

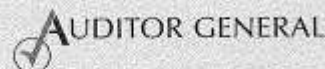
**CORRESPONDENCE FROM THE AUDITOR GENERAL FOR SCOTLAND,
DATED 4 MARCH 2013, ON AUDITING THE SCOTTISH RATE OF INCOME TAX**

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Iain Gray MSP
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Public Audit Committee
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1 March 2013

Dear Convener

Auditing the Scottish Rate of Income Tax

Thank you for your letter of 31 January requesting my comments on a number of areas relating to the Scottish rate of income tax.

1. Relationship between National Audit Office and Audit Scotland

Audit Scotland has a good working relationship with the National Audit Office (NAO) and we work together in a number of areas including the audit of the Whole of Government Accounts, European funding and the audit of the Forestry Commission. I set out below the origins and ways of working for each of these:

Whole of Government Accounts

The NAO are the lead auditors for the Whole of Government Accounts, which consolidate the accounts of the vast majority of public bodies across the UK. Scottish bodies are not covered directly by the legislation governing WGA but they participate by agreement between HM Treasury and the Scottish Government. Audit work by Audit Scotland is therefore also not covered by the WGA legislation but Audit Scotland has the power to provide audit services to public bodies under the Public Finance and Accountability (Scotland) Act 2000 (PFA Act), and this provides a legislative basis for the work.

Public bodies complete consolidation packs in a format determined by HM Treasury. The NAO issues instructions to auditors which Audit Scotland adapts for Scottish circumstances and issues to the auditors of Scottish bodies. Auditors provide audit opinions that the packs are correctly completed and are consistent with the audited accounts. The individual auditors' opinions are taken into account by the NAO in giving their overall opinion and report on WGA to the Westminster Parliament.

This work was originally undertaken by informal agreement but more recently a Memorandum of Understanding was drawn up to more formally set out the roles and responsibilities of each party. A copy of the MOU is attached for information.

European funding

The European Union requires an annual audit in each Member State of expenditure funded through the Common Agricultural Policy. In the UK the administration and accounting for those funds is a devolved matter and expenditure in Scotland is included in the Consolidated Accounts of the Scottish Government.

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Audit Scotland provides services to the Auditor General for Scotland and the Accounts Commission

The rules require a single audit opinion for the whole Member State and the NAO provide that opinion. Given that the expenditure has to be audited as part of the audit of each devolved administration's accounts it makes sense for there to be an arrangement whereby the auditors of the devolved accounts carry out the work necessary under EU rules. All the UK national audit agencies therefore work together under a common set of instructions, prepared by the NAO, to contribute to the overall opinion given by the C&AG. For this work reports are addressed to the NAO by the other audit agencies and are also available to the EU and its auditors.

Legislative cover for Audit Scotland to carry out the work is again provided by the PFA Act.

Forestry Commission

Prior to devolution the Forestry Commission was a single GB wide body based in Edinburgh and audited by the Scottish office of the NAO. After devolution forestry policy became a devolved matter and separate accounts were required for the Commission's activities in England, Scotland and Wales.

Whilst the Commission had operational arms in each country, its accounting remained largely in Edinburgh (although this has diminished over time). In accordance with normal auditing practice the NAO and the Wales Audit Office, as auditors of the English and Welsh accounts, seek assurance from Audit Scotland that the central finance systems are operating effectively. Audit Scotland auditors prepare reports on the operation of central systems addressed to the other audit agencies, who take them into account when forming an opinion on the accounts for England and Wales.

This work has been undertaken in accordance with the terms of an annual letter.

Other work

Audit Scotland and the NAO work together informally in many areas, with regular meetings of the Heads of Audit Agencies, the performance audit leads, the technical accounting and auditing leads and the corporate services leads. These meetings provide opportunities to discuss matters of common interest, to learn from each other and to agree approaches to issues that occur across the UK.

SRIT

At present I have adequate powers to report to you on any financial matters relating to the accounts of Scottish public bodies, but I have no right to access information held by UK bodies such as HMRC or the Office of Budget Responsibility. Similarly the Westminster C&AG has no explicit power or obligation to report to the Scottish Parliament.

For SRIT the degree of formalisation that might be necessary will depend to a great extent on the eventual requirements of the two Parliaments and Governments.

2. AGS and Audit Scotland auditing powers

As noted above Audit Scotland and I have extensive audit powers in relation to Scottish public bodies and their accounts under the Public Finance and Accountability Act. The current position in relation to audit reporting on the matters raised in your letter is as follows:

Borrowing powers of the Scottish Government

Both capital and revenue borrowing will appear in the accounts of the Scottish Government and/or the Scottish Consolidated Fund.

The amounts borrowed and repaid will therefore be subject to audit annually as part of the audit of those accounts, and any significant matters arising will be reported through the annual audit report to the Scottish Government's Audit and Risk Committee. I have the power to bring any matters arising from the audit of those accounts to the attention of Parliament by way of a report under section 22 of the PFA Act, and to report on the use of resources more widely under section 23.

Scottish cash reserve

The reserve is expected to operate in a similar way to the current Budget Exchange Mechanism, in that the Scottish Government will build up the reserve by not drawing down funds that are available for current spending in a given financial year. To access the reserve in a subsequent period, the amount to be drawn down will be added to the funding available to the Scottish Government for that period.

This means that the reserve is more closely related to the Budget setting process than to the annual accounts. The Committee may wish to consider whether additional information needs to be provided to Parliament when it considers the draft Budget and any subsequent Budget revisions, so that it can see exactly how much is available in the cash reserve, the Budget Exchange Mechanism and through borrowing, and the way in which each of these is planned to move over the financial year.

Office of Budget Responsibility forecasting, Scottish economic and SRIT data provided to the Scottish Government by HMRC

I will have access to all information supplied to the Scottish Government by the Office of Budget Responsibility and HMRC that is necessary for the purposes of an audit.

As with information on the cash reserve and borrowing, it will be important to ensure that this information is available to Parliament when the annual Budget and any subsequent revisions are being considered. At present I would not expect formally to audit and report on this information on an annual basis, although it will be an important consideration in any reports on the Scottish public finances that I may prepare.

Section 33 implementation reports

These reports will be produced annually by the Scottish Government and HMRC on preparations for the implementation of SRIT. Under the PFA Act I have the power to conduct examinations of the economy, efficiency and effectiveness with which Scottish public bodies have used their resources, and it would be possible to use those powers to conduct an examination of the preparations for the implementation of SRIT. Until the first of these reports have been produced it is difficult to predict where audit may best be able to add value.

In addition to any work that I may undertake in relation to the preparations for SRIT, the auditors of the Scottish Government, Registers of Scotland and SEPA will be monitoring the preparations for implementing the other new taxes introduced by the Scotland Act 2012 as part of their annual audit, and will raise any concerns through their annual audit reports. I have the power to bring any matters on those accounts to the attention of Parliament by way of a report under section 22 of the PFA Act, and to report on the use of resources more widely under section 23.

Block grant adjustments

The block grant moves each year for many different reasons; some of these are governed by a formula and others are subject to a degree of negotiation. These movements are not currently audited.

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The SRIT, once established, will give rise to an annual adjustment derived from the reconciliation of the amount forecast to be received in a previous year with the amount actually received. It is important that the adjustment is transparent to the Scottish Parliament and Government. I would therefore expect that the amount should be reconciled to the amounts appearing in the annual reports from HMRC on the operation of SRIT, and should also be separately shown in the annual Budget documents.

3. Transparency of Data

Transparent financial reporting is essential to the effective operation of Parliamentary scrutiny. My comments on the items listed by the Committee are as follows:

Borrowing

Under the current arrangements, borrowing by the Scottish Government for capital spending or to meet a shortfall between forecast and actual tax receipts would be reported in its accounts and/or the accounts of the Scottish Consolidated Fund, split between amounts due to be repaid within one year and those due to be repaid after more than one year. It would be good practice for the supporting note to the accounts to analyse this between borrowing for capital and other purposes.

Use of the cash reserve

As the cash reserve is essentially a budget construct it will not appear directly in any set of accounts. Transparency will be improved if its proposed use is included in budget documents presented to Parliament.

Income derived from SRIT

The income derived from SRIT is effectively an adjustment to the amount of the block grant, and it is not clear that it would be separately disclosed in the accounts of the Scottish Consolidated Fund. The budgeted split should be made available to Parliament as part of the Budget documents, together with the impact of any adjustment required as a result of differences between forecast and actual tax receipts in previous years.

The degree to which further legislation might be necessary will depend to a great extent on the eventual requirements of the two Parliaments and Governments. On the assumption that HMRC produce comprehensive annual reports on the operation of SRIT which are subject to audit and reporting by the NAO to the Scottish Parliament, then the need for further legislation would depend on the extent to which the Parliament expects me to report to it on the HMRC report and/or NAO audit report. As will be evident from my comments throughout this letter I believe that there needs to be more transparency about the sources of funding for public expenditure included in documents presented to Parliament, particularly at the Budget setting stage.

I would be happy to discuss this further with the Committee if you would find it helpful.

Yours sincerely



Caroline Gardner
Auditor General for Scotland

Dear Caroline

Auditing the Scottish rate of income tax

At its meeting on 30 January the Committee considered its approach to its report on the audit framework for the Scottish rate of income tax. At that meeting the Committee agreed that it would be beneficial for it to publish an interim report containing proposed recommendations on which it could seek views through an open call for evidence.

The Committee is grateful to you and Audit Scotland for your continuing dialogue with the Committee on this matter. In that regard the Committee agreed that it would be helpful if I wrote to you to seek written evidence on a range of issues which have been discussed informally. Your response will help inform the Committee's interim report and in turn we would welcome your views as part of the consultation on that interim report.

Relationship between National Audit Office and Audit Scotland

In oral evidence to the Committee on 22 November, you indicated that you and the National Audit Office (NAO) already have experience of working together in relation to a number of projects. In relation to your work in auditing European funding, the Forestry Commission, and whole of Government Accounts, the Committee would welcome further information on:

- how you work with the NAO (and how this relationship arose),
- whether this working relationship is underpinned by legislation or through some other form of agreement (or other mechanism);
- how the outcome of your working together is reported (and to whom)

The Committee would be grateful for any other examples of your working with the NAO that you consider might be relevant in relation to the auditing arrangements for the SRIT. The Committee would also welcome any views you may have on whether any future relationship between Audit Scotland and the NAO should be formalised and if so, how (such as through legislation or some form of memorandum).

AGS and Audit Scotland auditing powers

The Committee would welcome confirmation from you as to whether you would be able to provide audit reports to the Parliament on any of the following aspects of the financial powers arising under the Scotland Act 2012 (and if so, on what basis might you report, in what circumstances and to what frequency):

- Borrowing powers of the Scottish Government, specifically—
 - for capital spending;
 - for current expenditure (to manage potential deviations between forecast and overrun receipts);
- the Scottish cash reserve;
- Office of Budget Responsibility forecasting;

- Section 33 implementation reports (during implementation and during the transitional phase from 2016);
- Scottish economic and SRIT data provided to the Scottish Government by HMRC;
- block grant adjustments.

Transparency of data

The Committee would welcome your views on whether, under the current level of reporting, the Scottish Government's Accounts would report each of the following as a separate line within the accounts:

- borrowing for capital spending,
- borrowing for current expenditure;
- use of the cash reserve;
- income derived from the Scottish rate of income tax as distinct from income allocated by the block grant.

The Committee would welcome any other comments or observations that you would wish to make including any changes (such as legislative changes) you consider as necessary in order for you to undertake the audits you would propose in relation to the SRIT and to then report on those to the Scottish Parliament.

Whilst I acknowledge that work in in this area is ongoing (and that the final agreed Memorandum of Understanding has yet to be agreed and published) it would be helpful if you could respond to the Committee's request by Friday 28 February. However please do not hesitate to contact the clerk to the Committee should this deadline cause you difficulty, or you wish to discuss this further.

Yours sincerely

Iain Gray MSP, Convener