Developing financial reporting in Scotland

AUDITOR GENERAL

Prepared by Audit Scotland
July 2013

Auditor General for Scotland

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- examine how public bodies spend public money
- help them to manage their finances to the highest standards
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- further education colleges
- Scottish Water
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Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

Contents

Auditor General's statement

The financial environment for government in Scotland is changing. The Scotland Act 2012 is devolving new tax and borrowing powers to the Scottish Parliament, with the aim of increasing autonomy and strengthening accountability. And the debate about Scotland's constitutional future may lead to further financial powers. Both the Scottish Parliament and the Scottish Government are considering what arrangements are necessary to support this increased autonomy.

Transparent government accounts are a vital mechanism through which the public and the Scottish Parliament can hold the government to account for the money it spends and the services it provides. They can improve confidence in the public finances and provide important information to support decision-making.

The audited accounts of organisations across the devolved Scottish public sector are a sound base, containing valuable information about the amounts raised and spent by government and the assets and liabilities of public bodies. For example, the Scottish Government's consolidated accounts allow a comparison between the budget approved by the Scottish Parliament and the subsequent actual income and expenditure. However, there is currently no published picture of the assets and liabilities of the devolved Scottish public sector as a whole. The global financial crisis highlighted the importance of a thorough understanding of the public sector's assets and liabilities, and of the key risks to its financial position.

This report illustrates why publically reported information on the devolved Scottish public sector's assets and liabilities is important for accountability and decision-making, and discusses some of the issues they raise for the public finances. It focuses on the responsibilities currently devolved to the Scottish Parliament. It is based largely on information contained in the audited accounts of devolved Scottish public sector bodies, with an emphasis on their assets and liabilities.

The Scottish Government's financial reporting framework has continued to evolve since devolution, reflecting developments in recognised good practice. However, the changing financial environment suggests that this would be a good time for the Scottish Government to review, in discussion with the Scottish Parliament, the current arrangements. There is scope for the Scottish Government to further develop its financial reporting to make it more comprehensive and transparent. This report identifies four particular areas for the Scottish Government to consider how best to develop its financial reporting:

- **The long-term consequences of funding assets from borrowing or public private partnerships**
  Reductions in capital budgets mean the devolved public sector is increasingly using borrowing and public private partnerships to fund capital projects and build public assets. This allows repayments to be made over

the life of the asset. The Scottish Government will need to demonstrate that its investment plans are affordable, prudent and sustainable, and to ensure that any future borrowing is reported transparently.

- How forecasts and other estimates are made
  New tax-raising powers mean that the Scottish Government will, in time, bear the risk of tax receipts being more or less than forecast. It is important that the Scottish Government and the Office for Budget Responsibility can show that forecasts are soundly based and that the reasons for any variances between actual and estimated tax receipts raised are clear. In May 2013, the Cabinet Secretary for Finance, Employment and Sustainable Growth indicated that Scotland would require its own independent forecasting unit. Similarly the Scottish Government should be able to make information available about the key assumptions and risks associated with other valuations that appear in audited accounts, such as pension liabilities and provisions.

- How potential liabilities are assessed and monitored
  Audited accounts include the identification of potential future liabilities, which vary in their likelihood of occurring. The Scottish Government may need to ensure the continuity of vital public services if a third party provider is failing. It is important there is clear monitoring and reporting of these potential liabilities, including an assessment of the risks arising.

- The clarification of complex accounting issues
  The audited accounts of the Scottish Government contain several complex areas, for example the accounting treatment of student loans, that although consistent with the applicable accounting rules, can be difficult for the Scottish Parliament and the public to understand. Providing more transparent information on these areas and the future reporting of budget underspends within the new arrangements arising from the Scotland Act, would better support decision-making and enable effective scrutiny.

Comprehensive, transparent and robustly scrutinised public financial reporting will become increasingly important as the Scotland Act is implemented over the next three years and the Scottish Parliament attains its new fiscal and financial powers. This report provides a contribution to these considerations. It is important that:

- the Scottish Government engages further with the Scottish Parliament, Audit Scotland and others to discuss what changes to financial reporting may be necessary to support the implementation of the Scotland Act

- the Scottish Government gives further thought to how financial reporting needs to evolve in the longer term.

Caroline Gardner

Caroline Gardner
Auditor General for Scotland
July 2013

Part 1

Good financial reporting matters

1. This part of the report sets out why recent developments, at both a national and international level, increase the importance of the devolved Scottish public sector having good-quality financial reporting.

The devolved Scottish public sector covers a wide range of organisations and functions

2. The devolved Scottish public sector is responsible for a wide range of public services and for the management of the public funds needed to deliver them. The devolved Scottish public sector is made up of the public bodies that deliver services and policies in the areas of domestic policy where the Scottish Government is empowered to take decisions instead of the UK Government. This report draws together information on these public bodies for the 2011/12 financial year (Appendix 1). Our definition of the devolved Scottish public sector therefore includes:

- Scottish Government and its associated agencies, and Non-Departmental Public Bodies.
- The National Health Service in Scotland.
- Local government bodies, including councils and police and fire services.[1]
- Colleges which are incorporated under the Further and Higher Education (Scotland) Act 1992.
- Public corporations, such as Scottish Water and David MacBrayne Ltd.

accurate and robust financial information is a cornerstone of the good management of public services and finances

3. How these bodies are funded and their lines of accountability differ. The Scottish Parliament approves the budget of the Scottish Government and its associated bodies and how the block grant from the UK Government should be distributed. Accountable Officers are accountable for the use of these funds to the Scottish Parliament, while Scottish ministers are responsible to Parliament for policy decisions. The Scottish Parliament, via the Scottish Government, also provides local government with a significant proportion of its funding, but councils make their own spending decisions and elected members are accountable to the local population.

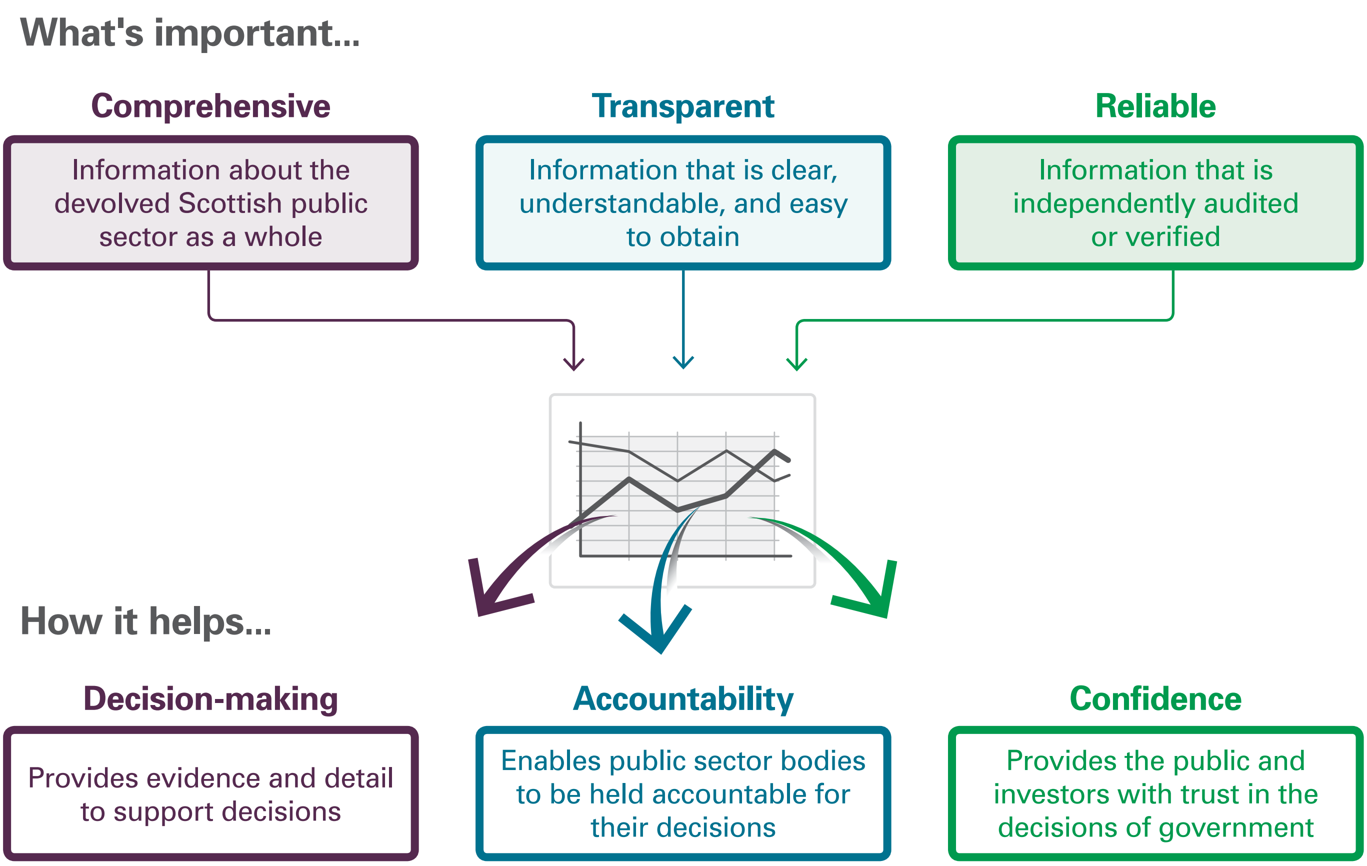
4. The UK's current budgetary control mechanism means that, apart from the budget exchange system which provides the devolved administrations with limited flexibility to carry forward unspent funding from one year to the next, the Scottish Government is unable to accumulate significant cash reserves to meet the cost of future liabilities.[2] This is in contrast to other public bodies such as councils where cash reserves may be accumulated in order to meet future cost pressures and other commitments.

Transparent, comprehensive and reliable financial information is important

5. Accurate and robust financial information is a cornerstone of the good management of public services and finances. The provision of comprehensive, reliable and transparent financial information by public bodies can help:

- support decision-making – by, for example, allowing decision-makers to analyse options and prioritise activities
- provide accountability – by, for example, allowing the Parliament to understand the rationale for decisions and to hold to account those responsible for the use of public funds
- generate public and other stakeholder confidence in the sustainability of public finances – by, for example, providing the public with information about how their taxes are being spent, and promoting investor confidence in Scotland's public finances (Exhibit 1).

Exhibit 1
The importance of transparent financial reporting



Source: Audit Scotland

6. The public reporting of financial information can take a number of forms, including audited annual accounts, budget documents and supporting materials, published plans, and statements to Parliament. Good financial reporting involves getting the right balance between these different methods, and ensuring that overall financial reporting meets users' needs. The audit process contributes to this by independently confirming the reliability of the annual accounts.

Financial reporting in Scotland has developed over time and continues to evolve

7. The devolved Scottish public sector receives the majority of its funding from the UK Government through a block grant, amounting to approximately £30.5 billion in 2011/12. The Scottish Government is the main recipient of the block grant, which is provided on an annual basis. The Scottish Government largely distributes its funding across the rest of the public sector to allow the devolved Scottish public bodies to meet expenditure in that financial year. Public bodies also generate funding from other sources such as taxes, fees and charges **(Exhibit 2)**.

8. Public bodies account for how they have spent this funding, including investment in assets, through their annual audited accounts. The format for the accounts has evolved over time reflecting changes in recognised good practice. For example:

- During the 1990s, central government bodies throughout the UK moved from preparing accounts on a ‘cash’ basis to an ‘accruals’ basis. Public bodies’ accounts now include, for example, estimates of the value of their capital assets, such as land and buildings, and their liabilities, such as obligations to make payments for goods and services received (known as creditors). The UK, including the devolved administrations, is one of only 14 EU member states to adopt full accruals accounting.[3]

- From 2009/10, public sector bodies changed accounting practices to produce annual accounts in accordance with International Financial Reporting Standards (IFRS). The presentation of accounts in a standard format is intended to promote comparability with other countries and the private sector.

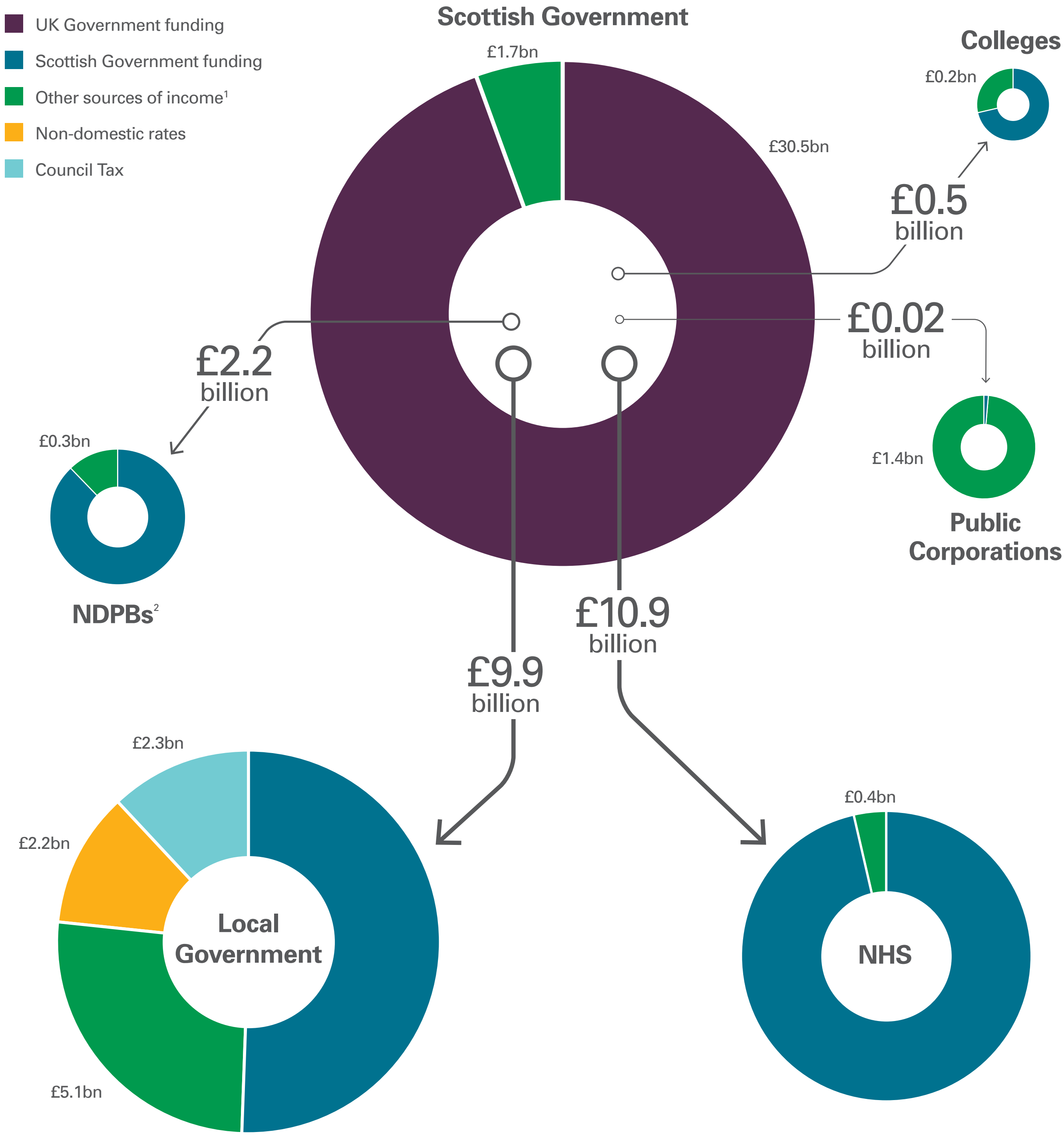
9. The establishment of the Scottish Parliament following devolution has led to the development of a clear budgetary control process intended to support budget scrutiny and to hold public bodies to account for the block grant and other money they receive:

- The Scottish Government is required to obtain annual approval for its expenditure plans from the Scottish Parliament. For example, the Scottish Government presents the Scottish Parliament annually with a three-year spending plan and an annual draft budget **(Exhibit 3, page 10)**.

- The Scottish Government consolidated accounts provide an analysis of outturn against its Scottish Parliament approved budget. The Scottish Government has a sound record of financial management, with outturn being reported within budget in each of the last seven years.

- The audited accounts are required to be presented annually to the Scottish Parliament within nine months of the financial year-end. The Scottish Government presented the 2011/12 accounts in September 2012, with clear audit opinions being issued in each of the last seven years.

Exhibit 2
The devolved Scottish public sector's sources of funding and income, 2011/12



Notes:
1. Other sources of income includes income from accounting adjustments which cannot be used to fund expenditure.
2. The Scottish Government funding for colleges is distributed by the Scottish Funding Council which is a NDPB. To avoid double counting, the £0.5 billion of Scottish Government funding for colleges is not included in the £2.2 billion to NDPBs.

Source: Audit Scotland analysis of 2011/12 annual accounts and Whole of Government Account returns

Exhibit 3

The Scottish Government's annual financial management cycle

Financial planning

Scottish Government reviews budget requirements based on variables including policy objectives, formula allocations, any spending review outcomes, and previous year outturn and reporting

Sep: Scottish Government publishes draft budget in September prior to start of financial year

Budget setting and approval

Scrutiny of draft budget by Scottish Parliament led by Finance Committee, with subject level scrutiny by individual subject committees, who can request any additional information

Dec: Finance Committee report on draft budget in December

Jan: Budget Bill introduced in January and subject to Scottish Parliament debate. Bill usually receives Royal Assent in March

Operation and monitoring

Monthly monitoring of outturn against budget

Autumn/Spring: Budget revisions (usually in autumn and spring) submitted to Scottish Parliament for approval

Reporting, audit and scrutiny

Jun: Provisional outturn against budget presented to Scottish Parliament in June following end of financial year

Sep: Audited Scottish Government consolidated accounts presented to Scottish Parliament and published usually around September

Dec: Cabinet Secretary lays statement on audited outturn for the Scottish Administration before the Scottish Parliament in December

Source: Audit Scotland

10. Since devolution, the Scottish Government has also introduced a number of measures, aimed at enhancing the transparency of information about the devolved Scottish public sector's finances. These include:

- Providing more detailed analysis of its portfolio spending plans to support Scottish Parliament budget scrutiny.
- Contributing to HM Treasury's initiative to develop Whole of Government Accounts (WGA) for UK public bodies to support transparency, increase accountability, and aid long-term fiscal analysis.[4]
- Publishing annually statistical analysis of total public sector expenditure and revenue for Scotland. This includes details of expenditure and revenue of the devolved Scottish public sector alongside estimates of the share of expenditure and revenue incurred and generated for Scotland by UK-wide bodies.[5]
- Publishing an Infrastructure Investment Plan showing the projected investment by the Scottish Government, its agencies, the NHS, central government, and investment by local authorities in the school estate. The Scottish Government also provides an update to the Scottish Parliament's Public Audit Committee on progress of individual capital projects every six months.

The global financial crisis highlighted why transparent, comprehensive and reliable financial information is important

11. The recent global financial crisis highlighted that the performance of the wider economy can have a major impact on the financial position of the public sector. For example, many national governments decided to provide financial support to ailing banks in an attempt to protect consumers, boost investor confidence and ensure funds were available for lending.

12. The financial crisis also underlined the importance of the public sector having comprehensive and transparent financial information. The Spanish government, for example, lacked comprehensive financial information about the total level of borrowing across all parts of the public sector. When tax income fell in Spain as a result of reduced business trading and higher unemployment, local government bodies were unable to afford to repay their borrowings, leaving central government to repay the debt by default.

13. There are clear differences in the organisation of government between Spain and Scotland and the financial difficulties encountered in Spain and elsewhere have not been replicated in Scotland. However, this example highlights how important it is for government to have comprehensive and transparent financial information.

Changes to the Scottish financial environment provide opportunities to consider how financial reporting can be further developed

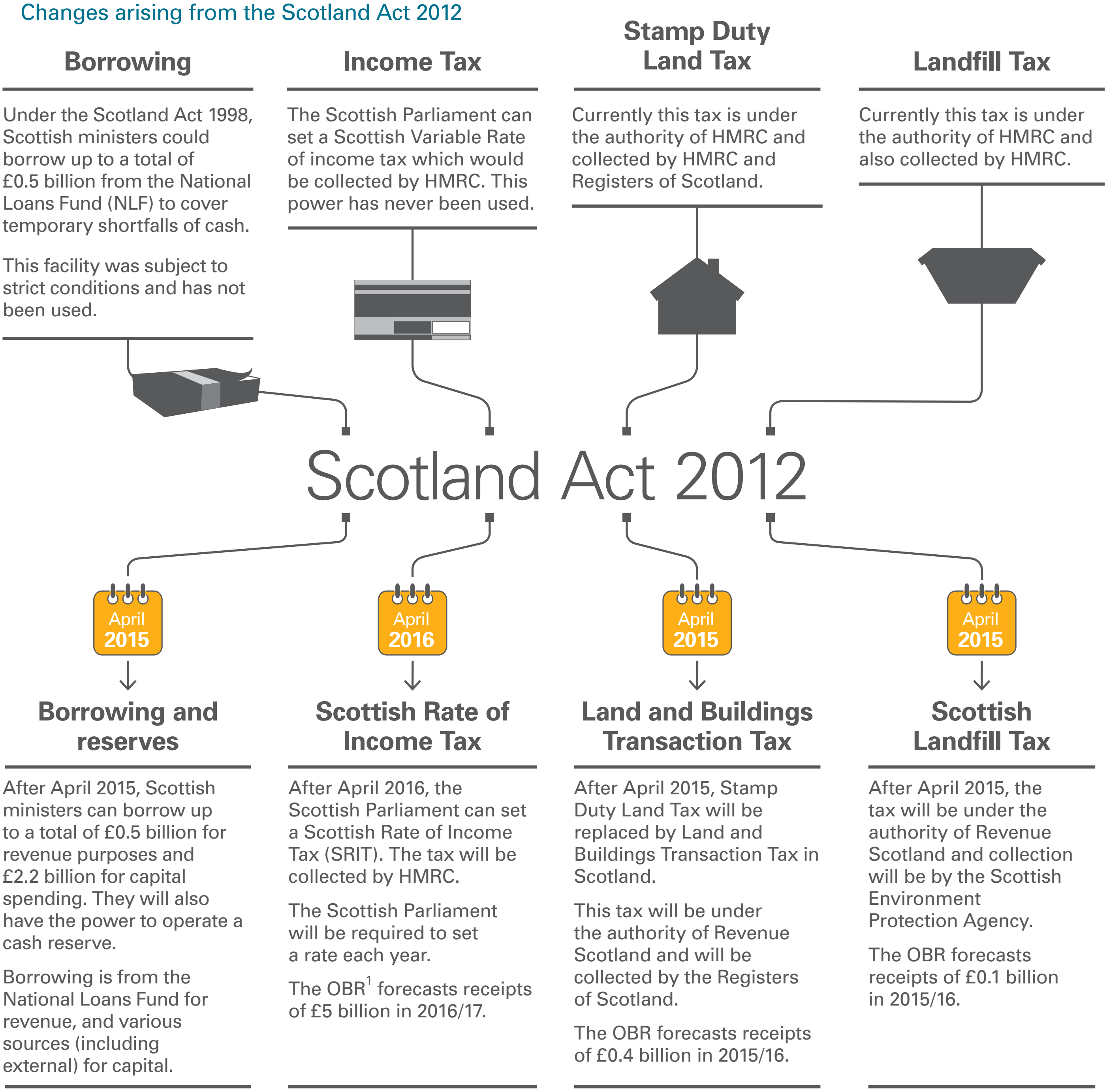
14. The Scotland Act 2012 (the 2012 Act) introduces significant changes to how the Scottish Government is funded. These changes are expected to come into force from April 2015. The Scottish Government will raise an proportion of funding through a land and buildings transaction tax and a landfill tax from 2015 (Exhibit 4, page 12). From 2016, a new Scottish rate of income tax (SRIT) will be set by the Scottish Parliament and collected by HMRC, with tax receipts paid over with the block grant. The UK Government will reduce the level of block grant to Scotland in recognition of the receipts from the devolved taxes and the SRIT. The 2012 Act also provides Scottish ministers with increased borrowing powers and the authority to establish a financial reserve.

15. The changes will bring greater fiscal autonomy to Scotland but will also introduce greater variability into its finances. In particular, Scotland's economic performance is likely to influence the amount raised through these taxes and ultimately the Scottish Government will bear the risk of tax receipts being more or less than forecast. This will have significant implications for wider policy-making. The Scottish Government will require good-quality financial information in relation to the tax base and factors affecting receipts to aid decision-making, as well as to provide the Parliament and public with confidence in the accuracy of its forecasts. Any changes to Scotland's status following the outcome of the 2014 referendum will only enhance this need.

16. The changing financial environment provides an opportunity for the Scottish Government to consider where financial reporting can be further developed. While the Scottish Government and other public sector bodies produce audited accounts, they do so individually. It would require the consolidation of over 100 sets of accounts, with appropiate adjustments for transactions between public bodies, to determine the assets and liabilities of the devolved Scottish public sector as a whole.[6] The provision of comprehensive, reliable and transparent financial information on the devolved public sector's assets and liabilities can help:

- encourage a shared understanding of how best to fund future service provision and investment, particularly in the light of current declining budgets
- generate investor confidence in the long-term sustainability of the public finances so that Scotland can borrow at competitive rates in the future
- demonstrate a clear understanding of the wider financial risks facing the public finances.

Exhibit 4
Changes arising from the Scotland Act 2012



Note: 1. Forecasts as published by the Office of Budget Responsibility: *Scottish tax forecasts*, March 2013.
Source: Audit Scotland

Part 2

Audited accounts highlight some issues and risks for future budgets

17. Audited accounts are a key source of financial information which support public accountability and confidence that the public finances are being managed well, and help inform decision-making. While public sector accounts are prepared in accordance with International Financial Reporting Standards, there is scope to further develop existing financial reporting in the accounts, and to supplement this with additional analysis where necessary. To illustrate this, this part of the report examines some of the issues and risks for future budgets associated with the more significant assets and liabilities held by Scottish public bodies.

Scotland's devolved public sector has significant assets and liabilities

18. In order to deliver vital public services such as healthcare and education, public bodies need a range of assets including hospitals and schools. Providing these services and purchasing or building assets also creates liabilities for the public sector. For example, public sector assets may be financed from borrowing, and employing staff creates longer-term obligations such as pension liabilities. Public sector bodies report their assets and liabilities in their annual accounts (Exhibit 5, page 14).

19. Based on our analysis of the 2011/12 audited annual accounts of individual public bodies, devolved public sector bodies in Scotland had total assets valued at approximately £86 billion at March 2012, with total liabilities of £94 billion (Exhibit 6, page 15).

20. Our analysis of the devolved Scottish public sector's assets and liabilities needs to treated with some caution for a number of reasons:

- The analysis reflects the current constitutional status of Scotland within the UK. We did not, therefore, include items such as Scotland's share of the UK national debt, its share of the assets and liabilities of the Principal Civil Service Pension Scheme or UK defence assets based in Scotland. Any future assignment of Scotland's share of these balances would be subject to negotiation between the Scottish Government and the UK Government.

- The analysis is only an approximation as it includes some balances which are the result of financial transactions between different Scottish public sector bodies, but which are not identified separately in the accounts. We have also not included small public bodies spending less than £10 million per annum, such as criminal justice authorities and joint valuation boards.

- In accordance with accounting standards, the valuation of many of these assets and liabilities are based on estimates or other judgements, and there can be instances when the basis of estimating the value of the same type of asset or liability differs between public bodies. For example, councils

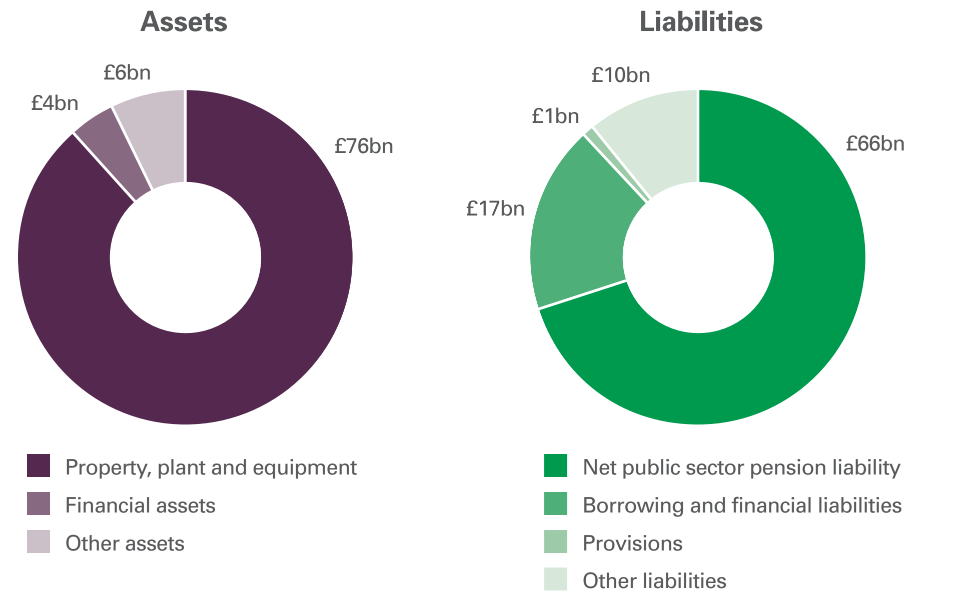
the valuation of some assets and liabilities is uncertain, increasing the importance of having transparent, comprehensive and reliable financial information

Exhibit 5
Description of assets and liabilities in the devolved Scottish public sector

Assets Resources controlled by the public sector from which future benefit can be generated		
	Description	**Basis of valuation**
Property, plant and equipment (PPE)	Includes schools, hospitals, council houses, road networks, vehicles, medical equipment.	Basis of valuation may differ according to type of PPE asset and sector. For example, Scottish Government-owned trunk road network is valued at depreciated replacement cost. Councils' local roads are valued at historical cost. Assets which are valued according to a market value are subjected to periodic professional revaluation,usually every five years, with index-based updates in other years.
Financial assets	Includes student loans, funds on deposit, and investments in shares and equity.	Valued at financial year-end, based on a snapshot of the position at that time. Where a future benefit is due, an estimate is made of the current value of the future payment.
Other	Including cash at bank, trade receivables (debtors) and stock.	Valued at financial year-end, based on a snapshot of the position at that time.
Liabilities Obligations on the public sector arising from past transactions or events		
	Description	**Basis of valuation**
Net public sector pension liability	Includes the pension liability on the NHS and Teachers' pension schemes, and also the net liability apportioned to local government organisations from the local government pension schemes. Excludes any share of the pension liabilities of the UK-wide Principal Civil Service Pension Scheme.	Usually valued every three to five years by an actuarial expert on the basis of a number of assumptions and variables such as life expectancy and discount rate used.
Borrowing and financing liabilities	Includes borrowings by local government and also liabilities arising from Public Private Partnership contracts, ie future repayments.	Valuation takes account of the current value of the total amount repayable over a number of years. Changes to the discount rate can affect the valuation.
Provisions	Provisions are estimates of future expenditure that an organisation is likely to have to make as a result of past decisions.	Valuation is an estimate by the management of the organisation, with appropriate expert assistance where required.
Other	Including trade payables (creditors), and lease obligations.	Valued at financial year-end, based on a snapshot of the position at that time.

Source: Audit Scotland

Exhibit 6
The devolved Scottish public sector's assets and liabilities



Source: Audit Scotland

currently value local roads at their historical cost, whereas Transport Scotland values its trunk roads at depreciated replacement cost. If councils were to value local roads using the same methodology as Transport Scotland, they estimate that the value of these assets could increase from £5 billion to £55 billion.

- Not all public sector liabilities are payable at the same time. For example, pension liabilities are accrued over the working lives of employees and will not fall due for payment until their retirement, in some cases 30 or more years into the future. The pension will then be payable over the retired employee's remaining life.

21. While the net difference between assets and liabilities is a useful indicator of the overall financial position, a net liability position does not necessarily mean that there are immediate risks to the financial sustainability of the devolved Scottish public sector. However, governments need to be aware of, and manage, the net financial position. A net liability which is allowed to continually increase may not be affordable in the long term. Our analysis serves to highlight that the inherent uncertainties associated with the valuation of some assets and liabilities increases the importance of having transparent, comprehensive and reliable financial information. This allows the key issues and risks arising from public sector assets and liabilities to be understood and managed.

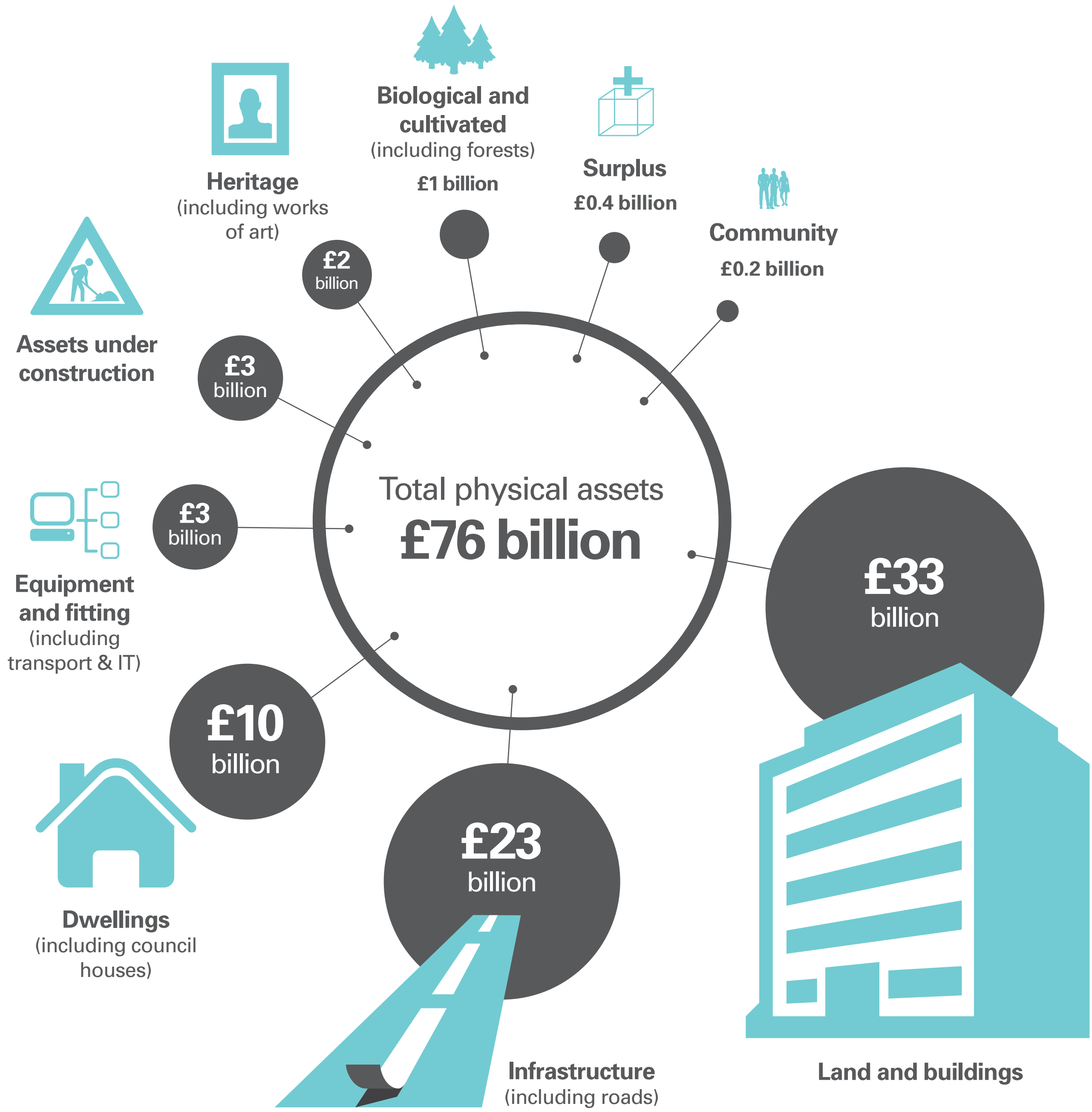
Owning assets creates opportunities and risks

The public sector needs well-maintained physical assets to support public service provision

22. Of the £86 billion of assets recorded in the 2011/12 accounts, physical assets such as schools, roads and hospitals make up some £76 billion (88 per cent)

(Exhibit 7). These assets are used to deliver a wide range of services and policy decisions can affect demand for them. For example, judicial sentencing policy can influence the demand for prison places, while reducing class sizes could result in extra demand for school class rooms. Decisions about future investment in assets are important, as they often involve significant amounts of money and are central to the provision of public services. These decisions also have long-term consequences, as choices over areas such as the type of building and their location can affect the way services are provided. The way asset investment is funded can also affect how future budgets are spent.

Exhibit 7
The devolved Scottish public sector's physical assets by value



Source: Audit Scotland

23. Public sector bodies also need to consider how demand and usage of physical assets affect their condition and future maintenance requirements. Previous audit reports have highlighted significant maintenance backlogs in parts of the public sector, including the NHS and local government, and how they could improve the quality and the information they use on the condition of their assets. For example:

- The 2009 Auditor General for Scotland report on asset management in the NHS highlighted that the sector lacked an overall picture of the condition of its estate but estimated that some £512 million would be needed to deal with all outstanding estate maintenance issues.[7] The Scottish Government subsequently reported in December 2012 that the NHS spent £114 million on property and facilities maintenance during 2010/11 but that the maintenance backlog now stood at £773 million (excluding £175 million which was required to address maintenance backlogs in buildings due to be disposed over the next ten years).[8]

- The 2009 Accounts Commission report on asset management in local government highlighted that the sector owned £13 billion of property assets but 27 per cent of these were in poor or bad condition.[9] Due to poor information, only 23 councils could report the size of their maintenance backlog but this amounted to £1.4 billion of which £376 million was needed urgently. Overall, many councils lacked effective scrutiny of their property assets.

- The 2011 joint Auditor General for Scotland/Accounts Commission report on roads maintenance highlighted that the condition of Scotland's roads has declined since 2005.[10] Only 78 per cent of trunk roads and 66 per cent of council-maintained roads were in acceptable condition in 2010, compared to 84 per cent and 70 per cent respectively five years earlier. The estimated cost of removing all network defects had risen in real terms, that is allowing for inflation, from £1.24 billion in 2004 to £2.25 billion in 2010.

24. The devolved Scottish public sector has incurred significant investment over the last few years on new and replacement assets. While this may have helped reduce maintenance backlogs, public bodies still need to consider the potential impact on service provision of maintenance backlogs, and how best to prioritise expenditure. Public bodies may decide to delay short-term expenditure on maintaining assets. If they do, they must be aware of how this might affect the long-term condition of the assets and the way they are used to support service provision. It is also important that public bodies identify assets that are no longer required in order to save on maintenance spending and also to consider opportunities to generate additional investment funding from their disposal.

Public bodies also lend money and undertake investments

25. The Scottish public sector owns a range of other assets which result in it receiving income, and other public benefits, over a number of years. These often vary between different public bodies according to how they are funded and the purpose to which the asset is put:

- The Scottish Government and other public bodies sometimes lend funds and make equity investments to support the delivery of policy objectives. Examples include Scottish Government lending to Scottish Water to support improvements in the quality of drinking water and wastewater treatment, and to students to support attendance at colleges and higher education institutions. Similarly, Scottish Enterprise invests in new and expanding private sector businesses as part of its role to support economic development.

- Unlike most other public bodies, councils are permitted to accumulate cash-backed reserves which are used to ensure stability in cash flow, to build up funds for predicted cost pressures, and as a contingency for unforeseen expenditure. Councils may also take advantage of beneficial interest rates and borrow in advance of immediate need to fund planned investment. Councils often put these cash reserves on deposit or invest in shares and equity in order to generate extra income from interest and dividend returns.

26. These assets create a range of issues and risks where more financial transparency, in addition to that currently provided in audited accounts, would be useful. For example, the Scottish Government's consolidated accounts 2011/12 show that the balance of loans outstanding with Scottish Water was £2 billion as at 31 March 2012.[11] During 2011/12, the Scottish Government provided Scottish Water with £0.2 billion of new loans and received £0.1 billion in loan capital repaid. Currently, annual budget documents only show net lending, that is new loans expected to be provided minus loans due to be repaid by Scottish Water.

27. Similarly, the Scottish Government bears the risk of non-repayment of student loans. Its consolidated accounts 2011/12 show that the total balance of outstanding student loans stood at £2.7 billion at 31 March 2012. However, it estimates £539 million of this will not be repaid as a result, for example, of students defaulting on loan payments or those who, after leaving education, do not earn more than the current threshold of £15,795 per annum when loans become repayable. The non-repayment of student loans has implications for some budgets which bear the cost of the write-off of bad debt, and also for future revenue streams.

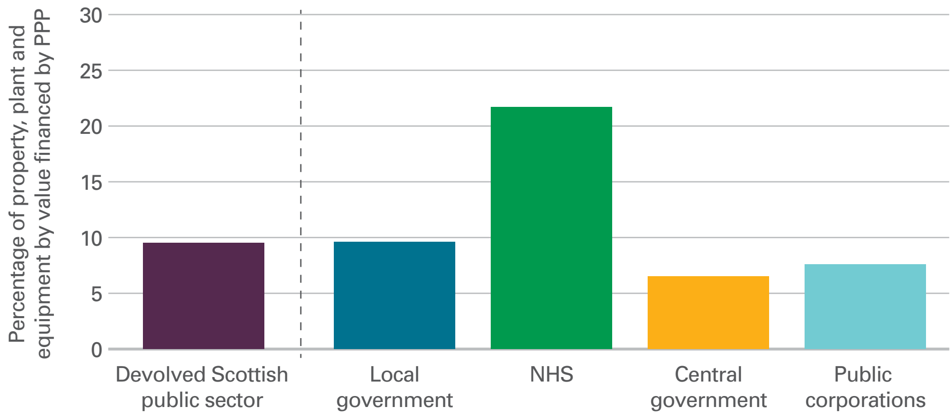
28. Councils owned £0.6 billion in shares and equity and also had £0.5 billion on deposit at March 2012. The Scottish Government permits councils to invest funds provided that investments are managed in such a way to minimise the risk to the sum invested and to maximise returns.[12] To help manage these funds, the Scottish Government requires councils to prepare an Annual Investment Strategy for each year detailing an assessment of the level of risks associated with each investment and how they are to be controlled. Councils are also required to produce an Annual Investment Report providing an objective evaluation of performance against their investment strategy.

The way assets are funded creates longer-term financial liabilities

29. Capital grants have long been the traditional method by which public bodies funded investment in assets. However, public sector spending constraints mean that certain areas of the public sector are increasingly looking beyond capital grants, and also using borrowing or private finance to fund assets. Both these funding methods mean that the costs are met from revenue budgets over a number of years.

30. During 2011/12, only local government, public corporations and colleges could borrow to fund capital investment. Central government and the NHS are making increasing use of private finance to fund new capital investment. For example, the NHS has used private finance to fund 22 per cent by value of its current property, plant and equipment portfolio, compared to ten per cent for local government (Exhibit 8, page 19).

Exhibit 8
The proportion of property, plant and equipment assets funded by Public Private Partnerships



Note: Excludes colleges.
Source: Audit Scotland

The devolved public sector is making more use of private finance

31. Scotland's public sector asset base currently includes 93 assets funded as a result of Public Private Partnerships (PPPs), including new hospitals, schools and waste management plants. These projects have a combined estimated capital value of £6.1 billion.

32. In summary, PPPs involve the private sector agreeing to build and maintain an asset that the public sector will use (Exhibit 9, page 20). In return, the public sector makes payments to the private sector supplier over the life of the contract. These charges represent capital and interest on the loan the private sector is assumed to have taken on to afford the construction cost, maintenance, and other service charges, eg catering, portering and cleaning. For the 93 PPP projects currently operational, the public sector has already paid an estimated £5.6 billion in charges for these assets, including £0.9 billion in 2011/12. Public bodies will pay further charges of an estimated £27 billion over the rest of the life of these contracts, including £15.6 billion in capital and interest (Exhibit 10, page 20).[13] Annual charges on current operational projects will peak at £1.2 billion in 2025/26.

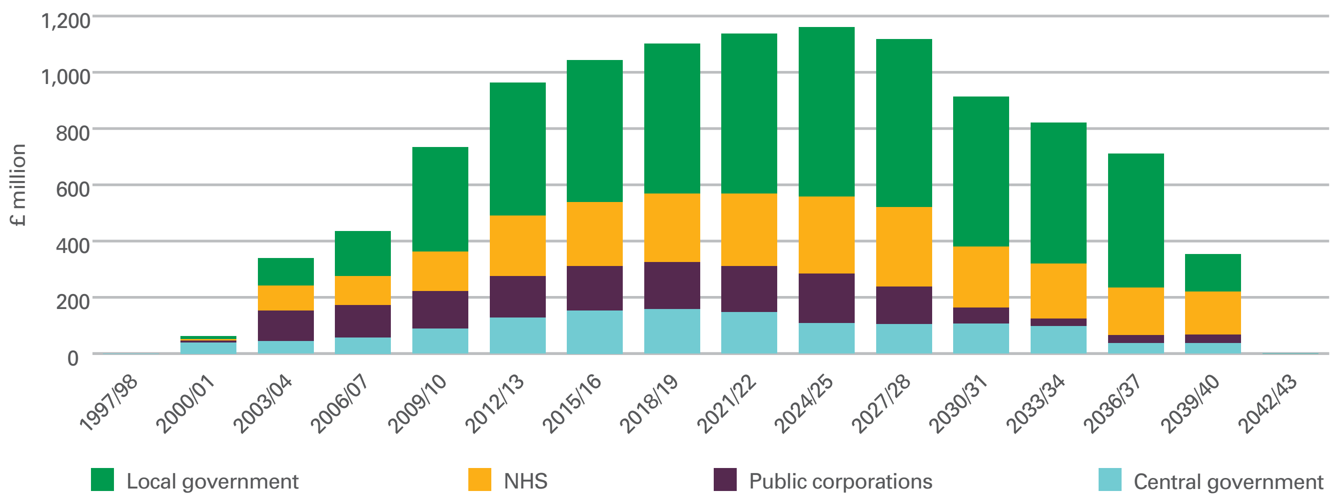
33. The Scottish Government's 2011 Infrastructure Investment Plan, and subsequent updates, shows that the public sector will continue to use private finance to pay for building some assets in the future.[14] There are 103 projects listed in the infrastructure investment plan, and 84 have an estimated capital value assigned. Of these, 53 are expected to be revenue funded. The Scottish Government estimates the capital value of these 53 projects at £3.1 billion, compared to £6.5 billion for the estimated capital value of all 84 projects. Annual service charges for PPP projects can therefore be expected to increase over time, both in absolute terms and as a proportion of revenue budgets.

Exhibit 9
Explanation of Public Private Partnerships

Public Private Partnerships (PPP)	A generic term for projects involving both the public and private sectors. Public and private sector partners agree a contract which involves the private sector building and maintaining an asset that the public sector will use over a set period of time, with annual charges being paid from the public sector body's revenue budget. Generally used as an alternative to grants and borrowing to finance capital investment in the public sector. Can take different forms, see below.
Private Finance Initiative (PFI)	Under PFI contracts the private sector partners pay the up-front costs of building the asset and ongoing maintenance costs in return for annual payments from the public sector. Contracts are usually for 25 to 30 years after which the asset either remains with the private sector or is transferred to the public sector.
Non-profit distributing (NPD)	Similar to PFI, NPD contracts involve the private sector paying the up-front construction cost of the asset and ongoing maintenance costs. However, NPD contracts limit the profits that the private sector company may retain and any surplus profit is reinvested in the public sector.

Source: Audit Scotland

Exhibit 10
Estimated annual PPP charges for PPP projects currently in progress, over the period of the contract



Source: HM treasury

Councils are making increasing use of borrowing to fund capital investment

34. The CIPFA Prudential Code provides a framework for councils within which each council is free to set its own borrowing limits. The level of borrowing by each council must be considered in the context of its overall financial strategy and circumstances. For example, the decision to transfer housing stock to another landlord will have a significant effect on a council's borrowing. Councils' annual capital investment has increased from £1.8 billion in 2004/05 when the Code was introduced, to £2.4 billion in 2011/12. The proportion of this investment funded by borrowing has doubled during this period, from 27 per cent in 2004/05 to 54 per cent in 2011/12.[15] At March 2012, councils had total borrowings of £10.5 billion.

35. In a time of reduced budgets, borrowing and PPP can be used to support investment, but their effect is to create longer-term financial commitments and to reduce decision-makers' flexibility in how future revenue budgets can be used. This increases the importance of public bodies having transparent financial information which allows them to consider the long-term affordability of financing physical assets from revenue budgets, and balance short-term and long-term benefits. To help achieve this balance, in 2011 the Scottish Government set a limit that future revenue payments for major investment projects should not exceed five per cent of its estimated capital and revenue budgets. Our report on *Scotland's key transport infrastructure projects* highlighted the importance of the Scottish Government demonstrating that these projects are affordable in the long term.[16]

Uncertainties over the valuation of many significant liabilities need to be monitored

36. The public sector usually knows the valuation of liabilities such as future PPP charges and borrowing because they are part of a contractual agreement. The valuation of other liabilities, including pension liabilities and provisions, often involves significant uncertainty. For example, the valuation reflects the value of the liability at a particular point in time, ie the financial year-end. In accordance with accounting standards, the valuation may also need to be based on estimates. As a result, depending on the assumptions used, the estimated value of liabilities may change from year to year and require ongoing monitoring.

Public service pension liabilities are significant

37. Public sector employers and employees contribute to one of six main pension schemes in Scotland, each with their own funding and administrative arrangements. The Local Government Pension Scheme is the only funded scheme, meaning that pension contributions are used to both pay current pensions and to invest in assets with the intention that investment returns are used to help meet the long-term cost of pensions. The other five pension schemes are unfunded, such that employer and employee contribution rates are set by HM Treasury and used to meet current pension costs but any unused cash balances are not invested.

38. The accounts of Scottish local government bodies include a share of the assets and liabilities of the relevant Local Government Pension Scheme. The accounts of the NHS Scotland pension scheme and the Scottish Teachers' pension scheme, showing their total assets and liabilities, are laid before the Scottish Parliament. However, the Principal Civil Service Pension Scheme (PCSPS) is a UK-wide scheme and the Scottish public sector's share of the assets and liabilities of the PCSPS is not readily available. We have therefore excluded them from the pension net liability amount of £66 billion shown in Exhibit 6.

39. Public sector pensions are earned according to pay and length of service. When accounting for the cost of pensions, organisations are required to account for retirement benefits at the time that they commit to paying them, even if the actual payment will not be made for several years. Therefore, each public body includes in its annual accounts an estimate of the long-term cost of meeting its pension liabilities. The value of the pension liability can be affected by changes in the number of members, or actuarial adjustments to average life expectancy. Changes in interest rates can also affect the financial assumptions made in the estimate. The valuation of pension assets and liabilities is used to inform employer and employee contribution rates, and therefore has an impact on future budgets.

40. The UK Government is currently introducing reforms to public sector pension schemes which will also apply to Scotland. Changes include:

- increasing employee contributions over a three-year period, starting in 2012/13 (excluding the Local Government Pension Scheme)
- equalising normal pensionable age with the state pension age (except for police and fire service personnel who will be able to receive a pension at age 60)
- linking future inflationary pension increases to the Consumer Price Index, instead of the Retail Price Index (this came into effect in April 2011)
- introducing, from April 2015, new pension schemes whereby annual pensions will be calculated based on career average revalued earnings (CARE) instead of final salary.

41. The Office for Budget Responsibility (OBR) has estimated the effect of these changes. It calculates that overall UK gross spending on public service pensions will fall from the current 2.3 per cent of Gross Domestic Product (GDP) to between 1.3 and 1.5 per cent of GDP by 2061/62.[17] Inevitably, there is a significant degree of estimation involved in the OBR's calculations and much will depend on factors such as future investment performance. However, pension costs are likely to remain a significant proportion of total public sector spending which will require the Scottish Government to monitor them on an ongoing basis.

Scottish public sector bodies' accounts include provisions of £1.1 billion

42. Annual accounts include estimations of future expenditure that public bodies may have to make as a result of past decisions. Provisions are included in the accounts as liabilities when payments are probable and their value can be reasonably estimated. Where there is less likelihood that a public body will need to incur expenditure, or if the amount of expenditure cannot be reasonably estimated with sufficient certainty, then the accounts disclose contingent liabilities as a narrative note.

43. Devolved Scottish public bodies had provisions of £1.1 billion at March 2012. The most significant provisions and contingent liabilities in the public sector are:

- Equal pay cases. A total of 25 councils have provisions for equal pay totalling £106 million at March 2012. Local government bodies have also paid out £475 million to date to settle equal pay claims. The NHS has received over 10,000 claims but two recent legal test cases have reduced the number of equal pay claims from NHS employees which are likely to be successful. NHS bodies are unable to reasonably estimate the potential cost of these claims, and therefore only recognise equal pay claims received as a contingent liability.
- Early severance costs. Scottish public bodies recognised provisions totalling £261 million for early severance costs in March 2012, as they seek to restructure in the face of declining budgets. We published a report on managing early departures in May 2013 which identified that £561 million had already been paid for early departures in 2010/11 and 2011/12.[18] We also plan to publish a further report on how the public sector is reshaping its workforce later in 2013.

- Clinical negligence. NHS bodies recognised provisions for clinical negligence of £210 million as at March 2012. Most NHS bodies also included some clinical negligence claims as contingent liabilities in their accounts, due to higher levels of uncertainty on these claims.

- European Union funding repayments. The Scottish Government has a provision of £80 million for potential repayments of EU funding, which are subject to negotiation.

44. The creation of a provision reflects public bodies' best estimate of the cost of future liabilities. However, by their nature, there is still uncertainty over whether a provision will need to be paid, the final amount to be paid, and on the likelihood of a contingent liability being realised. It is important that there is transparency over these key uncertainties across the public sector, so that the level of risk posed to public bodies is understood and used to inform future budget decisions.

The Scottish Government may need to act to maintain service provision if a provider is failing

45. Public bodies disclose in their annual accounts details of explicit guarantees and indemnities provided to third parties. These are often given to recognise the financial risks that a third party may face as a result of it being associated, either directly or indirectly, with delivering public sector services or policies. Before granting any guarantee or indemnity over £1 million, the Scottish Government must get the prior approval of the Scottish Parliament. The Scottish Government's consolidated accounts 2011/12 detail a number of circumstances where it will provide financial support or compensation. For example, the Scottish Government has provided guarantees or indemnities to the following:

- The Organising Committee of the 2014 Commonwealth Games for any economic shortfall incurred arising from the preparation for, and hosting of, the Games. This is unquantified in the Scottish Government's consolidated accounts 2011/12 as the value of any shortfall will not be known until after the Games take place.

- Owners of objects lent to the national galleries, museums and libraries for the purpose of exhibition: indemnities of £1.1 billion are noted in the consolidated accounts as potential compensation for damage or loss suffered.

46. As the principal public sector body in Scotland, the Scottish Government may also need to manage other financial risks and consider whether it may become, in effect, a funder of last resort for other bodies which get into financial difficulties. In 2011, for example, the collapse of Southern Cross Healthcare created significant difficulties for councils in securing continuity of care home provision. The same year, the Scottish Federation of Housing Associations estimated that the UK Government's welfare reform measures will adversely affect the income of around 20 per cent of housing association tenants, with implications for the financial stability of social landlords.[19] Should any of these organisations get into financial difficulty, the public sector may need to step in with financial and other assistance to secure continuity of services.

Part 3

Opportunities to further develop financial reporting

47. The Scotland Act 2012 will deliver important changes to the way the devolved Scottish public sector is funded and provides a useful opportunity for the Scottish Government, in discussion with the Scottish Parliament, to consider how best to develop its financial reporting arrangements. Audited accounts will remain a key way of reporting financial information. International accounting frameworks and standards help to ensure that they are prepared objectively and can be compared across different organisations. However, this can mean that they are hard to understand by a lay reader, and there is scope to further develop existing financial reporting in the accounts, and by supplementing this with additional analysis where necessary. This part of the report identifies areas where better commentary within the accounts and other reports could make financial information more comprehensive and transparent. This could aid decision-making, improve accountability and give the public and future investors increased confidence in public sector finances.

> the Scotland Act 2012 provides a useful opportunity for the Scottish Government to consider how best to develop its financial reporting

Understanding the long-term consequences of investment decisions is important

48. The use of borrowing and PPP to fund an increasing proportion of new investment in physical assets has long-term consequences for public sector revenue budgets. The Scottish Government will need to consider the information available in its overarching infrastructure investment plans to provide assurance that they are financially sustainable. The following features of investment plans likely to become increasingly important:

- What assets are currently owned and how they are to be used in future.
- What assets will be required to support Scottish Government objectives.
- The total value of planned new investment in assets and how this will be funded.
- The timing and value of future revenue payments associated with assets funded from borrowing and PPP, and the proportion of the overall revenue budget that this represents.

49. Public bodies also need to maintain assets to ensure continuity of service provision. Individual investment plans should therefore be part of overall asset management plans which include estimates of the level of future maintenance spending required. The plans should provide a link between the need for future investment and the condition and usage of assets which are currently operational.

50. Increasing the transparency of investment and borrowing decisions becomes more important if the Scottish Government starts to use the new borrowing powers introduced by the Scotland Act 2012. This will enable the Scottish Government to borrow up to ten per cent of its capital budget each year from 2015/16 to support capital investment, subject to a total cumulative borrowing limit of £2.2 billion. The 2012 Act also allows the Scottish Government to borrow up to a further £200 million in any one year, subject to a total of £500 million, to help manage differences between actual and forecast tax receipts, as a consequence of it gaining more tax-raising powers (see paragraph 14 and Exhibit 4).

51. These are significant new powers and it will be important that the Scottish Government can demonstrate that investment plans are affordable, prudent and sustainable, and supported by clear borrowing policies and practices. The Scottish Government will also need to consider how best to support effective scrutiny of borrowing decisions by ensuring it discloses relevant information in budget documents and its annual accounts. This could include providing clear statements on the purpose of borrowing, interest rate risk (ie, the extent to which debt is subject to variable or fixed interest rates) and the impact of interest charges and debt repayments on future budgets.

Risks affecting the valuation of forecasts and other estimates require ongoing monitoring

52. The Scotland Act 2012 will also give the Scottish Parliament new tax-raising powers. From April 2016, the main UK rates of income tax will be reduced by ten pence for each tax band for those identified as Scottish taxpayers. The Scottish Parliament will set, in its annual budget, the new Scottish rate of income tax (SRIT) to be added to the reduced UK rates. The Office for Budget Responsibility (OBR) will estimate the amount of tax to be raised from SRIT and there will be an equivalent reduction in block grant. In March 2013, the OBR produced its first estimates of the amount of income tax that would be raised through this ten per cent tax rate covering the five-year period to 2017/18.[20]

53. From April 2016 there will be a transitional period lasting two or three years, during which HM Treasury will bear the risk of actual receipts not matching the forecasts. This means that during the transitional period, the adjustment to the block grant will equal tax receipts, unless the Scottish Parliament sets a rate other than ten pence. After the transitional period, the Scottish Government will bear the risk of actual tax receipts being more or less than forecast. Such risks may arise from, for example, Scottish Government policy decisions, and relative economic performance.

54. This is a significant new responsibility and it is essential that the Scottish Government and HM Revenue and Customs (HMRC) provide transparency in their financial reporting arrangements over the use of SRIT as a source of funding. In April 2013, the Scottish Parliament's Public Audit Committee produced an interim report on arrangements for auditing the SRIT which included HMRC's role and responsibilities for collecting the correct amount of SRIT and for reporting its performance in doing so. It will be important to ensure that the accounting information provided to the Scottish Parliament about the SRIT is clear and transparent. In particular, the budgeted split of the block grant and SRIT receipts should be provided to Parliament as part of the budget documents, and the Scottish Government should consider how the SRIT income is to be reported in the consolidated accounts.

55. The Scottish Government, together with HM Treasury, HMRC and the OBR, will need to consider carefully the approach to forecasting SRIT receipts, and to ensuring that SRIT is correctly collected and accounted for. The Scottish Government will also need to consider its financial reporting arrangements so that it can monitor and explain clearly reasons for any variances between actual and forecast amounts raised, and the effect of this on the funding available in subsequent financial years.

56. In addition, as we previously highlighted, many assets and liabilities disclosed in the audited accounts, such as pension liabilities and provisions, are based on estimates because of inherent uncertainties over their valuation or need to make payment. It is important for public bodies to provide information on the key assumptions or methodology used to arrive at the valuations and the risks arising from this. The Scottish Government should continue to monitor the significant estimates continued within the accounts and consider how best to further report and explain significant changes.

The risk of potential liabilities should be monitored and reported

57. Audited accounts record a range of future liabilities, ranging from invoices which require to be paid within a short period of time, to narrative disclosure of contingent liabilities where it could take many years, if at all, before payment is made. It is important that there is financial transparency over the issues and risks associated with these liabilities due to the potential future impact on budgets.

58. For example, the Scottish Government makes an overall assessment of the likelihood of repayment of new student loans based on a number of assumptions. This leads to it creating a provision for bad debts in recognition that a proportion of new loans will not be repaid. More comprehensive and transparent information on the assumptions used to calculate the bad debt provision would assist understanding of the risk of bad debts arising, how they were being managed, and their affect on future revenue streams.

59. The Scottish Government may also need to become a funder of last resort for other bodies who get into financial difficulties. In order to maintain service provision, the Scottish Government might need to provide additional financial support to a third party provider if it encountered financial difficulties, or appoint another provider. A comprehensive assessment of these risks would aid decision-making and provide the Scottish Parliament and the public with confidence that these risks are being monitored.

More clarification would help understanding of some complex accounting issues

60. Some areas of the Scottish Government's consolidated accounts are particularly complex. Additional information would help to improve transparency, and ensure the risks and issues associated with the balances are understood by the Scottish Parliament and the public.

61. For example, the budget exchange system (paragraph 4) is a complex but important mechanism which provides budget flexibility by allowing some funding to be carried forward from one year to the next. The Cabinet Secretary for Finance, Employment and Sustainable Growth provided a statement to the Scottish Parliament on the 2011/12 provisional outturn in June 2012, which included a breakdown of the unspent amounts to be carried forward to 2012/13 and how they were planned to be used. However, the introduction of the new tax-raising powers under the Scotland Act will make further adjustments to the funding received through the block grant. Therefore there is scope for the Scottish Government to consider further how this information could be best reported to the Scottish Parliament and the public.

62. Other areas of complexity include Scottish Government lending to Scottish Water where annual budget documents currently only show net lending. The Scottish Government could give the Scottish Parliament and public a better understanding of the public sector's investment in Scottish Water and the risks associated with this investment. It could do this by providing more details about:

- the full amount to be loaned
- the purpose and timing of loans
- the interest rate used
- when the capital and interest loan repayments are due to be repaid.

There are opportunities to look at how other countries are developing their financial reporting

63. The Scottish Government could look to examples from around the world to see how it might further develop its financial reporting. International institutions, such as the International Monetary Fund (IMF) and the International Federation of Accountants (IFAC), publish guides on good practice in financial reporting, and highlight innovative practice in other countries or where improvement is needed. As the Scottish Government develops its approach in response to the Scotland Act, it could use international examples to inform its thinking and discussions with the Scottish Parliament.

64. For example, the New Zealand Government published in 2010 an Investment Statement providing an overview of the public sector's significant assets and liabilities, how they have changed over time, and how what the public sector owns and owes is forecast to change over the next five years.[21] The report also explained ways in which new investment can be funded, providing greater clarity around medium-term investment priorities, and signposting how the government is working to improve asset management.

65. The New Zealand Government considers its Investment Statement to be part of a regular suite of financial reporting documents which includes statements on budget policy, fiscal strategy and a half-yearly economic analysis and fiscal update. The stated intention of the Investment Statement is to help provide the public with a better understanding of government spending and the risks to the public sector's financial position. In line with our own thoughts, it concludes that better fiscal management requires governments to look across at the whole of the public sector's assets and liabilities to ensure that investments and risks are managed effectively.

Endnotes

1 From 1 April 2013 the previously separate police and fire services have restructured into single services covering the whole of Scotland. The two new public bodies created are Police Scotland and Fire Scotland.

2 The budget exchange system was agreed between HM Treasury and the devolved administrations in July 2011 and replaced the end-year flexibility system which then existed. It allows the Scottish Government to carry forward unspent funding to the next year, subject to limits of 0.6 per cent of the Departmental Expenditure Limit (DEL) revenue budget and 1.5 per cent of the DEL capital budget.

3 *Overview and comparison of public accounting and auditing practices in the 27 EU Member States*, prepared by Ernst and Young for Eurostat, December 2012.

4 The Whole of Government Accounts (WGA) is a single set of accounts consolidating the activities of the UK Government. HM Treasury's objectives for WGA are that it should improve transparency, increase accountability, provide more complete data on public finances than other sources, encourage public bodies to prepare their accounts in a more comparable way, and provide complementary data that can support long-term fiscal analysis and decision-making.

5 *Government Expenditure & Revenue Scotland 2011-2012*, Scottish Government, March 2013.

6 For example, any unpaid invoices at 31 March 2012 arising from one public sector body providing services to another would be shown as a debtor in the accounts of the service provider and a creditor in the accounts of the service receiver.

7 *Asset management in the NHS in Scotland*, Audit Scotland, January 2009.

8 *Annual State of NHSScotland Assets and Facilities Report for 2012*, Scottish Government, December 2012.

9 *Asset management in local government*, Audit Scotland, May 2009.

10 *Maintaining Scotland's roads: A follow-up report*, Audit Scotland, February 2011.

11 The Scottish Government's lending to Scottish Water appears in both bodies' annual accounts (as lending in the Scottish Government's Consolidated Accounts and as borrowing in Scottish Water's accounts). We have excluded these sums from the assets and liabilities shown in Exhibit 5 to avoid double counting.

12 *The investment of money by Scottish local authorities, Finance Circular 5/2010*, Scottish Government, April 2010.

13 The estimated charges of £27 billion are taken from Treasury information, and the £15.6 billion of capital and interest charges are taken from the audited accounts. Therefore the figures may be calculated on a different basis and may not be directly comparable.

14 *Infrastructure Investment Plan 2011*, Scottish Government, December 2011 and *Updated project pipeline*, Scottish Government, February 2013.

15 *Major capital investment in councils*, Audit Scotland, March 2013.

16 *Scotland's key transport infrastructure projects*, Audit Scotland, June 2013.

17 *Fiscal sustainability report*, Office for Budget Responsibility, July 2012.

18 *Managing early departures from the Scottish public sector*, Audit Scotland, May 2013.

19 *The impact of proposed Welfare Reform on HA/Co-op tenants*, Scottish Federation of Housing Associations, May 2011.

20 *Economic and fiscal outlook: Scottish tax forecasts*, Office for Budget Responsibility, March 2013.

21 *2010 Investment Statement of the Government of New Zealand*, New Zealand Treasury, December 2010.

Appendix 1

Methodology

Sources of data

This report is based on information from audited accounts and WGA returns. It focused on those public bodies audited by the Auditor General for Scotland or the Accounts Commission, except minor bodies who do not have to complete WGA returns for HM Treasury. To be excluded from the 2011/12 WGA consolidation process, HM Treasury defined minor bodies as those having gross annual expenditure and income of less than £10 million in 2010/11, and gross assets and liabilities of less than £10 million at 31 March 2011.

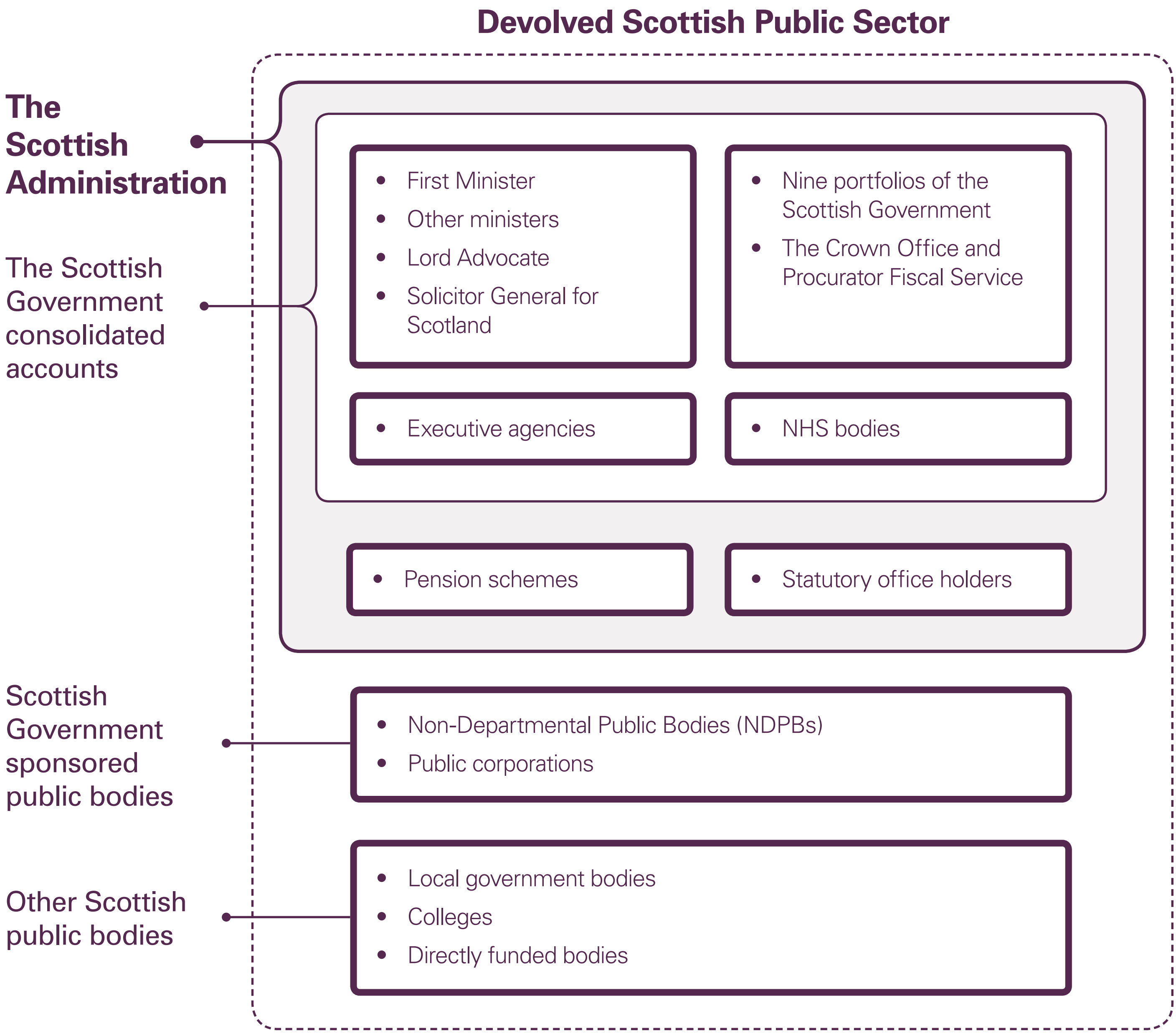
Our audit also included public corporations. Although Scottish Water is the only public corporation whose accounts are subject to audit by the Auditor General for Scotland, public corporations are 100 per cent owned by the Scottish Government. Public corporations are included in the Scottish Government consolidated accounts as a financial interest, and they are also required to complete WGA returns where applicable.

Our report uses data from the 2011/12 financial year for all sectors except the college sector. Unlike the rest of the public sector, colleges' financial year currently runs from 1 August to 31 July and the audits of the 2011/12 accounts were being finalised during the course of our work. We therefore used 2010/11 college figures in our analysis of the devolved Scottish public sector's assets and liabilities. In the context of the devolved Scottish public sector as a whole, we do not consider there to be any material difference between the college sector's 2010/11 financial position and that for 2011/12.

Public bodies included in the audit

The structure of the devolved Scottish public sector is highly complex. The following (Appendix 1 Exhibit, page 30) outlines the relationship between the different types of public body which make up the devolved Scottish public sector and lists the organisations and other accounts included in our analysis.

Appendix 1 Exhibit
The devolved Scottish public sector



Source: Audit Scotland

Bodies which are included in the Scottish Government Consolidation Accounting Boundary

- Core portfolios (generic name 'the Scottish Government')
- Crown Office and Procurator Fiscal Service
- Executive agencies
  - Accountant in Bankruptcy
  - Disclosure Scotland
  - Education Scotland

  - Historic Scotland
  - Scottish Housing Regulator (from 1 April 2012 changed to non-ministerial department)
  - Scottish Prison Service
  - Scottish Public Pensions Agency
  - Student Awards Agency for Scotland
  - Transport Scotland

- NHS bodies

  - All 14 territorial health boards
  - National Waiting Times Centre Board (Golden Jubilee National Hospital)
  - Healthcare Improvement Scotland
  - NHS 24
  - NHS Education for Scotland
  - NHS National Services Scotland
  - NHS Health Scotland
  - Scottish Ambulance Service
  - The State Hospital

Statutory office holders which, together with the bodies included in the Scottish Government Consolidation Accounting Boundary, comprise the Scottish Administration

- National Records of Scotland

- Registers of Scotland

- Scottish Courts Service

Pension schemes (both administered by the Scottish Public Pensions Agency)

- NHS Scotland Pensions Scheme

- Scottish Teachers' Pension Scheme

Scottish Government sponsored public bodies

- Non-Departmental Public Bodies

  - Care Inspectorate
  - Creative Scotland
  - Highlands and Islands Enterprise
  - National Galleries of Scotland
  - National Library of Scotland
  - National Museums of Scotland
  - Royal Botanic Garden Edinburgh
  - Scottish Children’s Reporter Administration
  - Scottish Enterprise
  - Scottish Environment Protection Agency
  - Scottish Funding Council
  - Scottish Legal Aid Board
  - Scottish Natural Heritage
  - Scottish Police Services Agency
  - Scottish Qualifications Authority
  - Scottish Social Services Council

  - Skills Development Scotland
  - Sportscotland
  - VisitScotland

- Public Corporations

  - Scottish Water
  - Highlands and Islands Airports Ltd
  - Caledonian Maritime Assets Ltd
  - David MacBrayne Ltd

Local government bodies

- All 32 councils

- All six fire and rescue services covering more than one council geographical area which existed up to 31 March 2013

- All six police forces covering more than one council geographical area which existed up to 31 March 2013

- Forth Estuary Transport Authority

- Tay Road Bridge Joint Board

- Strathclyde Partnership for Transport

Colleges

- All 37 colleges extant as at 31 July 2012

Directly funded bodies

- Forestry Commission Scotland (including its executive agency Forest Enterprise Scotland)

Methodology

To develop our analysis of the assets and liabilities of the devolved Scottish public sector, we aggregated the values from the individual accounts for each sector. Each sector was then added together to arrive at an estimate for the devolved public sector. We made some accounting adjustments to the aggregated figures to remove significant double counting, but we were unable to remove all inter-entity transactions as they are not fully identified in the accounts and WGA returns.

The Scottish Government also prepares other financial information about the sectors and public bodies included within this report. This includes:

- Government Expenditure and Revenue Scotland (GERS) publications

- Scottish Local Government Statistics

- Scottish National Account Project publications.

These publications are prepared following statistical rather than accounting frameworks and practices. This report does not seek to compare or contrast figures from our analysis to any other publication.

Appendix 2

Glossary

Term	Definition
Accountability	The mechanism by which the senior person in each public body is held responsible for the stewardship and use of public funds, and the performance of their organisations. Chief executives in local government bodies are accountable to elected members. Chief executives in most other public bodies are accountable to the Scottish Parliament.
Accounting year/Financial year	An accounting year (or financial year) is the 12-month period covered by the published annual accounts. In most Scottish public sector bodies, the accounting year covers the period 1 April to 31 March. The only exception to this is the college sector which currently runs from 1 August to 31 July, the same period as the academic year.
Accruals accounting	Accruals accounts are prepared on the basis that income and expenditure are recognised during the period they are earned or incurred, rather than when payment is received or made. For example, under accruals accounting, if a third party provides a service to a public body in March but does not invoice until April, the public body's accounts covering the period to the end of March would include an estimate of the amount due to be paid, as this was the period during which the service was provided.
Actuarial valuation	An assessment done by an actuary, usually every three or four years, to calculate the assets and liabilities of pension schemes. The actuary considers a range of factors, including estimated investment returns, employees' length of service, pay and life expectancy, to assess whether sufficient funds are available to meet future pension costs. The assessment helps inform the contribution rates employees and employers are required to pay into pension schemes.
Annual accounts	The annual accounts of a body provide information on its financial performance during the year and its financial position at year-end. The format of the annual accounts is set out in guidance which differs according to sector, eg central government, health, local government. As a result, the presentation of accounts differs between sectors but all accounts contain a statement of funding and expenditure for the year, and a balance sheet showing the organisation's assets and liabilities at year-end.
Assets	Any economic resource that is owned or controlled by the entity to produce value, eg property, investments, cash etc.

Cont.

Term	Definition
Capital expenditure	Expenditure incurred in the acquisition, disposal or modification of an identifiable fixed/non-current asset (see below).
Cash-backed reserve	Reserves that can be applied to fund expenditure and may have been set aside for a specific purpose. These represent available funds. Most often generated as a result of income exceeding expenditure.
Contingent liability	A possible obligation that arises from past events and whose existence will only be confirmed by the occurrence of future events. Included as a narrative disclosure in the annual accounts.
Creditor(s)	A creditor is an entity you owe money to for goods and services provided. At financial year-end, the creditors figure shows the amount of outstanding payments due to be made, eg invoices that are due to be paid. Under International Financial Reporting Standards creditors are called accounts payable.
Debtor(s)	A debtor is an entity that owes money to you for goods and services provided. At financial year-end, the debtors figure shows the amount of outstanding payments due to be received, eg outstanding invoices not yet paid. Under International Financial Reporting Standards debtors are called accounts receivable.
Departmental Expenditure Limit (DEL)	The majority of the Scottish Government's budget that covers programme expenditure and running costs. DEL is divided into revenue and capital budgets. Overall, DEL accounts for around 85 per cent of the Scottish Government's budget, with Annually Managed Expenditure (AME) making up most of the balance.
Depreciated replacement cost	A method of valuing assets based on the current cost of replacing an asset with its modern equivalent, less deductions for physical deterioration and relevant forms of obsolescence.
Equity investment	Investment in the shares of companies.
Fiscal autonomy	The degree to which decisions about taxes, government borrowing and spending can be made by the devolved administrations as opposed to being reserved to the UK Government. The Scotland Act 2012 will bring greater fiscal autonomy to Scotland.
Fixed/Non-current assets	Assets with a life of more than one financial year and so cannot easily be converted to cash or used to pay creditors, eg property, plant and equipment.
Governance/Corporate Governance	The establishment of policies and internal controls, and the continuous monitoring of how they are implemented by the management and board of an organisation.
Gross Domestic Product (GDP)	This is a basic measurement of a country's economic performance. It is defined as the market value of all the goods and services produced by a country.
Historical cost	When transactions are recorded at their original cost.

Cont.

Term	Definition
International Financial Reporting Standards (IFRS)	International accounting standards intended to provide greater comparability between organisations. First adopted by large, publicly listed companies within the EU in 2005, they have subsequently been adopted by the UK public sector: central government and health bodies in 2009/10; local government bodies in 2010/11. It is expected that the Further Education sector will adopt IFRS in 2014/15.
Liabilities	Obligations arising from past transactions or events which may result in the transfer of assets or services, eg borrowings, payments due, etc. The cumulative value is shown in the balance sheet of an entity.
Long-term investments	Investments that mature in more than 12 months.
National debt	This is all outstanding debt held by the UK Government.
Non-domestic Rates (NDR)	Business rates paid by local business to a local authority.
Property, plant and equipment (PPE)	Assets in this category are held for use in production or supply of goods and serves, for rental to others or for administrative purposes. They are expected to be used in more than one accounting year, eg buildings, motor vehicles, etc.
Provision	A liability of uncertain timing or amount but where there is more probability than a contingent liability that some payment will be due.
Public corporations	Industrial or commercial enterprises under direct government control. Public corporations employ their own staff, who are not civil servants, and manage their own budgets. Ministers normally appoint the board members of public corporations, and are often the organisation's sole shareholder. Public corporations usually operate in a commercial environment where their costs are recovered from fees and charges, eg Scottish Water.
Real terms	The value of money in comparable terms, ie figures that have been adjusted for the effects of inflation. This allows for a direct comparison of figures across a number of years as the effect of inflation has been removed to allow any underlying changes to be shown clearly.
Revenue budget and spend	The budget for the day-to-day running of the organisation and provision of services within the accounting year, and spending against this budget. For example salaries and rent.
Scottish Government consolidated accounts	The Scottish Government consolidated accounting boundary includes its core portfolios and executive agencies, the Crown Office and Procurator Fiscal Service and NHS bodies.
Underspend	When a public body spends less than it was allocated in a budget. The opposite to an overspend.

Developing financial reporting in Scotland

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ISBN 978 1 909705 09 8 AGS/2013/6

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