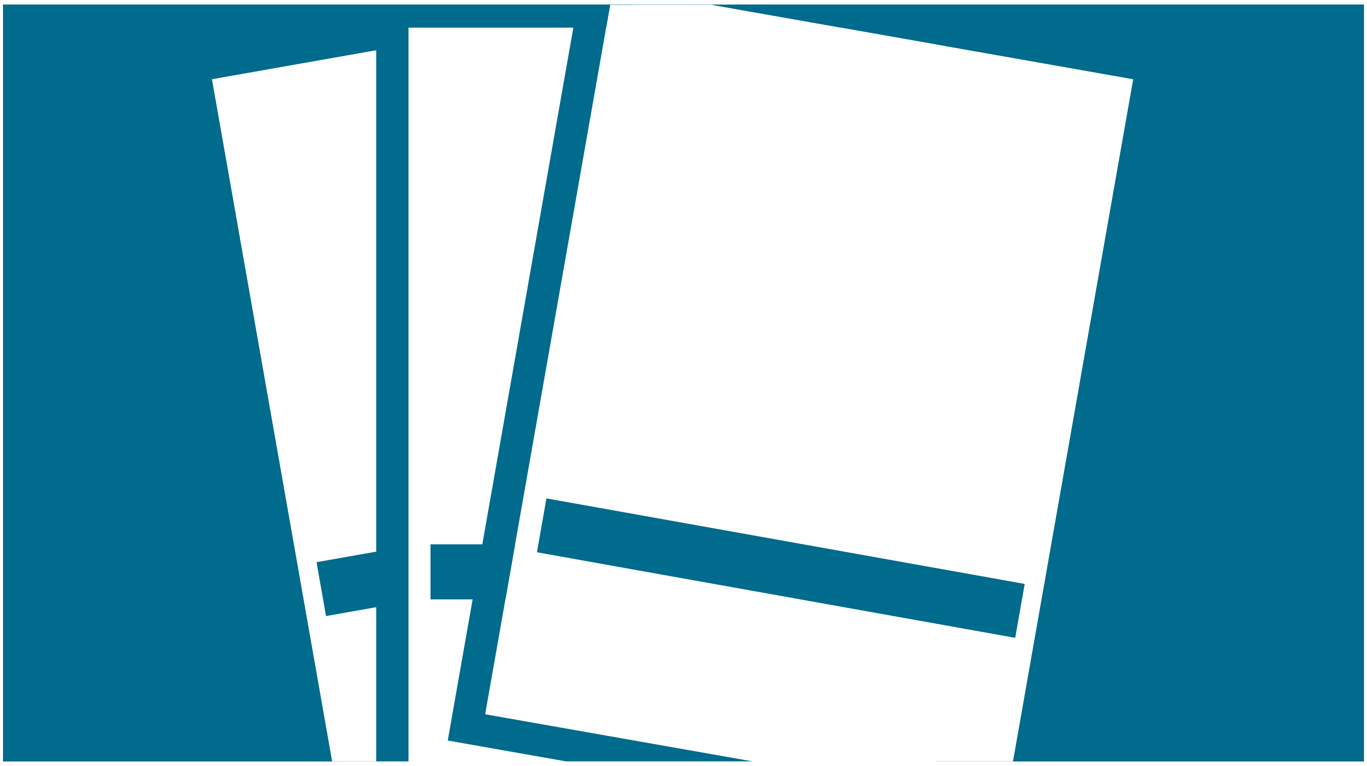
- Letter from the Auditor General for Scotland, 31 January 2023

6. The Committee will consider any further action it wishes to take after it has taken evidence from the Permanent Secretary.

Clerks to the Committee,
20 February 2023

Annexe A

The 2021/22 audit of the Scottish Government Consolidated Accounts



AUDITOR GENERAL

Prepared for the Public Audit Committee by the Auditor General for Scotland
Made under section 22 of the Public Finance and Accountability (Scotland) Act 2000
December 2022

Contents

Introduction

1. I provide this report on the 2021/22 audit of the Scottish Government Consolidated Accounts under section 22(3) of the Public Finance and Accountability (Scotland) Act 2000. My report is intended to support the Scottish Parliament in its important scrutiny role of the Government's finances. The report contains key information from the 2021/22 Consolidated Accounts and explains what they show about the Scottish Government's management of its budget. It also provides information on governance and financial and performance reporting.

2. Responding to the threat posed by the Covid-19 pandemic continued to be the primary focus of the Scottish Government throughout the 2021/22 financial year. Plans to support and protect public health alongside the development of economic recovery activity dominated decision-making including committing significant additional amounts of public spending during the year to support its ongoing response.

3. In addition to the challenges around Covid-19, the cost-of-living crisis emerged during the year as a result of higher food and global energy prices. The impact of Russia's invasion of Ukraine in February 2022 increased prices further and will continue to add pressure on the spending power of the Scottish Government's budget in the years ahead.

4. The economic and fiscal challenges facing the Scottish Government cannot be underestimated. Policy ambitions such as meeting climate change targets, reducing child poverty, delivering social security benefits, the resettlement of Ukrainian families, sustaining the NHS and establishing a National Care Service all have significant cost implications that are exacerbated in the current economic climate. Good use of public money together with sound governance and financial planning remain essential to ensuring that maximum value can be delivered within a financial sustainability environment.

5. In January 2021, the Scottish Government published its draft 2021/22 Scottish Budget which set out its spending priorities and plans for the year. This was subsequently revised through two separate budget revisions during the year which reflected additional monies available to support the Covid-19 response, taking the Scottish Government's total budget for the year to £51.2 billion. The Scottish Government's Consolidated Accounts for 2021/22 provide information on how this budget was managed and where money was spent and are a key component of the Scottish Government's accountability to the Scottish Parliament and the public.

6. The accounting boundary for the Consolidated Accounts reflects the areas for which the Scottish Government has direct responsibility and accountability, including the core portfolios, supporting administration, the executive agencies and NHS bodies. It does not include bodies where the Scottish Government holds significant shareholdings such as Ferguson Marine (Port Glasgow) Holdings Limited, Caledonian Maritime Assets Limited (CMAL), Scottish Futures Trust, Prestwick Airport or the Scottish National Investment Bank. These are reflected as investments within the Consolidated Accounts. Other public bodies such as local authorities are also outwith the Scottish Government accounting boundary.

7. The Consolidated Accounts:

- cover around 90 per cent of the budget approved by the Scottish Parliament
- report the amounts the Scottish Government spent against each main budget heading, and the reasons for any significant differences
- show the amounts distributed to other public bodies including local government
- report the assets, liabilities and other financial commitments of the core Scottish Government, and bodies within the consolidated boundary, carried forward to future years
- contain a performance report, in which the government gives an account of its performance during the year.

Key messages

- The 2021/22 financial year is the second in which significant amounts of funding to support the Covid-19 pandemic response are reflected in the Scottish Government's financial performance. The 2021/22 Consolidated Accounts show that the Scottish Government's total net expenditure for the year was £49.2 billion including £5.8 billion of Covid-19 related funding. These funds were used to support the NHS, businesses, local government and the wider economic response to the disruption caused by Covid-19 during the year.
- Overall, total spending was £1,988 million less than budget. The resource budget was underspent by £1,822 million (3.7 per cent) against a budget of £49,023 million and capital was underspent by £166 million (7.5 per cent) against a budget of £2,202 million.
- My independent audit opinion is unqualified. This means in my opinion, I am content the Scottish Government Consolidated Accounts show a true and fair view, following accounting standards, and that the income and expenditure for the year is lawful.
- The Scottish Government is facing an intensely challenging period in managing its finances. It has strengthened its focus on longer-term financial planning but the constraints on public finances caused by significant economic pressures, combined with stretching policy commitments, mean its ability to achieve financial sustainability in the years ahead is at risk.
- The Scottish Government's 2022 resource spending review and medium-term financial strategy highlight many of the fiscal and economic challenges facing the public sector in Scotland. The Scottish Government will need to ensure its policy choices and spending commitments are fully costed and transparently reported in forthcoming budgets. This will support effective scrutiny of spending plans and intended outcomes and will increase the likelihood of a sustainable financial position being achieved, particularly when tough choices are required.
- The volume of challenges faced by the Scottish Government throughout the year meant there continued to be considerable strain placed on staffing capacity and wellbeing. This is likely to

intensify in the years ahead given the Scottish Government's intention to limit the size of the public sector workforce to pre-Covid levels by 2026/27 and hold the total public sector pay bill at 2022/23 levels. A comprehensive workforce strategy is required to ensure that its approach to staffing levels is appropriately planned and coordinated across the organisation.

- In recent years, the Scottish Government has taken a direct role in providing financial support to businesses such as Burntisland Fabrications Limited, Ferguson Marine Engineering Limited, Prestwick Airport and the Lochaber Aluminium Smelter (Liberty Group). Financial support for these four companies has not delivered expected outcomes and is unlikely to achieve value for money. A framework has been developed by the Scottish Government which outlines its principles and approach for decisions about future investment in private companies. There is scope to strengthen this framework so that it better outlines intentions over risk tolerance, risk appetite and the expected public benefit of future interventions.

- The Scottish Government needs to do more to improve the quality and transparency of its financial and performance reporting. The continuing absence of a devolved public sector consolidated account means it is difficult to assess the overall health of Scotland's public finances at a time of greatest need. Similarly, the absence of defined, measurable performance targets means it is difficult to assess whether the Scottish Government is delivering its intended aims in support of national outcomes. Robust and transparent financial and performance reporting provides information about the impact of past decisions on future budgets, performance and intended outcomes. This is vital in supporting the long-term decision-making required for essential public sector reform.

- The Scottish Government has continued to strengthen aspects of its governance arrangements during 2021/22. There remained a strong focus on the impact of the Covid-19 pandemic on the organisation as well as an increased focus on performance and delivery towards the end of the year. Risk management processes continued to improve but more work is required to ensure planned actions are robust and realistic in addressing risks.

- The Scottish Government has committed to improving its sponsoring arrangements of public bodies, but I remained concerned as to whether the timescales will be met and whether actions planned will fully address each recommendation.

Financial management

Scottish Government budget performance 2021/22

8. The Consolidated Accounts show that total net expenditure during 2021/22 was £49,237 million, £1,988 million less than budget (Exhibit 1). The resource budget was underspent by £1,822 million (3.7 per cent) against a budget of £49,023 million and capital underspent by £166 million (7.5 per cent) against a budget of £2,202 million.

Exhibit 1
Total expenditure (resource and capital) against the Scottish Budget approved by the Scottish Parliament

The Scottish Government consolidated total was £1,988 million under budget in 2021/22.

Portfolio	Actual (£m)	Budget (£m)	Over/(under) spend (£m)
Health and Social Care	18,462	18,398	64
Social Justice, Housing and Local Government	16,290	16,411	(121)
Finance and Economy	2,080	2,616	(536)
Education and Skills	3,781	4,587	(806)
Justice and Veterans	3,084	3,123	(39)
Net Zero, Energy and Transport	4,061	4,536	(475)
Rural Affairs and Islands	876	948	(72)
Deputy First Minister and Covid Recovery	63	72	(9)
Constitution, External Affairs and Culture	355	354	1
Crown Office and Procurator Fiscal Service	185	180	5
Scottish Government consolidated total	**49,237**	**51,225**	**(1,988)**

Source: Scottish Government Consolidated Accounts 2021/22 (page 110). Further information on individual portfolio spending performance can be found in pages 111 to 122 in the Consolidated Accounts.

9. High-level reasons for significant variances between actual and budgeted spend are included in the Consolidated Accounts (pages 111-122). The largest variances relate to underspends in the Education and Skills portfolio (£806 million), the Finance and Economy portfolio (£536 million), and the Net Zero, Energy and Transport portfolio (£475 million). The Scottish Government reported that the underspend in the Education and Skills portfolio relates predominantly to the costs of providing student loans which uses a complex economic model and which is affected by interest rate movements. This underspend represents a non-cash saving which cannot be used to fund expenditure elsewhere.

10. The variances for the Finance and Economy portfolio included underspends in relation to Covid-19 business support grants, self-isolation grants and lower demand on business ventilation funds. Similarly, underspends in the Net Zero, Energy and Transport portfolio were attributed to demand for energy programmes being severely impacted by Covid-19 as well as delays caused by supply chain issues for energy projects.

11. My independent auditor's report is set out at pages 106-109 of the Consolidated Accounts. My opinion on the 2021/22 financial statements is unqualified. This means, in my opinion, I am content the Scottish Government Consolidated Accounts show a true and fair view and have been properly prepared to follow accounting standards and that the income and expenditure for the year is lawful.

12. The Scottish Government allocated £5.8 billion funding to support its Covid-19 response activity during 2021/22. This formed a significant part of the Scottish Government's financial response to supporting the health service, businesses, local government and the wider economy during the year.

13. High-level details are provided in the Scottish Government's accounts over how this money was spent during the year (pages 46-51). The highest spending portfolios were Health and Social Care (£2.6 billion), Social Justice, Housing and Local Government (£1.5 billion) and Finance and Economy (£789 million). Although this information is welcome, it does not provide the public with a comprehensive understanding of how Covid-19 funding was allocated including clear lines of sight between budgets, funding announcements and spending levels. Similarly, it does not provide information on how any underspends were reallocated or added to reserves. The recovery from Covid-19 will continue for some years to come so transparency over how funding was spent remains important.

14. It is the Scottish Government's responsibility to ensure it can appropriately assess the levels of error and fraud that may exist within its accounts. I reported in 2020/21 that the Scottish Government needed to regularly assess and improve its estimates of fraud and error in Covid-19 grant schemes and assure themselves that controls to detect and prevent fraud and error are working in practice. During 2021/22, the Scottish Government continued to strengthen the internal controls and utilised established systems and processes to minimise risk.

15. In the Governance Statement (page 69), the Scottish Government has outlined how it obtained assurance on grants to local authorities for the payment of these large support schemes including its own estimate of fraud and error. The Scottish Government estimates this to be no more than one to two per cent of payments, similar to its estimate in 2020/21. Review of fraud levels at local government level has been informed through engagement with local internal auditors and other delivery partners. I am content that the estimate is not unreasonable, and I am pleased to see the Scottish Government being more proactive in its assessment of fraud and error and their disclosures within the Consolidated Accounts.

Social Justice, Housing and Local Government portfolio

16. The 2021/22 financial year is the third full year that Social Security Scotland, an executive agency, is consolidated into the Scottish Government's accounts as a separate component audited body. The relevant expenditure is disclosed within the Social Justice, Housing and Local Government portfolio outturn statement (page 112).

17. The 2021/22 accounts of Social Security Scotland include benefit expenditure of £3,320 million administered by the Department for Work and Pensions (DWP) under agency agreements with Scottish ministers. Due to these delivery arrangements, Social Security Scotland cannot directly assess the levels of fraud and error in these benefits and is instead reliant on the DWP's annually published estimates.

18. The estimated overpayments as a result of fraud and error in relation to each type of benefit that is delivered by the DWP, ranged from 1.5 to 5.2 per cent of expenditure. This means an estimated £67.5 million of overpayments were made in Scotland. As a result, the auditor qualified their regularity opinion as these overpayments were not incurred in accordance with relevant legislation and regulations. Further details can be found in the 2021/22 Annual Audit Report of Social Security Scotland.

19. The auditor also commented on the need for Social Security Scotland to develop its estimate of the level of fraud and error within benefits administered by Social Security Scotland itself. While the auditor concluded that the absence of an estimate of the level of fraud and error in 2021/22 was not a significant financial statements audit issue, this assessment is becoming urgent as the value of benefits administered by Social Security Scotland increases rapidly over the coming years.

20. In May 2022, I published a report on Social security: Progress on implementing the devolved benefits. I reported that the Scottish Government has continued to successfully deliver new and complex social security benefits in challenging circumstances which is a significant achievement. There is a conscious focus on the needs of service users, building on the principles of dignity, fairness, and respect. The challenge will be to continue to deliver further benefits within agreed budgets while ensuring the financial sustainability of the service going forward.

21. As a component audit, the qualified audit opinion on the Social Security Scotland accounts requires me to assess the potential impact of its inclusion within the Scottish Government's Consolidated Accounts. I concluded that, for 2021/22, the likely amount of error and fraud incurred is not significant enough to influence the economic decisions of the users of the accounts and therefore I have not qualified my opinion in respect of this matter.

Crown Office and Procurator Fiscal Service

22. The Scottish Government's Consolidated Accounts include special payments of £11 million made by the Crown Office and Procurator Fiscal Service (COPFS) during 2021/22 (page 104) which relates to specific legal cases brought against the Lord Advocate by individuals in connection with the acquisition and administration of Rangers Football Club. Provisions for liabilities and charges (page 162) include £24 million in respect of the same cases.

23. Exhibit 1 (page 7) above records that COPFS overspent its annual budget by £5 million due to unplanned costs arising from ongoing court proceedings against the COPFS. The Scottish Government authorised the overspend.

24. To date the COPFS has accounted for £60 million of unplanned costs in connection with these claims against the Lord Advocate. Some cases have been resolved, with sums paid to the pursuers totalling £35.5 million to March 2022 with a further £24.5 million provided in respect of cases still to be finalised. In February 2021, the Lord Advocate made a statement in the Scottish Parliament about this matter and has committed to further public accountability and to a process of inquiry once all litigation has concluded.

Capital and resource borrowing

25. Under the terms of the Scotland Act 2016, Scottish ministers can borrow up to £3 billion for capital purposes, with an annual borrowing limit of 15 per cent (£450 million) of the overall borrowing cap. In 2021/22, the Scottish Government borrowed £150 million. This was less than the £450 million outlined by Scottish ministers as part of the 2021/22 Scottish budget. The loan will be repaid to the National Loans Fund over 20 years. This is in line with timescales outlined in the Fiscal Framework. The Scottish Government has advised that 2021/22 borrowing was used to support its overall capital programme although no detail of the assets being purchased through the loan is provided within the Consolidated Accounts. As I have reported in recent years, the Scottish Government needs to increase transparency over its capital borrowing plans including how these relate to individual projects within its programme. This will help support Parliament's scrutiny of its capital investment programme.

26. In 2021/22, the Scottish Government borrowed to fund resource expenditure for the second year running. During the year it borrowed £319 million from the National Loans Fund to be repaid over five years. The £300 million limit for resource borrowing was revised to £600 million for financial years 2021/22 to 2023/24 due to the conditions for a Scotland-specific shock being met. The Scottish Government can only apply this borrowing to meet forecast error in relation to receipts or demand-led Social Security spending.

27. As at 31 March 2022, the total principal level of capital borrowing outstanding was £1,309.9 million, with interest of £174.3 million applying over its remaining life. Resource borrowing outstanding at 31 March 2022 was £505.5 million with interest of £16 million accruing over the five-year repayment period.

28. Resource borrowing is repaid over a shorter time period (five years) than capital borrowing which is up to twenty-five years. Due to the accumulation of annual borrowing in recent years, loan repayments are increasing and totalled £95 million in 2021/22. The Scottish Government will need to continue to manage this financial pressure of repayments alongside all other financial pressures in the years ahead.

29. Details of the overall loan, repayments and interest payments are outlined on pages 55 and 56 of the Consolidated Accounts. The Scottish Government's borrowing and associated repayments are made via the Scottish Consolidated Fund (SCF). Borrowed amounts and repayments are made between the SCF and HM Treasury with the corresponding adjustments made to funding received by the Scottish Government from the SCF. This means there is no associated liability disclosed in the Statement of Financial Position within the Scottish Government's Consolidated Accounts. Details of the amount of borrowing and the associated liability are set out within a separate account prepared for the SCF.

Overall financial position

30. The Consolidated Statement of Financial Position (page 123) is one of the primary financial statements in the Consolidated Accounts. It summarises what is owned and owed by the core Scottish Government and those public bodies within the consolidated boundary. This shows taxpayers' equity – an accounting measurement of the amount of taxpayers' money applied that has continuing public benefit. It shows how much of this has arisen from the application of parliamentary funding (arising from the Scottish Block Grant, borrowing and devolved taxes) and how much resulted from changes in the value of physical assets over time.

31. Taxpayers' equity has increased in each of the last five years from £32.6 billion to £37.6 billion, largely due to an increase in physical assets (such as property and roads) and financial assets (such as loans and investments). Total liabilities (such as payments for private-financed projects) have increased from £9.9 billion in 2020/21 to £10.9 billion in 2021/22. It is important to note that the position does not reflect all the assets and liabilities of the Scottish public sector. Key assets and liabilities are excluded such as resource and capital borrowing, local government borrowing, and all public sector pension liabilities funded from the Scottish budget. This demonstrates the need for the development of a public consolidated account for the devolved public sector in Scotland (see paragraph 54).

Financial support to private companies

32. I have reported previously about the Scottish Government's direct role in providing financial support to private companies. This is in addition to support provided through its enterprise agencies, Scottish Enterprise, Highlands and Islands Enterprise and South of Scotland Enterprise. The financial support has included:

- **Prestwick Airport**. Purchased by the Scottish Government in November 2013 and has had loan support of £43.4 million up to 31 March 2022 which is currently valued at £11.6 million. Total interest accrued is £7.4 million which has been impaired to nil.
- **Ferguson Marine (Port Glasgow) Holdings Limited**. Acquired by the Scottish Government in December 2019. The existing voted loans (£97.7 million) were terminated and the difference between the valuation of the ferry vessels (£74.8 million) and the valuation of the outstanding loans (£22.9 million) was written-off through the Scottish Government 2020/21 Consolidated Accounts. During 2021/22, the Scottish Government wrote off £52 million from the capital value. The value of vessels 801 and 802 in the Consolidated Accounts at 31 March 2022 was £78 million.
- **Burntisland Fabrications Limited (BiFab)**. In 2018/19, the Scottish Government converted £37.4 million commercial loans into equity in BiFab which was valued at nil in 2019/20. During 2019/20 and 2020/21, the Scottish Government provided further loans of £13.5 million which were subsequently written off.
- **Lochaber Aluminium Smelter – Liberty Group**. In December 2016, the Scottish Government issued a 25-year financial guarantee contract to SIMEC Lochaber Hydropower Limited. The Scottish Government receives an annual fee in return for the guarantee. The annual exposure to the Scottish Government is between £14 million and £32 million, over the lifetime of the contract. The Scottish Government has assessed that the level of provision required for their guarantee was £114 million as at 31 March 2022, factoring in the value of its security package held as part of the guarantee agreement. I have concluded for 2021/22, the Scottish Government's approach to setting the level of provision against the potential exposure through the guarantee is reasonable.

33. There remains significant uncertainty regarding the financial stability of the GFG Alliance group which impacts on the likelihood of a call on the guarantee. In March 2021, Greensill Capital (UK) Limited, a major provider of working capital to GFG Alliance, went into administration. This impacts on the Lochaber smelter as it is a subsidiary of Liberty Industries UK Limited, alongside Liberty Steel Limited, under GFG Alliance. The situation is further complicated as the hydro power station that supplies the smelter is owned by GFG Alliance through its other main group of companies, SIMEC. GFG continue to publicly state their commitment to investing in the area and I am aware that GFG Alliance submitted plans for a new £94 million recycling and casting facility which were approved by the Highland Council in September 2021. I will continue to monitor the position in relation to the financial guarantee and the planned investment.

The strategic approach to financial interventions

34. In recent years, I have highlighted the need for the Scottish Government to learn lessons from its experience of recent financial interventions in private companies. I noted that in adopting a framework for investment, it is important that the Scottish Government clearly outlines its plans for future investment in private companies to ensure there is greater transparency over the value of financial support provided, the risks involved and the expected outcomes for the public.

35. In March 2022, the Scottish Government published its Business Investment Framework to outline its principles and approach for decisions about future investment in private companies. The framework forms part of its investment guidance within the Scottish Public Finance Manual. I welcome the publication of the framework. It should help the Scottish Government provide a structure to future investment decision-making and highlight the many areas that require consideration before funds are committed.

36. There is scope to further develop the framework by, for example, strengthening financial control over interventions and expanding commercial outcomes to include impact on the public such as jobs and future growth opportunities. The framework should also make a direct link between risk tolerance and risk appetite for investment considering the financial capacity of the Scottish Government. There is also scope to strengthen the guidance by removing some of the flexibilities in the application of the principles.

37. During 2022, the Strategic Commercial Assets Division (formerly the Strategic Commercial Investments Division) was formed. The roles and responsibilities of the Division mirror those of its predecessor which was slow to develop. Its main purpose is to consolidate expertise and knowledge and increase capacity to respond to cases that arise seeking support or intervention from the Scottish Government. The Division is not expected to be fully established until December 2022.

European Structural and Investment Funds

38. The Scottish Government is responsible for managing two European Structural and Investment Funds for the period 2014 to 2020; the European Social Fund (ESF) and the European Regional Development Fund (ERDF). The Funds remain operational with access to funding available until June 2024.

39. In November 2019, the EC placed the ESF programme in suspension after the Scottish Government was unable to resolve all outstanding issues by this deadline. While programmes are suspended, the Scottish Government's claims to the EC for reimbursement of funds will not be paid until all issues identified are resolved.

40. In 2020/21, the Scottish Government recognised that implementing the agreed methodology will likely result in greater expenditure over the course of the programme than can be reclaimed from the EC. As a consequence, and in line with accounting standards, the Scottish Government wrote off £16 million in the 2020/21 Consolidated Accounts in respect of grant payments already made. This estimate was reviewed and revised downwards to £14 million in 2021/22.

41. The Scottish Government has reviewed the level of provision required relating to the future under-recovery of costs and has provided a further £14 million in 2021/22 resulting in the recognition of a total provision of £43 million at 31 March 2022.

42. Formal agreement from the EU lifting the suspension was received on 31 October 2022 as the conditions for lifting the suspension were met.

43. Following the UK's withdrawal from the European Union, ESF and ERDF funding will be replaced by UK Government-led funding programmes including the Shared Prosperity Fund, Community Renewal Fund, Community Ownership Fund and the Levelling-up Fund. Guidance setting out the requirements of the Shared Prosperity Fund was issued in August 2022. The UK Government has committed to match previous EU funding. Under the Withdrawal Agreement, the UK will continue to participate in the Multiannual Financial Framework programmes, like ESF, until it ends in 2024.

Financial and performance reporting

Financial reporting

44. In May 2022, the Scottish Government published its first Resource Spending Review (RSR) since 2011. The RSR sets out indicative spending plans for five years up to 2026/27 aimed at delivering on its Programme for Government and Bute House Agreement commitments. It also highlights the economic and fiscal challenges facing the government over the medium term. High-level spending plans are outlined for each government portfolio and include a number of assumptions and expectations such as current tax forecasts under a central scenario, the delivery of three per cent efficiency savings from all public bodies and maintaining public sector pay costs at around 2022/23 levels.

45. In May 2022, the Scottish Government also provided an update to their 2021 Capital Spending Review (CSR). The 2022 CSR covers the three-year period from 2023/24 to 2025/26. The CSR highlights plans for additional capital borrowing to fund the capital programme to support the implementation of the Government's Infrastructure Investment Plan. The Review also notes an element of over-programming to maximise the use of available funding: the management of the capital programme will be essential to ensure the Scottish Government takes full advantage of the funding available.

46. Also in May 2022, the Scottish Government produced its fifth Medium-Term Financial Strategy (MTFS). The strategy aims to provide an assessment of the medium-term outlook for Scotland's public finances covering years 2022/23 to 2026/27. The 2022 Strategy sets out its assessment of Scotland's economic and fiscal outlook, as well as a broad spending outlook considering the effects of changing funding levels for government spending as outlined in the RSR.

47. Together, the MTFS, RSR and CSR give a welcome focus on medium and longer-term financial planning. Since their publication, the financial pressures facing the Scottish Government have intensified as tougher economic conditions such as higher inflation and increased interest rates have emerged in recent months. Public sector pay issues remain unresolved in key sectors such as nursing and midwifery, rail transport and teaching which will likely add further pressures both in the current financial year and beyond. Demand for health and social care services remains unsustainable while the number of people accessing social security benefits is significant, adding considerable pressures to already constrained budgets.

48. In recent months, the Scottish Government has worked with NHS bodies and local authorities to consider ways to ease financial pressures. This involved exploring options to utilise funding held in reserves by local authorities and health and social care integration joint boards. For example, the Scottish Government has provided councils with a capital grant of £120.6 million in 2022/23 and 2023/24 which councils are able to substitute with monies currently sitting in their reserves or planned revenue expenditure. This aims to release revenue-related aspects of earmarked reserves to help fund local government pay awards. Similarly, in February 2022, £619 million of Covid-19 funding was distributed to integration authorities to be held in earmarked reserves. The Scottish Government has since indicated that, due to changes in public health policies in recent months, this funding is unlikely to be required and therefore plans to reclaim surplus reserves from integrated joint boards later this year to apply them elsewhere.

49. Using reserves to smooth financial commitments over several years is an important component of good financial management. Accessing reserves may provide some short-term relief to financial pressures, however, the use of reserve balances to support recurring pressures is not sustainable in the longer term. There is a need for greater transparency over the Scottish Government's policy and approach to using reserves to manage existing cost pressures, particularly where there are funding implications for the wider public sector. This should include an assessment of reserve balances held by public bodies, their intended purpose as well as any plans to access monies held. The associated opportunities and risks of accessing reserves should be clearly articulated and documented. This will allow greater parliamentary scrutiny over the Scottish Government's financial decision-making, particularly when there are significant and immediate cost pressures.

Scotland Reserve

50. The Scotland Act 2016 allows the Scottish Government to build up funds when devolved revenues are higher than forecast, smooth all types of spending (including carrying-forward underspends), assist the management of tax volatility and determine the timing of expenditure. The Scotland Reserve applied from 2017/18 onwards and is split between resource and capital.

51. The Reserve is capped at £700 million and annual drawdowns from the Reserve are limited to £250 million for resource and £100 million for capital. These drawdown limits were removed for years 2021/22 to 2023/24 as the Scottish Fiscal Commission forecast a Scotland-specific economic shock.

52. The Scottish Government's policy is to apply any underspends for use in the following financial year. The 2021/22 provisional outturn statement (published June 2022) notes that £608 million was used to support expenditure in 2021/22 with a further £650 million due to be applied in 2022/23 and will be confirmed following the audit of the 2021/22 consolidated accounts.

53. There is publicly available information about the Scottish Government's approach to the Scotland Reserve. There is also information available about the intended drawdowns from the Reserve to support annual spending plans. The Reserve balance is not disclosed within the Scottish Government consolidated accounts. There is an opportunity for the Scottish Government to increase transparency in the Consolidated Accounts and raise awareness about the balances held within the Scotland Reserve and the movements of funds into, and out of, the Reserve each year. This will strengthen the Scottish Government's financial reporting and provide the Parliament and the public with a better understanding of the Reserve's purpose, its application in supporting spending plans and also its limitations.

Public sector consolidated account

54. In 2016, the Scottish Government committed to producing a consolidated account to cover the devolved public sector in Scotland including total assets, investments, and liabilities such as local government borrowing and public sector pension liabilities.

55. Some progress has been made in the preparation of the devolved public sector account. In 2020/21, the Scottish Government committed to a two-stage process. The first stage, which combines the Scottish Administration level together with the other directly funded bodies, was to be submitted for audit by Spring 2022. A draft version was provided for comment in April 2022 with a response provided in early July. The second stage plans to explore further the use of the UK Whole of Government Accounts process to obtain information about NDPBs, other public bodies and local authorities.

56. There have been delays in finalising the 2020/21 UK Whole of Government Account which forms the basis for these accounts due to ICT issues at HM Treasury. In addition, Scottish Government finance staff availability has impacted progress. Progress in finalising the stage one draft account for audit remains slow with the Scottish Government prioritising the preparation of the 2021/22 Consolidated Accounts. The Scottish Government needs to revise its timetable for completion, taking account of both ICT issues and staff availability.

57. The consequences of the pandemic, challenging global economic conditions, the cost of living crisis together with existing pressures in public services, all pose significant risks to the sustainability of Scotland's public finances. The need for a public consolidated account to provide a comprehensive and transparent assessment of the state of Scotland's public finances has never been greater. This is important for decision-making over the longer term as it will provide information about the impact of past decisions on future budgets, the potential risks to financial sustainability, the scale of assets and liabilities and the opportunity to re-think how public finances are managed as the Scottish Government seeks to deliver public service reform.

58. The Scottish Government needs to move swiftly towards fulfilling their commitments to producing this important account.

Performance reporting

59. The 2021/22 Consolidated Accounts include a performance report and an accountability report in line with the basic requirements of the Government Financial Reporting Manual (FReM).

60. The Scottish Government's performance report (pages 4 to 58) summarises financial performance for the year, with emphasis on performance against budget. It also contains some specific performance information which is required by current guidance on supplier payment performance, and signposts where more information is available on sustainability and environmental performance.

61. The performance analysis section provides the reader with a range of information on each portfolio's policy aims, the key challenges and financial results, what was delivered during the year and associated primary and secondary outcomes.

62. I noted last year that the information provided required to be refined further to ensure greater accessibility and transparency to the reader. Some limited improvements have been made, but it remains difficult to form an overall picture of the performance of the Scottish Government from the various strands of information presented. In the absence of defined, measurable targets, it is difficult for the reader to assess whether the Scottish Government is delivering its intended aims in support of national outcomes.

63. The performance report needs to reflect clear targets and progress towards achieving them. An assessment should also be made of the achievement towards priority outcomes and strategic objectives. This should help demonstrate the Scottish Government's own contribution to the delivery of national outcomes outlined in the National Performance Framework which is for all of Scotland, not just the Government. Key performance indicators should be identified together with performance during the year to give the public a clear understanding of the Government's achievements in the year. The lack of good indicators and milestones make monitoring the impact of policy and spending decisions more difficult. It also makes it harder for the Parliament and the public to scrutinise the Government's performance and assess whether spending is achieving maximum value.

Governance

64. A Governance Statement (pages 59-85) prepared by the Permanent Secretary is a key feature of the Consolidated Accounts. It forms part of a wider accountability report and summarises how the core Scottish Government organisation is controlled and directed. The statement confirms that the Scottish Government complies with relevant guidance on corporate governance. It also highlights the main risks and opportunities for the organisation and any significant internal control issues in 2021/22. I am content that the Governance Statement is consistent with the financial statements and has been prepared in accordance with guidance issued by the Scottish ministers.

65. The Scottish Government continued to strengthen aspects of its governance arrangements during 2021/22. There remained a strong focus on the impact of the Covid-19 pandemic on the organisation as well as an increased focus on performance and delivery towards the end of the year. Risk management processes continued to improve, most notably, in risk identification and escalation. Further work is required to ensure that actions proposed to manage and mitigate risks are robust and anticipated future risk levels and timescales are realistic. The volume of challenges faced by the Scottish Government throughout the year meant there continued to be considerable strain placed on staffing capacity and wellbeing. This is likely to intensify in the years ahead given the Scottish Government's intention to limit the size of the public sector workforce to pre-Covid levels by 2026/27. A comprehensive workforce strategy is required to ensure that its approach to staffing levels is appropriately planned and coordinated across the organisation.

66. There were several changes to the Scottish Government's Corporate Board during the year. In January 2022, a new Permanent Secretary took up post and shortly prior to this, in November 2021, two interim Directors General were appointed for Net Zero and Economy, splitting the previous remit of Director General Economy. Recruitment is under way for appointing to these posts on a permanent basis.

67. Established assurance arrangements are in place to provide and support the new Permanent Secretary in his role as principal accountable officer. Quarterly assurance group meetings are held with directors general, directors and NXDs, together with various corporate groups covering areas such as infrastructure investment, performance, people and place. There are also weekly Executive Team meetings and quarterly meetings of the Corporate Board. The Scottish Government's Audit and Assurance Committee, chaired by an NXD, oversees the assurance process. Following the appointment of the new Permanent Secretary, the Executive Team's role and responsibilities were reviewed. The Executive Team now meets weekly but in different 'modes', aimed at addressing the key priorities and issues facing the Scottish Government. These different modes include delivery (weekly meetings to consider priorities, risk and finance); strategy (fortnightly meetings covering corporate matters) and people (fortnightly meetings covering workforce matters). I welcome this development and the renewed focus it aims to have on addressing key priorities and issues.

68. This new approach to the running of the Executive Team provides an opportunity for a further review of governance arrangements within the Scottish Government. Many of the main governance groups referred to above are attended by the same individuals (both executive and non-executive) and cover similar topics, themes and risks. This introduces risks of duplication, inefficiency, or the potential for blurred lines of responsibility between the different roles and remits of each group. The role of the Audit and Assurance Committee is paramount in ensuring that efficient and effective arrangements are in place to support its role in providing advice, support and challenge to the Permanent Secretary, and in doing so, promoting good governance across the organisation. Such a review would offer the Scottish Government the opportunity to consider further its governance and operational structures, streamline its decision-making processes, and assess senior membership and attendance to ensure it can fully support the various demands, both internal and external, on the organisation in the years ahead. This is particularly important during a continuing period of change and uncertainty.

Sponsorship of public bodies

69. The Scottish Government's arrangements for sponsoring public bodies remains an area of concern. Last year, I reported that the Public Bodies Support Unit (PBSU) had restarted its support and training role for sponsors, board members and accountable officers.

70. During 2021, the Scottish Government commissioned an external consultant to conduct a review of the Scottish Government's relationships with public bodies. The report made 14 recommendations which were accepted by the Scottish Government. The Permanent Secretary has committed to all recommendations being implemented by the end of 2022. The PBSU has been proactive in attending each DG-led assurance group and the Audit and Assurance Committee to outline required actions. The Permanent Secretary expects all Directors General to have established the recommendations as best practice and will seek assurance of that. In addition, steps are being taken to ensure matters of concern within sponsored bodies are escalated through the assurance group process to ensure visibility across the Scottish Government.

71. I am pleased to see the commitment shown by the Scottish Government to addressing the recommendations made in the report. I remain concerned as to whether actions will fully address each recommendation or whether actions identified will be delivered within the timescales planned such as: the development of further guidance on establishing new public bodies; self-assessment checklists for sponsored bodies; training modules on risk, managing difficult relationships and difficult situations; and the roll out of 'stress-test' exercises. The report referred to significant levels of churn resulting in inexperienced staff in sponsorship roles as well as many vacant posts amongst sponsor teams meaning that the delivery of actions, leading to improvements across the Scottish Government, will be very challenging.

72. More significantly, it will take a much longer timeframe for the Scottish Government to be able to fully demonstrate the impact of actions taken in response to the recommendations. This largely stems from the cultural and behavioural changes needed to foster good relationships with public bodies over time. Similarly, the benefits realised from improvements in training and support offered to sponsor teams will take time to evidence. I will continue to review the impact of actions taken in forthcoming audit work.

Corporate transformation

73. The Governance Statement (page 77) refers to corporate transformation being an urgent priority for the Scottish Government. Corporate transformation is a way for the Scottish Government to achieve greater efficiencies in the longer term. I am aware that there is uncertainty over available funding to deliver the whole programme and no committed timeline for the project.

74. As part of this corporate transformation, the Scottish Government intends to implement both a human resources and financial planning system during 2023 to replace the current main accounting and e-HR systems. The new system is to be rolled out to both core Scottish Government and its 36 shared-service clients with an estimated cost of £55 million over the next seven years. This includes payments to partners who manage different aspects of the system. The project is currently in the design phase prior to moving to build phase.

75. I am aware of a number of challenges around this project. These include capacity and capability of staff resources and slower progress than originally planned due to design and validation issues. The expectation is that the new HR module will be introduced between July and September 2023, followed by the introduction of a new finance system and associated modules by the end of 2023.

76. There is a risk that corporate transformation will not deliver fully on its stated aims within planned timescales and within cost estimates. It is essential that there is clarity over how this programme is funded and when it is expected to be fully implemented. I will continue to monitor progress on this transformation programme including the new human resources and financial planning systems and their implementation across each of its clients.

Conclusion

77. The Consolidated Accounts remain a critical component of the Scottish Government's accountability to the Scottish Parliament and the public. They are particularly important during times of significant challenges and uncertainty, none more so than recovering from the Covid-19 pandemic, the impact of the war in Ukraine, rising prices and addressing financial pressures as they emerge such as public sector pay deals.

78. The unprecedented impact on public finances and the economy means the Scottish Government will need to manage further turbulence over the next few years. Strong financial management, effective longer-term financial planning and good governance remain essential to ensure the Scottish Government can minimise the effects of any further disruption.

79. Looking ahead, the Scottish Government should:

- continue to strengthen its focus on longer-term financial sustainability. In doing so, it should ensure its policy choices and spending commitments are fully costed and transparently reported in forthcoming budgets. It should also ensure greater transparency over its policy and approach to using reserves to help manage existing cost pressures, particularly where there are funding implications for the wider public sector
- take the opportunity to increase transparency in the Consolidated Accounts and raise awareness about the balances held within the Scotland Reserve, the movements of funds into, and out of, the Reserve each year. This will provide the Parliament and the public with a better understanding of the Reserve's purpose, its application in supporting spending plans and its limitations
- support better parliamentary scrutiny of its capital investment programme by increasing transparency over its capital borrowing plans including details of the underlying assets being purchased through loans
- further develop its framework for investment in private companies by, for example, strengthening financial control over interventions and expanding commercial outcomes to include outcomes for the public such as jobs and future growth opportunities. The framework should also make a direct link between risk tolerance and risk appetite for investment considering the financial capacity of the Scottish Government
- fulfil its commitments to producing public sector consolidated accounts. The need for a public consolidated account to provide a comprehensive and transparent assessment of the state of Scotland's public finances has never been greater

- ensure greater accessibility and transparency of its performance reporting within the Consolidated Accounts. The performance report needs to reflect clear targets and progress towards achieving them. An assessment should also be made of the achievement towards priority outcomes and strategic objectives. This will help strengthen accountability and scrutiny of the Scottish Government's own performance
- undertake a further review of governance arrangements within the Scottish Government to consider risks of duplication, inefficiency, or unclear lines of responsibility within its governance structure. Such a review would offer the Scottish Government the opportunity to consider its governance and operational structures, streamline its decision-making processes, and assess senior membership and attendance to ensure it can fully support the various demands, both internal and external, on the organisation in the years ahead
- develop a comprehensive workforce strategy to ensure that its approach to staffing levels is appropriately planned and coordinated across the organisation
- provide clarity over how its corporate transformation project will be funded and when it is expected to be fully implemented. The Scottish Government should ensure that the essential human resources and financial planning systems are implemented effectively, to time and to budget and, include plans to ensure its successful delivery for each of its clients.

The 2021/22 audit of the Scottish Government Consolidated Accounts

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Annexe A

Briefing

Scotland's public finances

Challenges and risks

AUDITOR GENERAL

Prepared by Audit Scotland
November 2022

Contents

Introduction

1. The pressures placed on Scottish public finances have been significant and varied for several years. The level of funding available to the Scottish Government has fluctuated, falling in real terms between 2010/11 and 2017/18 but steadily increasing since.[1] The response to the Covid-19 pandemic saw further, significant increases to the Scottish budget but this funding was temporary and has now come to an end.

2. The Scottish public sector has had to adapt to these changes in funding levels alongside managing increasing demand for services and external events such as the Covid-19 and cost of living crises. These challenges continue to grow, with real-life implications for people in Scotland.

3. The re-opening of economies following Covid-19 led to inflation across the world because of growing demand, labour shortages and increased transport costs. The war in Ukraine has increased energy prices.[2] Inflation is outstripping any increases that people are seeing to wages or benefits, and real earnings fell at the fastest rate since records began between April and June.[3]

The rising cost of living is described as a ‘cost of living crisis’

4. According to the Office for National Statistics, 87 per cent of adults in the UK reported an increase in their cost of living in August-September 2022.[4] Businesses, the third sector and the public sector also face higher operating costs, including higher labour costs as wages rise in response to inflation. In this paper, when we talk about the cost of living crisis, or the cost crisis, we mean all these pressures across the economy that are caused by rising prices.

5. The Scottish Government has said that it faces ‘significant financial challenges’ because of the cost crisis,[5] as it supports individuals and businesses affected by rising prices, at the same time as inflation means its funding buys less than was expected when the budget was set in December.

6. This paper focuses on the pressures facing the Scottish budget this financial year and in the medium term, and the implications this has for public services. It intends to inform and support scrutiny of proposed spending and tax plans in the current context, and emphasise the need for reform to public services.

[1] Institute for Fiscal Studies, How and why has the Scottish Government’s funding changed in recent years?, March 2021
[2] Institute for Fiscal Studies, The Cost of Living Crisis, accessed August 2022
[3] BBC, Inflation drives fastest fall in real pay on record, August 2022
[4] ONS, Public opinions and social trends, Great Britain, 30 September 2022
[5] Deputy First Minister, Letter to the Finance and Public Administration Committee, September 2022

Key messages

Scotland's public finances: challenges and risks

- **Rising costs and increasing demands mean that the Scottish Government has to closely and carefully manage its position, to avoid the real risk that it will overspend on the 2022/23 budget.** There have been significant financial pressures on public services for some time before the cost of living crisis. The current high level of inflation means that the Scottish Government faces higher public-sector pay and other costs, at the same time as it faces increasing demand for support from people impacted by the crisis. The budget was set when inflation was lower, and the Scottish Government is unlikely to receive additional funding to address this issue in the near future.

  If the Scottish Government were to overspend against its budget, this money could be clawed back from the following year's budget. This would be the first such occasion since the creation of the Scottish Parliament.

- **The Scottish Government has limited room for manoeuvre to make changes to balance the 2022/23 budget, and will face difficult choices setting the 2023/24 budget.** Within the year, much of the Scottish budget is committed, which means that there is limited flexibility available to the Scottish Government in the short term. Setting the 2023/24 budget will be challenging, and the UK Government's spending and tax decisions will impact on this. A balance must be struck between short-term necessities and longer-term priorities, and the Scottish Government will need to revisit its priorities if the economic and fiscal conditions worsen.

- **The pace and scale of reform required across the public sector needs to increase.** While the Scottish Government must continue to react to immediate events and financial pressures, this must not distract from the immediate need for broader reform. The Scottish Government's Resource Spending Review sets out its planned reforms and next steps. In the past, the Auditor General has highlighted an implementation gap between the Scottish Government's ambitions for reform and delivery on the ground. It is vital that these reforms are delivered effectively, and with public engagement, to deliver sustainable services that improve people's outcomes.

The cost of living crisis adds to the pressures on the Scottish budget

Sustainability pressures on Scotland's public finances pre-date the current cost crisis and the Covid-19 pandemic, and have worsened because of them

7. Significant risks to the financial sustainability of public services in Scotland are not new:

- In 2018, the Auditor General first stated that the NHS was not in a financially sustainable position.[6] NHS boards were increasingly reliant on additional financial support from the Scottish Government or non-recurring savings to break even.

- The Accounts Commission has also highlighted for some years that councils in Scotland are also facing financial sustainability pressures. In the Local Government Overview published in June 2020, the Accounts Commission highlighted that councils making continued use of reserves to manage the funding gap was unsustainable.[7]

8. The long-term financial and operational effects of Covid-19 are still being felt. The pandemic has had a range of indirect and direct health and societal impacts, such as backlogs in NHS treatments and court cases.

9. No additional separate funding was provided by the UK Government for Covid-19 in 2022/23, although the overall Scottish budget has grown in comparison to pre-pandemic levels. The extra pressures caused by the pandemic are being funded through the core Scottish budget, placing more pressure on Scottish public finances.

The Scottish Government must meet any additional spending above UK measures from its existing budget

10. The current high levels of inflation bring further uncertainty and volatility to UK and Scottish government budgets. During the Covid-19 pandemic, the UK Government response included both direct support for individuals and businesses (for example, the furlough scheme) and also increased departmental spending, which led to increased funding for the Scottish

[6] Audit Scotland, NHS in Scotland 2018, October 2018
[7] Accounts Commission, Local government in Scotland: Overview 2020, June 2020

Government. As set out in Scotland's financial response to Covid-19, the UK Government provided the majority of funding for the Scottish Government's £15.5 billion spending response to the pandemic in 2020/21 and 2021/22.

11. To date, the main financial responses to the cost crisis have been in reserved rather than devolved areas, which do not directly impact the Scottish budget. To help manage energy costs, the UK Government has announced the Energy Price Guarantee (for households) and the Energy Bill Relief Scheme (for non-domestic customers). Both these schemes were expected to cost £60 billion in 2022/23 across the UK when they were announced.[8]

12. Funding from the UK Government provided through the block grant is the main source of funding for the Scottish budget. This gives Scotland a proportion of the amount that the UK Government allocates to its departments for spending on devolved issues (such as health and education). The block grant only changes in response to UK Government decisions, and is not automatically uprated for inflation.

13. The UK Government has not changed its departmental spending this year to account for the higher costs facing the public sector, meaning that if the Scottish Government wishes to spend more money to support individuals and business through the cost of living crisis, this must be funded from the existing Scottish budget, rather than through additional Barnett consequentials.

14. Increased inflation means the public pound buys less than was expected when the budget was set. As part of the Programme for Government, the First Minister highlighted that because of inflation, the Scottish 2022/23 budget is worth £1.7 billion less than it was when it was set in December.[9]

15. The Comprehensive Spending Review (CSR) sets out the UK Government's intended spending over the medium term and was announced when forecasts for inflation were much lower. The CSR projected 3.3 per cent real-terms growth in its departmental resource budgets between 2021/22 and 2024/25. In August 2022, the Institute for Fiscal Studies estimated that the real terms growth in spending over that period has now dropped to 1.9 per cent.[10] Any increased costs must be met through the original spending envelope given to UK Government departments – and consequently, that given to the Scottish Government.

16. The UK Government has announced that it will deliver an Autumn Statement on 17 November. This will contain important information for the Scottish Government to consider as it sets its 2023/24 budget.

[8] UK Government, The Growth Plan, September 2022

[9] Scottish Government, Programme for Government 2022-2023: First Minister's speech, 6 September 2022

[10] Institute for Fiscal Studies, The inflation squeeze on public services, 10 August 2022. This is based on levels of inflation for the GDP deflator as opposed to the Consumer Price Index. Please see the article for more information.

The Scottish Government must manage the increased costs of running the public sector on an ongoing basis

17. Although inflation is not forecast to stay high over the long term,[11] the like-for-like increased costs are locked in for future budgets, and will not fall back to their previous levels. As a result, the Scottish Government must manage these higher unit costs permanently, or change the way it operates. Examples of the rising costs the Scottish Government faces are set out in Exhibit 1.

Exhibit 1
Examples of cost pressures on the public sector

The enhanced pay offers that have been made to date total over £700 million.[12] Agreement has yet to be reached with unions in some key areas of the public sector.
Electricity costs through the National Framework Agreement have increased by 27.5 per cent over the last year.
Gas prices through the National Framework Agreement have increased by 197 per cent over the last year.[13]
Food costs are estimated to increase by five per cent over the next year. Councils currently spend around £86 million on food each year.[14]
The costs of capital projects are also increasing, with councils reporting increases of around 30 per cent on anticipated costs.[15] This is likely to be reflected more widely across the public sector.

Source: Audit Scotland

18. Wages are the most significant of these costs, accounting for over £22 billion across the devolved public sector (including local government).[16] The Scottish Government pay policy set in December 2021 reflected inflation of 3.1 per cent,[17] but by the time of the next Medium-term Financial Strategy in May, this had increased to nine per cent.[18]

[11] Bank of England, Monetary Policy Report, August 2022
[12] Deputy First Minister, Letter to the Finance and Public Administration Committee, September 2022
[13] Scottish Parliament Written Answer, S6W-07596, March 2022
[14] COSLA/SOLACE/CIPFA Directors of Finance Section, Finance and Public Administration Committee consultation response, August 2022
[15] COSLA/SOLACE/CIPFA Directors of Finance Section, Finance and Public Administration Committee consultation response, August 2022
[16] Scottish Government, Scotland's Fiscal Outlook, May 2022
[17] Scottish Government, Scotland's Fiscal Outlook, December 2021. This is CPI inflation.
[18] Scottish Government, Scotland's Fiscal Outlook, May 2022

19. Public-sector trade unions have called for pay rises that match inflation.[19] The Scottish Government, local government, and trade unions agreed a deal over the summer. Funding for any future pay deals will need to be found from the 2022/23 budget.

The costs of supporting people through the crisis have increased

20. Social security spending is a key channel through which the Scottish Government provides support to individuals, and in 2022/23 accounts for approximately ten per cent of the Scottish Government budget.[20] The Scottish Fiscal Commission (SFC) forecast that higher inflation will increase social security spending by £156 million in 2023/24 and by £213 million in 2026/27, compared to their forecast in December 2021.[21] Social security spending is forecast to rise from £5,072 million in 2023/24 to £6,490 million in 2026/27.

21. The Scottish Child Payment (SCP) will also be increased from £20 per week to £25 when it is rolled out to households with children aged 6–15 in November 2022. From 2024/25 onwards the benefit is forecast to cost around £25 million more than forecast in May 2022, because of higher inflation.[22]

22. It is not clear if the current environment will lead to more people being eligible and applying for benefits. In their latest SCP costing from September, the SFC has not changed its assumption of the number of families receiving qualifying benefits or the underlying forecasts of unemployment. These will be updated in the SFC's next forecasts which will be published to accompany the Scottish Government's 2023/24 budget announcement. This could mean further cost pressures if the economic position were to worsen as social security spending is demand-led and needs-based.

23. The Scottish Government has also announced other new support in response to the cost of living crisis, including an extra £21.75 million to provide free school meals to eligible children over the school holidays[23] and the expansion of home energy schemes, including £161 million for the Warmer Homes Scotland scheme, Area Based schemes, and Home Energy Scotland.[24] The Scottish Government has also committed to doubling the quarterly bridging that will be paid in December to children and young people in receipt of free school meals.[25]

[19] STUC, Scotland Demands a Pay Rise, 2022
[20] The Scottish Fiscal Commission, Scotland's Economic and Fiscal Forecasts, May 2022
[21] The Scottish Fiscal Commission, Scotland's Economic and Fiscal Forecasts, Figure 5.11, May 2022
[22] The Scottish Fiscal Commission, Supplementary Costing – Scottish Child Payment, September 2022
[23] Scottish Government, Summer support for children, July 2022
[24] Scottish Government, Cost of living support, July 2022
[25] Scottish Government, Extra winter cash for children and young people in receipt of free school meals, October 2022

The Scottish Government faces tough choices for the 2022/23 and 2023/24 budgets

Without very close management of the budget, there is a real risk the Scottish Government overspends against its 2022/23 budget

24. The Scottish Government has reported balanced budgets since devolution was introduced in 1999. Early in 2022/23, the Scottish Government was forecasting a significant budget gap for the financial year, which was larger than could be managed through its usual budget processes. The Scottish Government identified the need for more substantial changes to spending, which were announced through the Emergency Budget Review process. The fiscal environment continues to be uncertain, and the Scottish Government must closely manage its budget for the rest of the financial year.

25. The Scottish Government has recognised that the financial situation it faces is by far the most challenging since devolution. An overspend on the budget would be a new development for Scottish public finances. The potential consequences and how this would take shape are unclear at this stage. Our understanding is that HM Treasury rules mean that any overspend against the 2022/23 budget would be deducted from the following year's block grant.[26] This would mean that there is less funding available for spending on next year's budget, exacerbating existing pressures on future public spending.

26. As set out in the fiscal framework, the Scottish Government can borrow to cover a temporary cash shortfall in year. Borrowing powers available to the Scottish Government are limited, and those available for resource borrowing must be paid back over three to five years. Ultimately, the Scottish Government's finances will not be sustainable if its spending commitments cannot be met by its funding and its tax raising powers.

[26] HM Treasury, Statement of Funding Policy, October 2021

Savings have already been found from the 2022/23 budget

27. In September, the Scottish Government has announced £560 million of additional income and savings to the 2022/23 budget to fund the increased cost of public sector pay deals.[27] In November, a further £615 million of savings were identified through the Emergency Budget Review process, the majority (£400 million) of which were changes within the health portfolio to support the proposed pay offer.[28]

28. At just under £1.2 billion, these changes include nearly £200 million of income and funding not expected at the time the budget was set and of the remainder, £300 million relates to capital changes, and £700 million relates to day to day spending.

29. The details of these changes are set out below, and in Exhibit 2 (page 11):

- **Changes to capital:** This includes deferral and reprofiling of capital spending, as well as some changes as result of reduced demand. An example includes £120 million of capital reprioritisation identified from multiple portfolios and transferred to local government to increase their overall resources available to support the local government pay offer.

- **Deferral of funding:** spending can be delayed into future years' budgets. For example, ring-fenced UK funding has been deferred for the Rural Affairs and Islands portfolios, and £70 million of Social Care and National Care Service (NCS) spending has been re-profiled.

- **Increased income and additional consequential funding:** additional funding has been applied to cover increased costs. For example, in September the Scottish Government applied £56 million of funding generated by the ScotWind clearance process to the 2022/23 budget, and has received an additional £82 million in Barnett consequentials.

- **Demand changes:** Where demand is less than expected, underspends are redeployed. Examples include a cut of £37 million in funding for concessionary fares, a £20 million reduction in further education student support, based on a forecast reduction in demand, and a reduction in justice spending based on a lower than anticipated requirement for services within the justice system as it recovers from backlogs. The Scottish Government notes that this does not impact on service delivery.

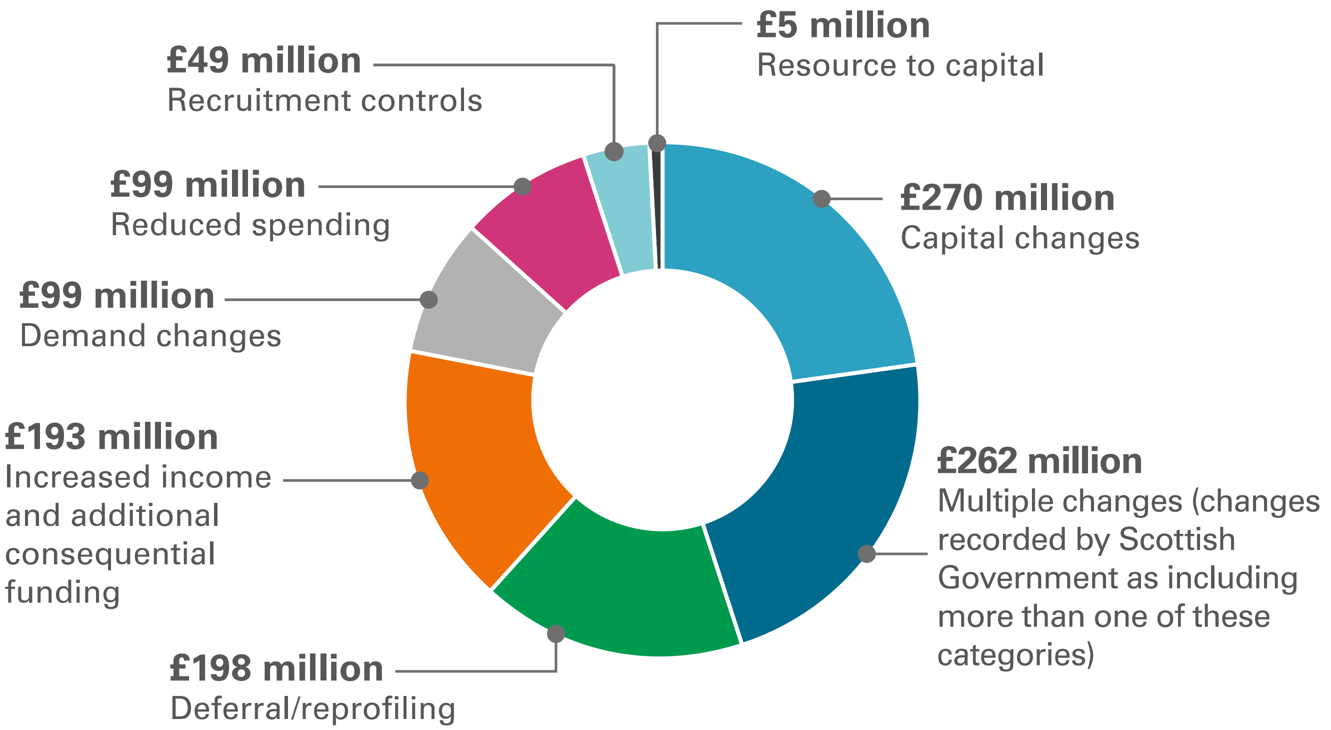
- **Reduced spending:** this includes a reduction of £53 million in funding for employability schemes, and £38 million of mental health spending that has been reprioritised to support the NHS pay offer.

[27] Deputy First Minister, Letter to the Finance and Public Administration Committee, 7 September 2022
[28] Scottish Government, Emergency Budget Review 2022/23, 2 November 2022

- **Recruitment controls:** restrictions in hiring across a range of public bodies.
- **Resource to capital switches:** resource spending is being replaced by capital spending, for example, within the Education and Skills portfolio for Gaelic support.

30. The EBR notes that as a result of the ongoing uncertainty, there remains a risk to balancing the 2022/23 budget.[29]

Exhibit 2
Breakdown of types of savings and reductions included in 2022/23 savings announced to date



Source: Scottish Government, Audit Scotland analysis. September changes come from the Deputy First Minister's letter to the Finance and Public Administration Committee, dated 7 September, and the November changes come from the Emergency Budget Review.

The Scottish Government has tools available to manage its budget, but its options are limited

31. The Scottish Government's options – its ability to flex its budget in response to events – comes from multiple sources, as set out in the following paragraphs.

[29] Scottish Government, Emergency Budget Review 2022/23, 2 November 2022

Fiscal framework tools and powers

32. The Fiscal Framework agreed between the Scottish and UK governments in 2015 includes levers that the Scottish Government can use to manage volatility in its budget. However, these were largely designed to address volatility that arises from forecasting error and were not designed to help balance the budget.

33. The Scotland Reserve is used to manage spending across years. In his letter to the Finance and Public Administration Committee, the Deputy First Minister confirmed that all the available funds from the reserve have been allocated to support spending in the 2022/23 budget.[30] As highlighted in Scotland's new financial powers: Operation of the Fiscal Framework 2018/19, when the Government plans to use the Scotland Reserve to carry forward significant amounts of budget and spending power from one financial year to the next, this will limit the extent to which the reserve is able to operate as a buffer against budget pressures, and this money can only be spent once.

34. The fiscal framework also included borrowing powers. As set out in paragraph 25, the in-year cash management borrowing powers can only be used to fund a temporary shortfall in cash flow or working capital, and do not enable the Scottish Government to spend beyond the funding as set in the budget.[31]

35. The Scottish Government also has capital borrowing powers. While capital borrowing cannot be used to support revenue spending, in the wider public sector (for example, local government) certain types of capital spending could be moved to resource spending. For example, during the Covid-19 pandemic, the Scottish Government identified a package of financial flexibilities for councils, including permitting the use of capital receipts received to fund day-to-day costs.[32] In such a scenario, the Scottish Government could use its capital borrowing powers to offset this, and to restore capital funding available. This would need to be done in line with HM Treasury's Consolidated Budgeting Guidance.

36. Taxes are another source of funding for the Scottish Government budget, and higher inflation can lead to higher tax takes as prices or wages grow faster than tax thresholds. However, Scotland's tax revenues will not change significantly for the rest of 2022/23, because the contribution that Scottish Income Tax, (which accounts for 94 per cent of Scotland's tax revenues)[33] makes to the 2022/23 budget was fixed in cash terms when the budget was agreed. The income tax policy for 2023/24 will be announced alongside the budget in December.

[30] Deputy First Minister, Letter to the Finance and Public Administration Committee, 7 September 2022
[31] For more information, see Audit Scotland, Operation of the Fiscal Framework, October 2018
[32] Scottish Government, Local Government Finance Circular No 2/2021, February 2021
[33] This is the share of Scottish Income Tax, Land and Building Transaction Tax and Scottish Landfill Tax. It does not include Non-domestic Rates revenues.

Controllable and non-controllable costs

37. Reducing budgets in an unmanaged way can have significant impacts on the quality of services provided, how accessible services are, and on people's long-term outcomes. The Scottish Government and other public bodies will need to understand well in advance what constraints there are to their flexibilities to cut spending. Examples include statutory services and duties that must be provided by law (for example, statutory targets for net zero commitments), the Scottish Government's human rights duties, and commitments such as no compulsory redundancies.

38. In addition, in the short term, much of the budget is fixed and committed, and there are limits to what can be changed without significant disruption. Much of the public spending incorporated in the Scottish budget is for areas such as staff costs that are difficult to change quickly.

39. The Scottish Government will need to understand where it is most able to quickly alter spending, and understand what options are available to it in responding to budget fluctuations. Public bodies are also likely to be required to budget more flexibly as a result. For example, to fund the local government pay deal agreed in August, the Scottish Government allowed councils to take some funding that had previously been ringfenced for another use and use this to cover the cost of the pay agreement.

40. In the medium to long term, fewer costs are fixed and more can be changed. This means there is more opportunity for reforming public services, as discussed in more detail in section 3.

Wider public sector flexibilities

41. Some public bodies, such as councils and integration health and social care authorities, also have reserves that can be used to carry funding over from one financial year to the next. However, funding held in reserves can only be spent once and cannot be reliably used to cover recurring costs. As highlighted in Scotland's financial response to Covid-19, some of the money held in council and integration authority reserves has been earmarked for specific purposes, such as the ongoing response to Covid-19. The Scottish Government has requested that some funding which is currently allocated for Covid-19 in integration authority reserves is now used for wider Covid-19 purposes.

42. As the Auditor General has highlighted in previous section 22 reports on the audit of the Scottish Government Consolidated Accounts,[34] there remains a need for a public consolidated account to provide a comprehensive and transparent assessment of the state of Scotland's public finances. This is important for decision-making over the longer term as it will provide information about the impact of past decisions on future budgets, the potential risks to financial sustainability and the scale of assets and liabilities, including those held by publicly owned companies. The report on the 2021/22 audit of the Scottish Government Consolidated Accounts will update on this matter when it is published later in 2022.

[34] Auditor General for Scotland, The 2020/21 audit of the Scottish Government Consolidated Accounts, December 2021

The Scottish Government will have to consider UK Government policies when setting the 2023/24 budget

43. The level of funding that will be available to the 2023/24 Scottish Budget is not yet known. There is ongoing uncertainty around UK Government policy on spending, tax, and social security, with the Chancellor of the Exchequer stating that 'nothing is off the table' in terms of changes to tax and cuts to public spending. Changes to UK Government spending in devolved areas impacts the size of the Scottish budget, and reductions to the budgets of public services such as the NHS in England will reduce the funding available to the Scottish Government. The Scottish Government will need to manage this uncertainty when setting the 2023/24 Scottish Budget.

44. While most of the changes to UK tax policy announced in the September mini-budget have been reversed, the changes that had been announced to Stamp Duty have been retained and will impact on the Scottish budget. While the Scottish Government is responsible for setting its own equivalent to Stamp Duty in the form of the Land and Buildings Transaction Tax (LBTT), changes to UK Government tax policy impact the net benefit to the Scottish budget as a result of this devolved tax. If the Scottish Government chooses to retain the existing rates and thresholds for LBTT, then UK Government changes to Stamp Duty would result in additional funding of approximately £65 million for the Scottish Budget in 2023/24.[35]

45. In March 2022, the UK Government announced that working age benefits would rise in line with inflation for 2023/24. It is unclear if this is still the UK Government's intention.[36] If the UK Government chooses not to increase benefits to fully cover inflation this has implications for Scottish social security spending.

46. If the UK Government decides to uprate the reserved benefits by less than inflation in April 2023, the devolved Scottish benefits that are administered by the Department for Work and Pensions (DWP) may need to be updated by the same rate. This is because of an agreement between the Scottish Government and DWP to ensure payments are consistent while clients are transferred to Scotland.[37]

47. In addition, this means that there would be less funding available for the benefits that are now administered by Social Security Scotland (such as Adult Disability Payment and Child Disability Payment) because the Block Grant Adjustment that the Scottish Government receives from the UK Government would increase at the lower rate. There is a statutory requirement in the Social Security Scotland Act (2018) to consider the effect of inflation and respond if

[35] Deputy First Minister, Letter to the Convener of the Finance and Public Administration Committee, 3 October 2022

[36] House of Commons Work and Pensions Committee, Letter to Chancellor of the Exchequer, October 2022

[37] For example, please see: the Secretary of State for Work and Pensions and the Scottish Ministers, Agency Agreement in respect of Personal Independence Payment for people resident in Scotland, 2020

that effect is, in the opinion of the Scottish Government, material. The Scottish Government has not yet published its report on the effect of inflation on benefits for 2023/24 so it is not clear what rates it will apply in 2023/24.

The Scottish Government has been developing its approach to managing financial sustainability risk

48. The Scottish Government recognises the issues and risks relating to the sustainability of the public finances over the medium term, and is changing how it manages its financial sustainability risks.

49. The Director-General Scottish Exchequer is responsible for managing the financial sustainability risks to the Scottish Government, and the core purpose of the Scottish Exchequer Directorate is 'a fiscally sustainable Scotland'. The directorate is developing its strategy for fiscal sustainability, with the goal of balancing the 2023/24 Budget. The Scottish Government has informed us that the work being undertaken aims to ensure there is an understanding of fiscal risks across the whole of the Scottish Government, and an early priority of this work is to strengthen the spending data available.

50. In Scotland's financial response to Covid-19, the Auditor General and the Accounts Commission highlighted that when the Scottish Government is understanding spending and performance information across several portfolios, it should consider the lessons learned from Covid-19, when the Scottish Government had difficulties in tracking actual spending because its budget processes were not designed to separate specific spending in areas across portfolios.

51. It will be important that the results of the Scottish Government's fiscal sustainability work are transparently shown to improve scrutiny of the financial position, and to highlight risks early.

The financial pressures faced may have implications for the scale, range and types of public services that can be provided

52. Worsening economic conditions will increase demand for public services. The Scottish Government may be in the difficult position of deciding what spending programmes and areas of government it will deliver differently, deliver less of, and which programmes it may need to stop delivering completely.

53. The Scottish Government set out four priority spending areas in the Resource Spending Review (RSR) published in May:

- tackling child poverty
- addressing the climate crisis
- securing a stronger, fairer, greener economy
- delivering excellent public services.[38]

[38] Scottish Government, Resource Spending Review, May 2022

54. If spending in these areas is protected, then reductions and changes to services will have to be applied to non-priority areas. In the RSR, the Scottish Government planned real-terms decreases in spending to areas such as local government, the police, prisons, justice, universities and rural affairs over the spending review period.

55. The current new financial realities mean that if the economic or fiscal environment continues to worsen, the Scottish Government may need to revisit all current priorities and policy commitments. Even if spending in priority areas is protected, services may be under significant pressure due to higher demands, especially on top of backlogs and challenges caused by Covid-19.

The Scottish Government needs to understand how its decisions will affect different groups

56. Recent research by the Glasgow Centre for Population Health has indicated that there is an increasing body of UK and international evidence attributing falls in life expectancy in the UK between 2011 and 2019 to reductions in UK Government spending, particularly in relation to social security, during that period.[39] To minimise the negative impacts from the any future changes to public spending on people's outcomes, the near-term pressures on the budget must be managed while maintaining a focus on long-term priorities.

57. This will be difficult in the current context, when it may be unavoidable that some of the choices that need to be made will negatively impact on wider work to improving outcomes. The more challenging the financial situation, the larger the impact this is likely to have on people and outcomes.

58. The Scottish Government and public bodies must understand how the decisions they make will impact on different groups in society. In advance of the Emergency Budget Review, several gender equality organisations wrote to the Deputy First Minister to highlight the importance of analysing the impact that the budget will have on women, children, and other marginalised groups.[40] Alongside the Emergency Budget Review, the Scottish Government published a summary of the evidence on equality and fairness of the Emergency Budget Review. This considers the evidence at a high level and focuses on the most substantial changes, but is more limited than a full Equality Impact Assessment.[41]

[39] Walsh D, Wyper GMA, McCartney G, Trends in healthy life expectancy in the age of austerity, Journal of Epidemiology and Community Health 2022
[40] Engender, Gender Budget Analysis in Budgetary Reviews, letter to DFM, October 2022
[41] Scottish Government, Emergency Budget Review: equality and fairness – evidence summary, November 2022

Reforms to public services are now required

Failure to make the necessary changes to how public services are delivered will likely mean further budget pressures in the future

59. In the long term, the economic and fiscal outlook means that continuing to make small-scale budget cuts is unfeasible. The Auditor General and the Accounts Commission have continued to underline the importance of reforming public services to manage the sustainability of public finances.

60. Reforming public services means changing how services are delivered to people in a way that more effectively meets both their needs and the Government's policy aspirations. Reform is most successful when it is planned and targeted – in contrast with flat budget reductions across the board which reduce spending across the public sector, without considering the impact on wider ambitions.

61. The significant pressures which require immediate reform are even greater than when medium-term plans were last set out by the Scottish Government. The Medium-term Financial Strategy (MTFS) published in December 2021, projected that by 2026/27 there would be a £3.5 billion gap between its central funding and spending scenarios.[42] The MTFS was then updated in May 2022 and published alongside the RSR.[43] This reflected a balanced medium-term position, where the central funding scenario and central spending scenario align, closing the previously identified funding gap. A key part of how the Scottish Government planned to close the funding gap was by making necessary budgetary savings through public service reform.

62. The RSR includes reference to four main types of reform, summarised in Exhibit 3 (page 18).

[42] Scottish Government, Medium Term Financial Strategy, December 2021
[43] Scottish Government, Medium Term Financial Strategy, May 2022

Exhibit 3
Public service reforms included in the RSR

Type of reform	Summary from RSR
New approaches to public services	Key reforms over the course of this Parliament include: • the establishment of the National Care Service • keeping the Promise (as set out following the Care Review), including by investing £500 million in preventative spend through the Whole Family Wellbeing Funding • the Vision for Justice in Scotland – the future justice system • Education Reform – replacing existing education bodies • National Strategy for Economic Transformation.
Public sector capacity and pay	The RSR includes plans to: • from 2023/24, a broad aim to keep the total cost of the overall annual pay bill the same as 2022/23 • a broad aim to return the total size of the devolved public sector workforce to around pre-Covid-19 levels by 2026/27, through effective vacancy and recruitment management • continued development of the use of technology within the public sector to support hybrid and flexible working.
Efficiencies for the public sector	Recurring annual efficiencies of at least three per cent will be required from public bodies. Planned efficiencies include: • further use of shared services • management of the public sector estate (around 30,000 properties) • effective procurement (current levels of procurement spending stood at £13.3 billion in 2020/21, or around a quarter of the Scottish budget) • management of public sector grants.
Reform to public bodies	The RSR notes that there are currently 129 public bodies in Scotland, and notes ‘reform is inevitable’.

Source: Audit Scotland, Scottish Government

63. The cost of living crisis, and the pressures on public spending and public services, mean that these reforms are more necessary than they were even when the RSR was announced earlier this year.

In the past, delivery of the reform of public services has not matched the original ambition

64. Both the Auditor General and the Accounts Commission have highlighted previously how difficult it is to reform public services, for example in their papers on health and social care integration, Scotland's colleges, drug and alcohol policy, and police and fire reform.

65. Reflecting on the progress made ten years on since the Christie Commission, the Auditor General commented that, "concerted action has been taken to try and implement progressive policies... But audit work consistently shows a major implementation gap between policy ambitions and delivery on the ground." [44]

66. For example, social care reforms aimed to offer people more choice and control about the services they received. A 2017 progress audit on self-directed support found that, after seven years, there was no evidence that authorities had made a transformation in services.[45]

67. The recent Social care briefing sets out key learning points from past public service reforms, including:

- realistic costs in financial memorandums accompanying parliamentary bills for legislative change
- a comprehensive business case, clearly setting out the purpose and objectives of reform
- evidence to support major changes and being clear about how they will improve outcomes, options, appraisals and economic modelling
- governance, accountability, roles and responsibilities in the new structure.

68. These points will be more important during a period of tight budgets to ensure reform achieves maximum value for money. Investing in good processes and data for reform may be challenging in the current context when money and capacity is restricted, but learning from previous reforms will help ensure reforms deliver the expected outcomes.

69. Audit Scotland has raised concerns about the approach being taken to some of the reforms currently planned. For example, in the recent Social care briefing paper, the Auditor General and the Accounts Commission noted that the proposals were not fully costed and there is much to do to establish the true costs of reform.[46] This briefing paper also noted the importance of strong, stable, and collaborative leadership. In recent years, the Auditor General and

[44] Auditor General for Scotland, Christie's clarion call can't wait another decade, September 2021
[45] Auditor General for Scotland, Christie's clarion call can't wait another decade, September 2021
[46] Auditor General and the Accounts Commission, Social care briefing, January 2022

the Accounts Commission have reported on the leadership capacity across the public sector, emphasising the critical need for effective leadership at a time of increasing pressures and change. Public bodies, including councils, integration authorities and the NHS are experiencing a high turnover in senior staff and are competing not only with each other for the best quality leaders but also with the private and third sectors.

70. In the face of the financial challenges, the pace and scale of reform needs to increase, and this will require a sense of urgency from the Scottish Government, at a time when it is also pressing to resolve short-term issues facing the budget.

71. If this does not happen, it will become increasingly difficult for the Scottish Government to manage the pressures on the budget, meaning that the cuts to spending necessary to balance the budget will become larger, and the quality of public services delivered will worsen.

72. Following the publication of the RSR, the Scottish Government has set up a new Public Spending Portfolio Board, to ensure the delivery of the RSR across directorates, identify links across workstreams, and provide advice across Scottish Government as needed. This aims to link the RSR both to the Emergency Budget Review and to the 2023/24 budget.

73. The board has met three times since June, and is at the early stages of its role of overseeing the implementation of the required reforms, and has focused so far on the workstreams (such as public sector pay and the reform of public bodies) which will feature in the 2023/24 budget. A Public Spending Analytical Unit has also been set up to monitor public spending and support the reform agenda.

74. To be effective, the Scottish Government's new approaches will need to clearly set out what reform intends to deliver, how it intends to track and monitor both savings and other financial impacts and the impacts on outcomes, and how these link across the public sector.

A shift to preventative spend is essential alongside meeting immediate challenges

75. The recent Social care briefing reflected that the Christie Commission stated that one of the major barriers to increasing preventative spending – that is, public spending that aims to prevent negative social outcomes from occurring in the first place – was the extent to which resources are currently tied up in dealing with short-term problems. The report warned that without a shift to preventative action, increasing demand would swamp public services' capacity to achieve outcomes.

76. This still holds true, over a decade later. Although it will be difficult, investing in preventative spending will be necessary to meet some of the Scottish Government's core outcomes. Recently the Auditor General and the Accounts Commission have reported on two areas where preventative spend in priority areas may be under pressure because of the cost of living crisis:

- The Scottish Government had significantly increased in investment in employability support for parents to reduce child poverty. In September 2022, this spending was reduced from £81 million to £29 million as part of the Emergency Budget Review statement.[47]
- The Accounts Commission's recent briefing on Scotland's councils' approach to addressing climate change reported that the cost of living crisis could lead to climate change activity being deprioritised or delayed by councils.[48]

77. In the recent Drug and alcohol services update, we highlighted that public health prevention programmes are cost-effective in drug and alcohol services, but it was not clear what percentage of spending in this area was targeted on early intervention and prevention. The Auditor General noted that over the last ten years since the Christie Commission report the focus has still been on short-term metrics for public services.[49] Preventative spend, like the reform agenda, will stop the problems Scotland is facing now from growing over time.

Covid-19 has shown that public bodies can change how services are provided – and at speed

78. The Covid-19 pandemic and the lockdowns that were implemented to reduce the spread of the virus completely changed what was possible in terms of providing public services, at the same time as individuals and communities needed entirely new forms of support.

79. In our work on public services' response to the pandemic, we have highlighted that public bodies worked well together to deliver new funding and work in different ways. As reported in the Covid-19: Vaccination programme briefing paper, excellent progress was made in rolling out the Covid-19 vaccination programme, and new digital tools were developed at pace to support this. In the Local government in Scotland: Overview 2021, the Accounts Commission noted that councils' working practices changed at a pace and scale 'that would have been considered impossible in the past'.

80. Since the pandemic, the number of challenges has multiplied, and uncertainty can make it harder to focus on the longer term and reform. However, the pandemic response has shown that change can be achieved quickly, and decisions can be taken in different ways with wider public participation (paragraph 85).

[47] Auditor General for Scotland and the Accounts Commission, Tackling child poverty, September 2022
[48] Audit Scotland, Scotland's councils' approach to addressing climate change, September 2022
[49] Auditor General for Scotland, Christie's clarion call can't wait another decade, September 2021

The public should be fully involved in the key decisions about how public services will need to change

81. The changes required to public services are significant, will be long standing, and will impact on people's lives. As such, it is important that citizens and communities are informed about the scale of the challenge and have a say in how services change.

82. The Accounts Commission's community empowerment and Best Value audit work has noted limited progress in citizen participation in budget processes, particularly for marginalised groups, for example in relation to participatory budgeting. The recent Tackling child poverty briefing paper reported that not enough involvement of children and families with lived experience of poverty are hindering the development of sufficiently targeted policies for tackling child poverty.

83. We have however found good examples of public engagement from our work on social security.[50] The programme continues to learn from existing benefit recipients through user experience panels and engagement with targeted client groups to inform its design decisions.

84. Empowering communities to participate in democratic processes can help to reduce disadvantage and inequality and improve outcomes for communities and individuals. There are many benefits of getting community empowerment and public participation right, as set out in our Principles of community empowerment work with scrutiny bodies in 2019. However, good public participation needs a lot of investment and capacity building to include a cross-section of the community, not just the most vocal, articulate, or resourced.

85. The Community empowerment: Covid-19 update found communities played a crucial role in the response to the pandemic. Public bodies can learn from this by encouraging public participation and adopting new ways of working. Issues to consider include:

- designing flexible governance and decision-making processes best suited to the communities they serve
- implementing more local decision-making structures with active local participation
- reducing the digital divide and continue to learn from and improve digital engagement with communities.

[50] Auditor General for Scotland, Social Security: Implementing the devolved powers, May 2019

It must be clear how changes in budgets affect performance if value for money is to be attained

86. It is important that it is clear how spending is affecting the outcomes the Scottish Government wants to achieve. In The 2020/21 audit of the Scottish Government Consolidated Accounts, the Auditor General noted that based on the current information published on Scottish Government spending and outcomes, it is hard to form an overall picture of the performance of the Scottish Government and assess whether the national outcomes are being achieved.

87. In its recent paper on the National Performance Framework (NPF), the Finance and Public Administration Committee (FPAC) set out some recommendations to better link budgets to outcomes. This highlighted the need to consider how money can be allocated (including through procurement and grants) based on the intended impact of the programmes it will fund and how these will contribute to the NPF. It also recommended looking at how funding can be used to incentivise different parts of the public sector to work together.[51]

Linking performance and budgets requires good quality data

88. To understand how to best target support and monitor how reform and change is affecting people, it is essential that public bodies have access to good quality and up-to-date data.

89. A lack of data limits public bodies' ability to target spending to where it is needed, as it is harder to understand and predict where demand for services will come from. For example, in recent outputs both the Auditor General and the Accounts Commission have highlighted some significant gaps in the outcome data available:

- The NHS in Scotland 2021 report (February 2022) highlights a lack of robust data in relation to health inequalities and the need for intersectional equality data. Without this data it will be hard to measure the impact of the cost of living crisis and find appropriate ways to target support.

- The Accounts Commission's Local government in Scotland: Overview 2022 highlights that a lack of up-to-date, publicly available data makes it difficult to assess the extent to which council activities have returned to pre-pandemic levels, the level of demand for services and levels of unmet need.

90. The national indicators that underpin the NPF give a measure of national wellbeing. Ideally, these indicators could be monitored in real time to evaluate the impacts of budget changes and prioritisations on the people of Scotland. However, many of the indicators reflect data from the pre-pandemic period, or have no data available at all.

[51] Finance and Public Administration Committee, Report on the National Performance Framework: Ambitions into Action, October 2022

91. Given that outcomes are long-term in nature, milestones are helpful in judging progress. The current lack of milestones for National Outcomes will make monitoring how changes to budgets impact on people and longer-term goals much more difficult. It also makes it harder for parliament and other bodies to scrutinise the work of public bodies and have assurance that spending is providing maximum value for money.

92. The Planning for outcomes briefing paper published in 2019 noted that for equalities and poverty outcomes, public bodies should consider whether the data they have is sufficient to measure the impact of decisions about services, funding and taxation on different equality groups affected.

93. Collecting this data will require both time and money, but will be an important step towards mapping spending to the aspirations of the Scottish Government. We have recently published a blog on data and the radical action needed in Scotland's public sector.

Conclusion

94. At the time of writing, the picture for the Scottish public spending is still developing. The UK Autumn Statement is expected 17 November, with the Scottish Budget 2023/24 budget to be announced in December. The Spring Budget Revision in the new year will set out the final budget for 2022/23. In March 2023, the Scottish Fiscal Commission will publish its first Fiscal Sustainability Report, which will give a long-term outlook for the Scottish Government's finances.

95. Audit Scotland will continue to monitor how the Scottish Government's financial position develops, through both financial audit work and performance audit work. The Auditor General will shortly publish the 2021/22 audit of the Scottish Government Consolidated Accounts, which will contain key information from the 2021/22 Consolidated Accounts and explain what they show about the Scottish Government's management of its budget.

96. This paper has set out the urgent case for the reform of public services. The Auditor General and the Accounts Commission will return to these issues through the forward work programme in the coming months. Examples of relevant planned work for 2023/24 includes performance audits relating to:

- Early learning and childcare
- Drug and alcohol services
- Social care
- Climate change.

97. For more information on planned outputs, please see our work programme. This is dynamic and regularly updated, meaning that we can respond to changing circumstances as required.

Scotland's public finances

Challenges and risks

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ISBN 978 1 913287 98 6 AGS/2022/10