

Public Audit Committee

**32nd Meeting, 2023 (Session 6), Thursday,
7 December 2023**

The 2022/23 audit of the Scottish Government Consolidated Accounts

Introduction

1. At its meeting today, the Committee will take evidence from the Auditor General for Scotland on [The 2022/23 audit of the Scottish Government Consolidated Accounts](#), which was published on 16 November 2023.
2. The Auditor General has prepared a note on the key messages from the report, which can be found at **Annexe A**. The full report can be found at **Annexe B**.
3. The Committee will decide any further action it wishes to take after the evidence session today.

**Clerks to the Committee,
4 December 2023**

Annexe A

BRIEFING PAPER BY THE AUDITOR GENERAL FOR SCOTLAND

The 2022/23 audit of the Scottish Government Consolidated Accounts

1. The Auditor General's report on the 2022/23 audit of the Scottish Government Consolidated Accounts was laid in the Parliament on

16 November 2023. The report is made under section 22 of the Public Finance and Accountability (Scotland) Act 2000. The Consolidated Accounts are a key component of the Scottish Government's accountability to the Scottish Parliament and the public. The report is presented to support the Parliament's scrutiny of public finances in Scotland. The audit opinion on the 2022/23 Consolidated Accounts is unqualified.

2. The Scottish Government's Consolidated Accounts for 2022/23 show that total net expenditure during 2022/23 was £49,767 million, £509 million less than budget. The resource budget was underspent by £188 million (0.4 per cent) against a budget of £47,895 million. Capital was underspent by £321 million (13.5 per cent) against a budget of £2,381 million.
3. The largest resource variances were in the portfolios of Health and Social Care (£211 million underspend), Net Zero, Energy and Transport (£62 million underspend), and Social Justice, Housing and Local Government (£77 million overspend). There were capital underspends across all portfolios with the largest occurring in Education and Skills (£94 million underspend) and Social Justice, Housing and Local Government (£72 million underspend). The Scottish Government has reported the main reasons for the variances in the Consolidated Accounts.
4. The Scottish Government responded quickly to emerging financial pressures during 2022/23 by initiating Emergency Budget Reviews. This enabled the Scottish Government to manage its expenditure in line with the limits set by the Scottish Parliament, but many of the options applied were non-recurring which provided short-term relief but is not a sustainable approach to dealing with long-term budget pressures.
5. In recent years, the Scottish Government has taken a direct role in providing financial support to private companies. These interventions have had a significant financial consequence for the Scottish Government. The strategic approach to, and management of, financial interventions has been strengthened during 2022/23 with the establishment of the Strategic Commercial Assets Division. The due diligence exercise for MV Glen Sannox and MV Glen Rosa (vessels 801 and 802) was in accordance with the requirements set out in the Scottish Public Finance Manual.
6. The Scottish Government is facing an intensely challenging period in managing its finances. The Scottish Government's 2023 medium-term financial strategy highlight many of the fiscal and economic challenges facing the public sector in Scotland. The delivery of public services in their current form is not affordable. The Scottish Government is working with public bodies to identify barriers and opportunities for reform and to establish the actions and decisions required. The Scottish Government must develop a clear roadmap of how the design and delivery of public services will be transformed to be financially sustainable.

7. Workforce reform must be a core part of the Scottish Government's wider approach to reforming Scotland's public services. It has set out a two-track approach targeting short-term efficiencies alongside more systemic long-term reform. The Scottish Government has agreed over £1.7 billion extra in pay deals during 2022/23 and 2023/24 and will have to make in-year budgetary changes to meet these costs. A comprehensive workforce strategy is required to ensure that its approach to staffing levels is appropriately planned and coordinated across the organisation, including factoring in the anticipated growth in NHS staffing.
8. There is no devolved public sector account which captures all of the assets and liabilities within the Scottish public sector. Previous plans were impacted by the pandemic and no progress was made during 2022/23. The Scottish Government is currently exploring how this information can be collated and presented in a meaningful and transparent way.
9. The Scottish Government Shared Services Programme is set to deliver a new HR and Finance system for the Scottish Government and over 30 other public bodies. There have been changes to the timescales and costs associated with this project with the current expected go-live date now 1 April 2024. The implementation of this programme will support financial sustainability, public service reform and improve the reliability and security of key systems.
10. The Scottish Government's approach to public performance reporting needs to improve. The current review of the National Outcomes presents an important opportunity to better align national performance reporting with the key activities that support the achievement of the critical missions outlined in the Policy Prospectus.
11. The Annual Audit Report has been fully agreed with the Scottish Government and includes an agreed action plan with responses and provides responsible officer and timescale. The report is available to the Committee and has been provided for their interest.

Annexe B

The 2022/23 audit of the Scottish Government Consolidated Accounts



AUDITOR GENERAL 

Prepared for the Public Audit Committee by the Auditor General for Scotland
Made under section 22 of the Public Finance and Accountability (Scotland) Act 2000
November 2023

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Introduction

1. I provide this report on the 2022/23 audit of the Scottish Government Consolidated Accounts under section 22(3) of the Public Finance and Accountability (Scotland) Act 2000. My report is intended to support the Scottish Parliament in its important scrutiny role of the government's finances. The report contains key information from the 2022/23 Consolidated Accounts and explains what they show about the Scottish Government's management of its budget. It also provides information on financial sustainability, financial and performance reporting and governance.

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

3. The Consolidated Accounts:

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

Key messages

- My independent audit opinion is unqualified. This means, in my opinion, I am content the Scottish Government Consolidated Accounts show a true and fair view, follow accounting standards, and that the income and expenditure for the year is lawful.
- The Scottish Government responded quickly to emerging financial pressures during 2022/23 by initiating Emergency Budget Reviews. This enabled the Scottish Government to manage its expenditure in line with the limits set by the Scottish Parliament, but many of the options applied were non-recurring which provided short-term relief but is not a sustainable approach to dealing with long-term budget pressures.
- The strategic approach to, and management of, financial interventions has been strengthened with the establishment of the Strategic Commercial Assets Division. This is a welcome development given previous interventions have had a significant financial consequence for the Scottish Government. The due diligence exercise for MV Glen Sannox and MV Glen Rosa (vessels 801 and 802) was in accordance with the requirements set out in the Scottish Public Finance Manual.
- The delivery of public services in their current form is not affordable, with inflationary pressures and public sector pay settlements having a significant impact. The Scottish Government must work with partners to develop a programme of public service reform, including workforce redesign, which balances the short-term financial pressures with the need for longer-term change, recognising that this may require financial investment. It is important that the Scottish Government understands the overall assets and liabilities within the Scottish public sector but no progress has been made on the development of a devolved public sector account during 2022/23.
- I have reported previously about the underinvestment in core IT systems and the risk that the current systems are no longer fit for purpose. The Scottish Government must move forward with the implementation of the corporate transformation programme to mitigate the related risks and realise future efficiencies.

- The Scottish Government is currently undertaking a review of the National Outcomes which form part of the National Performance Framework. This creates an important opportunity to better align national performance reporting with the key outcomes the Scottish Government is now focusing on and the main policy commitments it has put in place to support delivery. The Scottish Government's approach to public performance reporting needs to improve. I am concerned by the number of indicators not being reported five years after the first National Outcomes were agreed and it remains difficult to monitor the impact of policy and spending decisions on performance.

Financial management

Scottish Government budget performance 2022/23

4. The Consolidated Accounts show that total net expenditure during 2022/23 was £49,767 million, £509 million less than budget ([Exhibit 1](#)). The resource budget was underspent by £188 million (0.4 per cent) against a budget of £47,895 million. Capital was underspent by £321 million (13.5 per cent) against a budget of £2,381 million.

Exhibit 1

Expenditure against the Scottish Budget approved by the Scottish Parliament

| | Final budget £m | Outturn £m | Underspend £m |
|----------|--------------------|---------------|------------------|
| Resource | 47,895 | 47,707 | (188) |
| Capital | 2,381 | 2,060 | (321) |
| Total | 50,276 | 49,767 | (509) |

Source: Scottish Government Consolidated Accounts 2022/23 (page 120). Further information on individual portfolio spending performance can be found in pages 121-132 of the Consolidated Accounts.

5. High-level reasons for significant variances between actual and budgeted spend are included in the Consolidated Accounts. The largest resource variances were in the Health and Social Care, Net Zero, Energy and Transport, and Social Justice, Housing and Local Government portfolios.

6. For Health and Social Care, lower than anticipated non-cash accounting transactions, including NHS provisions, impairments and depreciation, resulted in a £211 million underspend. Net Zero, Energy and Transport was underspent by £62 million due to lower than expected active travel schemes, low carbon and other transport initiatives. These underspends were partially offset by an overspend in the Social Justice, Housing and Local Government portfolio of £77 million due to the teachers' pay award and higher than expected year-end fair value adjustments for housing loans, shared equity schemes and charitable bonds.

7. There were capital underspends across all portfolios with the largest occurring in the Education and Skills and Social Justice, Housing and Local Government portfolios. Due to the accounting for student loans, with applications for loan funding being less than expected and student loan repayments being higher, the Education and Skills portfolio reported an underspend of £94 million. Social Justice, Housing and Local Government portfolio reported an underspend of £72 million primarily due to higher than anticipated capital receipts from individual homeowners who are part of the shared equity schemes.

8. My independent auditor's report is set out at pages 116-119 of the Consolidated Accounts. My opinion on the 2022/23 financial statements is unqualified. This means, in my opinion, I am content the Scottish Government Consolidated Accounts show a true and fair view and have been properly prepared to follow accounting standards and that the income and expenditure for the year is lawful.

Emergency Budget Reviews

9. During the year, the Scottish Government carried out Emergency Budget Reviews (EBR) to assess all devolved 2022/23 spend. It focused on identifying opportunities for savings that could then support measures to help with the cost-of-living crisis and support a path to balance in light of emerging pressures including inflation, pay deals and increased demand.

10. Two reviews were undertaken during 2022/23. In September 2022, a package of £560 million savings was proposed. This included budget reductions for employability schemes (£53 million), concessionary fares (£37 million) and the deferral of ring-fenced agriculture funds (£33 million). There was also an increase of in-year funding of up to £56 million generated by the ScotWind clearing process.

11. The November 2022 review identified additional options for spending reductions and reprioritisation. These amounted to £615 million and included the reprioritisation of spend within the Health and Social Care portfolio (reprofiling of the National Care Service, utilisation of reserve funding held by integration authorities and mental health reduction) and £180 million of capital and financial transaction reductions (construction delays in further education projects, City Deals re-profiling and Low Carbon Funds).

12. The EBR also identified areas of growth with savings to fund around £35 million for a range of initiatives to provide support with the cost-of-living crisis. These included an increase to the fuel insecurity fund, Scottish Child Bridging Payment and a new Island Cost Crisis Emergency Fund to help island households manage higher energy costs.

13. During 2022/23 there was also an increased focus on workforce planning, with recruitment controls introduced. These included the requirement for Director General approval before any recruitment, re-grading of roles and new temporary responsibility supplement opportunities. These measures are expected to be in place until the end of the 2023/24 financial year.

14. The introduction of the EBRs indicates the Scottish Government was able to quickly apply financial management approaches to ensure a balanced budget was achieved. However, many of the options applied are non-recurring or delays to expenditure/policy introduction, such as utilising the drawdown of Scotwind monies or reserve balances. While this provides short-term relief to financial pressures it is not sustainable in the longer term.

Social Justice, Housing and Local Government portfolio

15. Social Security Scotland is now well established and, as an executive agency, is consolidated into the Scottish Government's accounts as a separate component audited body. The relevant expenditure is disclosed within the Social Justice, Housing and Local Government portfolio outturn statement (page 122).

16. The 2022/23 accounts of Social Security Scotland include benefit expenditure of £3,402.6 million administered by the Department for Work and Pensions (DWP) under an agency agreement with Scottish Ministers. Due to these delivery arrangements, Social Security Scotland cannot directly assess the levels of fraud and error in these benefits and is instead reliant on the DWP's annually published estimates.

17. The estimated overpayments as a result of fraud and error in the benefits delivered by the DWP, ranged from 1.1 to 5.2 per cent of expenditure. This means an estimated £60.7 million of overpayments were made in Scotland. As a result, Social Security Scotland's external auditor qualified their regularity opinion as these overpayments were not incurred in accordance with relevant legislation and regulations. Further details can be found in the 2022/23 Annual Audit Report of Social Security Scotland.

18. As a component audit of the Scottish Government's Consolidated Accounts, the qualified audit opinion on the Social Security Scotland accounts requires me to assess the potential impact of its inclusion within the Scottish Government's Consolidated Accounts. I concluded that, for 2022/23, the likely amount of error and fraud incurred is not significant enough to influence the economic decisions of the users of the consolidated accounts and therefore I have not qualified my opinion in respect of this matter.

Crown Office and Procurator Fiscal Service

19. The Scottish Government's Consolidated Accounts include special payments of £16 million made by the Crown Office and Procurator Fiscal Service (COPFS) during 2022/23 (page 115) which relates to specific legal cases brought against the Lord Advocate by individuals in connection with the acquisition and administration of Rangers Football Club. Provisions for liabilities and charges (page 175) include £8.8 million in respect of the same cases.

20. To date the COPFS has accounted for £60.5 million of unplanned costs in connection with these claims against the Lord Advocate. Some cases have been resolved, with sums paid to the pursuers totalling £51.7 million to March 2023 with a further £8.8 million provided in respect of cases still to be finalised. In February 2021, the Lord Advocate made a statement in the Scottish

Parliament about this matter and has committed to further public accountability and to a process of inquiry once all litigation has concluded.

Capital and resource borrowing

21. Under the terms of the Scotland Act 2016, Scottish Ministers can borrow up to £3 billion for capital purposes, with an annual borrowing limit of 15 per cent (£450 million) of the overall borrowing cap. In 2022/23, the Scottish Government borrowed £300 million, less than the £450 million outlined by Scottish Ministers as part of the 2022/23 Scottish Budget. The loans will be repaid to the National Loans Fund over 15 years. This is in line with the timescales outlined in the Fiscal Framework. The 2022/23 borrowing was used to support the overall capital programme.

22. In 2022/23, the Scottish Government borrowed to fund resource expenditure, as it has done in 2020/21 and 2021/22. During the year it borrowed £47 million from the National Loans Fund to be repaid over five years. The £300 million limit for resource borrowing was revised to £600 million for financial years 2021/22 to 2023/24 due to the conditions for a Scotland-specific shock being met. The Scottish Government can only apply this borrowing to meet forecast error in relation to tax receipts or demand-led social security spending.

23. As at 31 March 2023, the total principal level of capital borrowing outstanding was £1,542.7 million, with interest of £249.7 million applying over its remaining life, up to 25 years. Resource borrowing outstanding at 31 March 2023 was £480.3 million with interest of £17.1 million accruing over the five-year repayment period.

24. Due to the accumulation of annual borrowing in recent years, loan repayments are increasing and totalled £160 million in 2022/23 (£95 million in 2021/22). The Scottish Government needs to continue to manage these loan repayments alongside all other financial pressures in the years ahead.

25. Details of the overall loan, repayments and interest payments are outlined on pages 18 and 19 of the Consolidated Accounts. The Scottish Government's borrowing and associated repayments are made via the Scottish Consolidated Fund (SCF). Borrowed amounts and repayments are made between the SCF and UK National Loans Fund with the corresponding adjustments made to funding received by the Scottish Government from the SCF. This means there is no associated liability disclosed in the Statement of Financial Position within the Scottish Government's Consolidated Accounts. Details of the amount of borrowing and the associated liability are set out within the SCF annual accounts.

The strategic approach to financial interventions

26. Last year I reported that the Scottish Government had published its Business Investment Framework, to outline its principles and approach for decisions about future investment in private companies, but that there was scope for further development. I welcome the fact that the framework is currently being updated to take account of the lessons learned reviews and ongoing engagement with the audit team.

27. During 2022/23, the Strategic Commercial Assets Division (SCAD) was formed. Its main purpose is to consolidate expertise and knowledge and increase capacity to respond to cases that arise seeking support or intervention from the Scottish Government and provide support across the whole lifecycle. The division is now fully established with five units covering initial assessment for investment through to potential exit strategy.

28. I have reported previously about the Scottish Government's direct role in providing financial support to private companies. [Exhibit 2](#) outlines the financial support that has been made to private companies that is now being managed by SCAD. I have asked the audit team to continue to monitor and report on these interventions.

Exhibit 2

Financial interventions to private companies

| Financial intervention | Total incurred in 2022/23 | Total financial investment | Value in Consolidated Accounts |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------|----------------------------|--------------------------------|
| <p>Prestwick Airport</p> <p>Purchased by the Scottish Government in November 2013 with the stated aim of protecting jobs and safeguarding the asset. Responsibility transferred from Transport Scotland to the Scottish Government in January 2023.</p> <p>Total investment consists of capital of £43.4 million and interest of £9.1 million.</p> | £1.7 million | £52.5 million | £11.6 million |
| <p>Ferguson Marine (Port Glasgow) Holdings Limited</p> <p>Established by the Scottish Government in December 2019 after Ferguson Marine Engineering Limited (FMEL) went into administration. The existing voted loans (£97.7 million) were terminated and the difference between the valuation of the ferry vessels (£74.8 million) and the valuation of the outstanding loans (£22.9 million) was written-off in 2020/21.</p> | £63.2 million | £237.5 million | £82.6 million |
| <p>Burntisland Fabrications Limited (BiFab)</p> <p>In 2018/19 the Scottish Government converted £37.4 million commercial loans into equity representing a total equity stake of 32 per cent. BiFab were placed</p> | Nil | £50.9 million | Nil |

| Financial intervention | Total incurred in 2022/23 | Total financial investment | Value in Consolidated Accounts |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------|----------------------------|--------------------------------|
| <p>into administration in December 2020 and the Scottish Government is now pursuing a return through the administration process.</p> <p>The Scottish Government provided further loans of £13.5 million which were subsequently written off.</p> | | | |
| <p>Lochaber Aluminium Smelter – Liberty Group</p> <p>In December 2016, the Scottish Government issued a 25-year financial guarantee contract to SIMEC Lochaber Hydropower Limited. The Scottish Government receive an annual fee in return for the guarantee. The Scottish Government’s annual exposure is between £14 million and £32 million, over the lifetime of the contract.</p> <p>In March 2021, Greensill Capital (UK) Limited, the major provider of working capital to GFG Alliance (the holding company), went into administration. There continues to be uncertainty regarding the financial stability of GFG Alliance group.</p> | £21 million increase in provision | Nil | Provision of £135 million |

Source: Audit Scotland

European Structural and Investment Funds

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

30. A different methodology for reclaiming costs was agreed with the EU following the suspension of the ESF programme. The suspension was lifted in October 2022. As a result of implementing the new methodology, the Scottish Government anticipates being able to reclaim less than it pays out to lead partners. As a consequence, the Scottish Government assessed the recoverability and have written off £36 million to date in respect of grant payments already made (£16 million in 2020/21; £2 million unwinding of the write-off in 2021/22, and a further £21.5 million in the 2022/23 Consolidated Accounts).

31. During 2022/23 the Scottish Government reviewed the calculation underlying the provision for the future under-recovery of costs and reduced it from £43 million to £12 million. This reflects the increased level of write off and the reduction in the time remaining for the programme. The Scottish Government recognises the risks around the receipt, checking, claiming and disbursement of EU funds. A number of mitigating actions have been introduced to ensure the Scottish Government maximises the receipt of income. I shall continue to review progress in finalising all claims until programme closure.

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

Resettlement of displaced Ukrainians

33. Following the invasion of Ukraine in February 2022, and the displacement of its people, Scotland made a commitment to support 3,000 people displaced from Ukraine in the initial wave, and at least a proportionate share of the total number who come to the UK thereafter. The Scottish Government had to mobilise quickly in order to provide accommodation and support to those escaping the conflict and introduced, at pace, new processes and procedures to deal with the Scottish super sponsor scheme and large number of arrivals. By the end of July 2023, the Scottish Government had sponsored over 32,600 visas and more than 25,100 displaced people from Ukraine had arrived in the UK on a visa with a Scottish sponsor.

34. The super-sponsor scheme was paused in order to stabilise the level of arrivals and refine capacity planning processes. The Scottish Government also decided to alleviate accommodation pressures by renting two passenger ships on a short-term basis with both ships departing by summer 2023.

35. In September 2022, the Scottish Government introduced the Ukraine Longer Term Resettlement Fund (£50 million capital fund) to bring vacant homes back into use in order to reduce the demand for temporary accommodation and improve the supply of housing stock for the medium term. By the end of March 2023, £10 million of the fund had been allocated.

36. The Scottish Government Consolidated Accounts reflects total expenditure of £231 million and a financial commitment of £25.5 million in relation to temporary accommodation contracts.

37. I note the swift action taken by the Scottish Government to assist displaced Ukrainians applying some of the lessons learned from its response to the Covid-19 pandemic.

Financial sustainability

Overall financial position

38. The Consolidated Statement of Financial Position (page 136) is one of the primary financial statements in the Consolidated Accounts. It summarises what is owned and owed by the core Scottish Government and those public bodies within the consolidated boundary. This shows taxpayers' equity – an accounting measurement of the amount of taxpayers' money applied that has continuing public benefit. It shows how much of this has arisen from the application of parliamentary funding (arising from the Scottish Block Grant, borrowing and devolved taxes) and how much resulted from changes in the value of physical assets over time.

39. As detailed in [Exhibit 3 \(page 14\)](#) taxpayers' equity has increased in each of the last five years from £33.3 billion to £44.8 billion, largely due to an increase in physical assets (such as property and roads) and financial assets (such as loans and investments). Total liabilities (such as payments for private-financed projects) have increased from £8.8 billion in 2018/19 to £9.6 billion in 2022/23.

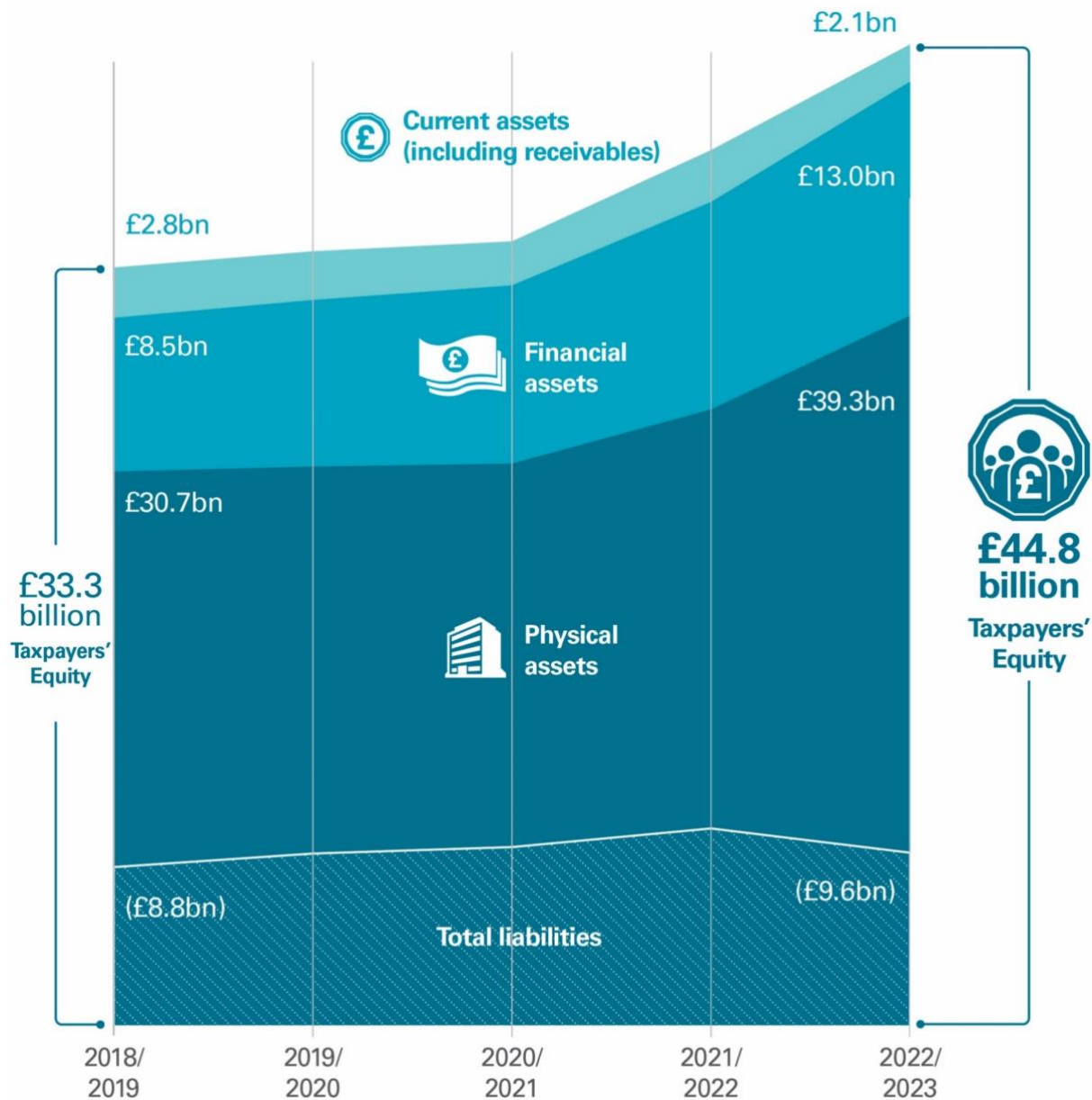
40. It is important to note that the position does not reflect all the assets and liabilities of the Scottish public sector. These accounts do not include resource and capital borrowing (paragraphs 21-25), local government assets and borrowing and all public sector pension liabilities. In 2016, the Scottish Government committed to producing a consolidated account to cover the devolved public sector in Scotland and in recent years I have reported on the limited progress that has been made.

41. The original intention was for the wider Scottish public sector consolidated accounts to utilise data from the Whole of Government Accounts (WGA) process prepared by HM Treasury. The Covid-19 pandemic has had a significant impact on the WGA process with the 2020/21 account not signed off until July 2023. Further, in response to the pandemic impact on the audit regime, HM Treasury raised the threshold for audit review. This means that the WGA returns for the majority of Scottish public sector bodies are now below the audit threshold. The level of assurance that could therefore be taken from the process has reduced.

42. The Scottish Government continues to explore how it intends to prepare these accounts while ensuring they are meaningful and transparent. I understand that an alternative proposal is currently being developed.

43. The Scottish Government needs to agree its approach to the provision of consolidated information for the Scottish public sector and agree a timetable for completion. The continuing absence of a full public sector account reduces the transparency and accountability over public spending, assets and liabilities in Scotland.

Exhibit 3 Financial position



Source: Audit Scotland

Public service reform

44. As part of the Medium-Term Financial Strategy (MTFS) and the First Minister's Policy Prospectus (April 2023), the Scottish Government set out a ten-year programme of public sector reform. In response, the Scottish Government has established the Public Service Reform Directorate which has responsibility for overseeing a range of activities across policy areas and identifying common themes, conditions and characteristics of reform.

45. The Scottish Government is working with public bodies to identify barriers and opportunities for reform and to establish the actions and decisions required. Core templates and a framework for action were issued, and returns are currently being reviewed and collated. A focused workstream on potential revenue raising opportunities from public bodies will report later in the year, and three further thematic clusters with bodies collaborating on specific issues or topics have been established with initial outputs expected in early 2024.

46. I recognise that public service reform will take time and that the Scottish Government will need to balance short-term efficiencies, to assist the challenging immediate financial situation, with longer-term 'spend to save' reform plans.

47. The Scottish Government must develop a clear roadmap of how the design and delivery of public services will be transformed to be financially sustainable.

Workforce reform

48. In May 2022 the Scottish Government published its first Resource Spending Review (RSR) since 2011. In the RSR, the Scottish Government committed to keeping the total cost of the overall annual pay bill the same as 2022/23 from 2023/24 onwards and returning the total size of the devolved public sector workforce to around pre-Covid-19 levels by 2026/27.

49. The Scottish Government has now moved away from this approach, instead setting out a broader obligation for public sector bodies to ensure workforce plans and projections are affordable.

50. Workforce reform is part of the Scottish Government's wider approach to reforming Scotland's public services. It has set out a two-track approach to reform, targeting short-term efficiencies alongside more systemic long-term reform. Immediate reform areas include making efficiencies in service delivery, as well as new pay and workforce strategies. I have considered this further in my recently published briefing [The Scottish Government's workforce challenges](#).

51. Higher levels of inflation have meant that managing the in-year consequences of pay settlements has been particularly challenging over the last two years. The Scottish Government has agreed over £1.7 billion extra in pay deals during 2022/23 and 2023/24 and will have to make in-year budgetary changes to meet these costs. Recent pay deals have exceeded the Scottish Government's pay policy. In addition, wider changes to terms and conditions are being agreed which will likely also result in higher costs.

52. The MTFS identifies that NHS workforce will continue to grow which will in turn place pressure elsewhere in the system. Any decisions about the NHS workforce size and costs will have a large impact on Scottish Government sustainability in the medium term. The Scottish Government should ensure it has a cohesive workforce strategy that factors in the impact of growth in the NHS.

Financial and performance reporting

Financial reporting

53. In May 2023 the Scottish Government produced its sixth MTFS. The MTFS provides an assessment of the medium-term outlook for Scotland's public finances covering 2023/24 to 2027/28. It sets out the assessment of Scotland's economic and fiscal outlook, alongside plans to manage the financial risks, as well as broad spending plans considering the effects of changing funding levels for government spending as outlined in the RSR.

54. The Scottish Government continues to face significant pressures on public finances including the cost-of-living crisis, inflationary pressures, public sector pay, demand-led expenditure, the cost of delivering the statutory targets for child poverty and net zero, together with the impact of an aging population. Fiscal sustainability is one of the highest-ranking risks in the corporate risk register.

55. The Scottish Government expects available resource funding to grow from £45.3 billion in 2023/24 to £51 billion by 2027/28, an increase of 12.6 per cent (cash terms) and 6.8 per cent (real terms). This is due to increases in the Block Grant and the growth of the net tax position over this period. However, the projected increased spending over the medium term outstrips the forecasted increase in funding.

56. Scottish Government resource spending is forecast to increase from £45.3 billion in 2023/24 to £52.8 billion in 2027/28. This is an average increase of 3.6 per cent a year, higher than the forecast funding growth of 3.1 per cent. Current projections indicate a resource funding deficit of £1 billion (2 per cent) in 2024/25, rising to £1.9 billion (4 per cent) in 2027/28.

57. The capital funding outlook is even more challenging with a projected increase from £6 billion in 2023/24 to £6.8 billion in 2025/26. As a result of the expected real terms fall in capital funding there will be a 16 per cent capital funding deficit in 2025/26. This means the Scottish Government cannot deliver all their capital commitments to the original timescales within the funding available. A programme of reprioritisation of capital projects is currently underway.

58. In September 2023 I published a briefing paper on [Investing in Scotland's infrastructure](#) which highlighted these future challenges and the need for the Scottish Government to prioritise, delay or cancel projects and consider how the public sector estate can support transformation of services.

Scotland Reserve

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

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

61. The Scottish Government's policy is to apply any underspends for use in the following financial year. The [2022/23 provisional outturn statement](#) notes that £700 million was used to support expenditure in 2022/23 with a further £244 million due to be applied in 2023/24, which will be confirmed following the audit of the 2022/23 Consolidated Accounts.

62. There is publicly available information about the Scottish Government's approach to the Scotland Reserve, including the intended drawdowns to support annual spending plans and reporting on Reserve movements. The Scotland Reserve balance is not in the financial statements within the Scottish Government Consolidated Accounts. Information about the Scotland Reserve should be considered as part of the Scottish public sector consolidation detailed at paragraph 43 above.

Performance reporting

63. The 2022/23 Consolidated Accounts include a performance report (pages 4-75) and an accountability report (pages 76-115) in line with the requirements of the Government Financial Reporting Manual (FReM).

64. The performance overview section (pages 10-31) sets out the National Performance Framework together with progress towards 11 National Outcomes. Eighty-one national performance indicators have been assessed, with 18 improving, 30 being maintained, and 13 worsening. Twenty indicators have no performance information reported as the data was either in development or not comparable to previous years. I am concerned by the number of indicators not being reported five years after the first national outcomes were agreed.

65. The performance analysis section (pages 32-75) provides the reader with a range of information on each portfolio's key priorities, performance against key targets and indicators.

66. The performance report needs to be shorter, more concise and more transparent with a golden thread linking all aspects of performance and providing an overall view of progress. The lack of good indicators and milestones across all areas makes monitoring the impact of policy and spending decisions more difficult. It also makes it harder for the Parliament and the public to scrutinise the Scottish Government's performance and assess whether spending is achieving maximum value.

67. I noted last year that some limited improvements had been made to the performance report and recognise that this has continued. It still remains difficult to form an overall picture of the performance of the Scottish Government and its own contribution to the national outcomes.

68. The Scottish Government has an opportunity, with the new Policy Prospectus and Programme for Government, to clarify its priorities and focus activity on the areas that support the achievement of the critical missions. However, the Policy Prospectus and the Programme for Government together have over 300 commitments or outcomes. In addition, there are a number of major programmes currently being progressed by the Scottish Government, each with their own objectives, targets and policies. These need to be reviewed and streamlined. This increased focus will also assist public service reform in its widest sense by recognising what needs to be done to support the critical missions.

Governance

Governance arrangements

69. A Governance Statement (pages 77-93) prepared by the Permanent Secretary is a key feature of the Consolidated Accounts. It forms part of a wider accountability report and summarises how the core Scottish Government organisation is controlled and directed. The statement confirms that the Scottish Government complies with relevant guidance on corporate governance. It also highlights the main risks and opportunities for the organisation and any significant internal control issues in 2022/23. I am content that the Governance Statement is consistent with the financial statements and has been prepared in accordance with guidance issued by the Scottish Ministers.

70. Established assurance arrangements are in place to provide and support the Permanent Secretary in his role as principal accountable officer which involve both senior management and non-executive directors. I reported last year that many of the main governance groups are attended by the same individuals (both executive and non-executive) and cover similar topics, themes and risks. This increases the risk of duplication, inefficiency, or blurred lines of responsibility between the different roles and remits of each group.

71. I am aware that alternative approaches are being piloted, however the governance and assurance process should be reviewed, refined and streamlined where appropriate. Such a review would offer the Scottish Government the opportunity to consider further its governance and operational structures and streamline its decision-making processes to fully support the various demands, both internal and external, on the organisation.

Written Authority: MV Glen Sannox and MV Glen Rosa (vessels 801 and 802)

72. Over 2017 and 2018, the Scottish Government provided commercial loan facilities totalling £45 million to Ferguson Marine Engineering Limited (FMEL), a shipbuilding and engineering company based in Port Glasgow. The purpose of the loan was to support FMEL's completion of a contract to build two 'dual-fuel' ferry vessels (MV Glen Sannox and MV Glen Rosa (vessels 801 and 802)) for Caledonian Maritime Assets Limited (CMAL). By April 2019, FMEL had drawn down the full loan facility of £45 million and no extended facilities were provided.

73. In August 2019, FMEL entered administration which led to the Scottish Government acquiring the business in December 2019 following a review of bids by the administrator. Following administration, a new company was established, Ferguson Marine (Port Glasgow) Holdings Limited (FMPPG), which is a company wholly owned by Scottish Ministers established under the Companies Act 2006.

74. The oversight of FMPG by the Scottish Government is undertaken by a specific Ferguson Marine Governance and Oversight Unit which is part of SCAD. SCAD is being proactive in addressing matters raised in response to previous audit reports.

75. Work to revise the framework agreement is ongoing and will set out the obligations and requirements for FMPG as a public sector organisation. The framework will include reference to compliance with the Scottish Public Finance Manual and is anticipated to be finalised by December 2023. I have asked the audit team to monitor and report on this review.

76. The Scottish Public Finance Manual (SPFM) requires the Accountable Officer to ensure the propriety and regularity of finances and ensure that any resources are used economically, efficiently and effectively, ie that value for money is achieved. If value for money cannot be achieved, then the Accountable Officer should obtain written authority from ministers before taking any further action. [Exhibit 4](#) outlines the timeline, associated costs to complete the vessels and due diligence processes that have taken place.

Exhibit 4

MV Glen Sannox and MV Glen Rosa (vessels 801 and 802): timeline and due diligence

| Date | Vessel 801 timeline | Vessel 802 timeline | Total cost to complete both vessels (since public ownership) | Due diligence process |
|------------|---------------------|---------------------|--------------------------------------------------------------|------------------------------|
| Dec 2019 | Dec 2021 | Oct 2022 | £110.3m - £114.3m | Initial decision to acquire |
| Aug 2020 | June 2022 | Feb 2023 | £110.3m - £114.3m | - |
| June 2021 | Sep 2022 | July 2023 | £110.3m - £114.3m | - |
| March 2022 | May 2023 | Dec 2023 | £119m - £123m | High level AO assessment |
| Sep 2022 | May 2023 | Jan 2024 | £202.6m | Full AO assessment |
| March 2023 | May 2023 | March 2024 | £209.6m | - |
| June 2023 | Dec 2023 | Dec 2024 | £223.1m | - |
| Sep 2023 | March 2024 | May 2025 | £240m | AO assessment update planned |

Source: Audit Scotland

77. In September 2022, as a result of the revised estimate of costs to complete MV Glen Sannox and MV Glen Rosa (vessels 801 and 802), the Scottish Government undertook a due diligence exercise to assess the estimates provided by FMPG. As a consequence, the Accountable Officer (Director General - Economy) formed the view that value for money could not be achieved in respect of MV Glen Rosa (vessel 802) given its stage of completion, expenditure to date and the forecast costs to complete.

78. In accordance with the SPFM, on 13 May 2023, the Director General - Economy requested a written authority from the Cabinet Secretary for Wellbeing Economy, Fair Work and Energy. In response, on 14 May 2023, the Cabinet Secretary for Wellbeing Economy, Fair Work and Energy provided the Director-General - Economy with the written authority, under section 15(8)(a) of the Public Finance and Accountability (Scotland) Act 2000, to continue with the build of MV Glen Rosa (vessel 802) at FMPG based on the current cost projections.

79. Full access to officials and the documentation that supported the Accountable Officer's decision to request a written authority was provided. I can confirm, from the evidence available, that the process followed was in accordance with the requirements set out in the SPFM.

Sponsorship of public bodies

80. The Scottish Government has implemented the recommendations set out in the independent review of its relationships with public bodies. The Public Bodies Support Unit (PBSU) has attended each Director General assurance group and the Audit and Assurance Committee to highlight areas of concern and outline required actions. The regular updates include the use of a RAG system to advise of any that are then escalated to ensure visibility across the Scottish Government.

81. It will take time for the Scottish Government to be able to fully demonstrate the impact of actions taken in response to the independent review. Cultural and behavioural changes are needed to foster good relationships with public bodies over time. Similarly, the benefits realised from improvements in training and support offered to sponsor teams will take time to evidence.

82. The relationships already built up between the PBSU and sponsored bodies are now being used to further the public service reform agenda. There continues to be a risk around staffing capacity and capability to successfully engage, support, challenge and maintain relationships with public bodies.

Corporate transformation

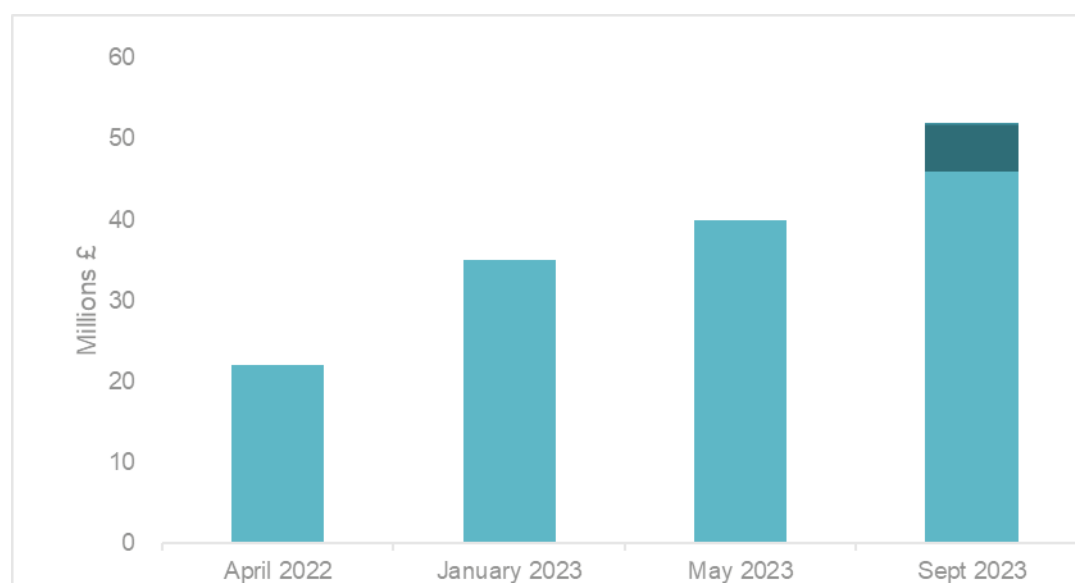
83. As part of its corporate transformation, the Scottish Government Shared Services Programme (SSP) is set to deliver a new HR and Finance system (Oracle Cloud), which replaces decades-old systems and is expected to provide shared services to the Scottish Government core and over 30 other public bodies. The original expectation was that the new HR module will be introduced between July and September 2023, followed by the introduction of the new finance system and associated modules by the end of 2023.

84. There have been changes to the initial timeframe with the current expected go-live date now being April 2024 for both elements. As shown in [Exhibit 5](#), the cost of the project, which was originally estimated to be £22 million in April 2022, increased to £35 million in January 2023 and to £40 million in May 2023. As at September 2023, the current estimated cost range is £46 - £52 million which takes account of increased costs due to initial underestimation of the scale and complexity of the programme, and re-stated timelines in response to these challenges.

85. The shared service programme has been subject to a number of gateway and technology assurance framework reviews all of which highlighted issues around delivery confidence. The most recent gateway review (July 2023) resulted in an amber/red assessment recognising that the project had reached a critical point in user acceptance testing and ultimate delivery. There remains a risk around delivery timescales. Cost benefit analysis undertaken by the Scottish Government indicates that the costs of running the new system over the next seven years will be £56.9 million, compared to £82.8 million for the current system.

Exhibit 5

Shared Services Project cost



Source: Scottish Government

86. The successful implementation of this new finance system is essential in terms of contributing towards financial sustainability due to reduced continuing cost, public service reform due to the ability to further share services and will increase the reliability and security around this key financial system. I have reported previously about the under-investment in core IT systems and the risk that the current systems are no longer fit for purpose. I will report further on the transformation programme upon its completion.

Climate change

87. The Scottish Government has a legally binding target of becoming net zero by 2045, five years earlier than the rest of the UK. Interim targets have been set which include a 75 per cent reduction in greenhouse gas emissions by 2030 (compared with 1990). The public sector in Scotland as a whole has a key role to play in ensuring these targets are met and in adapting to the impacts of climate change.

88. The Scottish Government's 'Update to the Climate Change Plan' 2020 includes a 'pathway to 2032' and 'vision for 2045' and contains a number of policies and proposed actions for each of the outcomes in the Climate Change Plan. The most recent Annual Monitoring Report was published in May 2023 and includes policy outcome indicators which relate to the outcomes in the Climate Change Plan. As at May 2023, of the 43 indicators, 21 were reported to be on track, 9 off track, and 13 too early to say. It is difficult to ascertain the direct contribution from the Scottish Government to the overall climate change targets.

89. I reported in April 2023 on [How the Scottish Government is set up to deliver climate change goals](#). In response, in September 2023, the Director General - Net Zero reported that action had been taken to address a number of the issues raised around risk management which would help to identify, focus and mitigate risk more easily. Governance arrangements are continuing to develop.

90. The Scottish Government published details of a proposed Deposit Return Scheme (DRS) in 2019 following a public consultation. The policy was then developed with support from The Deposit Return Scheme Implementation Advisory Group whose members provided a range of industry experience of relevance to the operation of the scheme.

91. The legal framework for the scheme was created by the [Deposit and Return Scheme for Scotland Regulations 2020](#), which were passed by the Scottish Parliament in May 2020. However, following the decision by the UK Government not to grant a full exclusion from the Internal Market Act, the regulations were amended in 2023 which delayed the launch date of DRS until October 2025 which will align with schemes in the rest of the UK. As a result, it is likely elements of Scotland's scheme will need to be redesigned to be fully inter-operable with the UK.

92. As at May 2023, the Scottish Government reported, in response to a freedom of information request, that the costs associated with the setting up of the DRS since 2018 totalled £219,000. This included the costs for public consultation, publication of regulations and associated documents, evaluations, independent reviews and assurance. Funding for the Scottish Environment Protection Agency (SEPA) and Zero Waste Scotland (ZWS) in their role implementing DRS was separately agreed with the Scottish Government as part of the annual budget process.

93. In May 2022, the Scottish National Investment Bank committed £9 million to Circularity Scotland Limited, a company set up to administer the DRS. Due to

the delay in implementation, Circularity Scotland Limited are now in administration and the full repayment of the loan is unlikely.

94. Climate change is one of the Scottish Government's key priorities of which DRS is a key contributor. There are a number of risks remaining around the implementation of DRS. These include the absence of a scheme administrator now that Circularity Scotland is no longer operational, uncertainty around the 2025 date for UK-wide implementation and more generally the impact on the ability to meet the net zero targets. Climate change remains a key area in my forward work programme.

Conclusion

95. The Consolidated Accounts remain a critical component of the Scottish Government's accountability to the Scottish Parliament and the public. The recent, unprecedented impact on public finances and the economy means the Scottish Government will need to manage further turbulence over the next few years. Strong financial management, transparent financial and performance reporting, effective longer-term planning and good governance remain essential to ensure the Scottish Government can transform public services and deliver its policy priorities.

96. Looking ahead, the Scottish Government should:

- agree its approach to the provision of consolidated information for the Scottish public sector and agree a timetable for completion as a matter of urgency.
- develop a clear roadmap of how the design and delivery of public services will be transformed to be financially sustainable, this should include the establishment of a cohesive workforce strategy that takes account of key factors such as the impact of growth in the NHS.
- clearly prioritise projects and programmes and consider how the public sector estate can support transformation of services.
- use the Policy Prospectus as an opportunity for a step change in the accessibility and transparency of its performance reporting. The performance report in the Consolidated Accounts should present clear targets and outline the progress that has been made in achieving the critical missions.
- review its governance and assurance arrangements to ensure they are efficient and effective and support the continued period of change and uncertainty being faced.

The 2022/23 audit of the Scottish Government Consolidated Accounts

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