

# Non-Domestic Rating Account

2017/18 Annual Audit Report



 AUDIT SCOTLAND

Prepared for the Scottish Government and the Auditor General for Scotland

February 2019

## Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.
- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



## About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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# Key messages

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## Audit of the 2017/18 financial statements

- 1** The independent auditor's report for the 2017/18 Non-Domestic Rating Account is unqualified.
- 2** The deficit on the NDR pool, which represents the balance between amounts contributed by local authorities less the amounts distributed to local authorities over time, has reduced at the end of 2017/18.

## Financial management and sustainability

- 3** The surplus for 2017/18 was £156 million resulting in a cumulative deficit balance on the account of £141 million at the end of 2017/18.
- 4** The draft Scottish Budget 2018/19 outlined how the Scottish Government plans to eliminate the current deficit by 2018/19, and balance the pool.

## Governance, transparency and value for money

- 5** The Scottish Government has made some progress in increasing the transparency of its financial information and reporting on NDR. There remains scope for further improvement to help provide the Parliament and the wider public with a fuller understanding of how NDR funding operates.

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# Introduction

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1. This report is a summary of our findings arising from the 2017/18 audit of the Scottish Government's Non-Domestic Rating Account (NDR Account).

2. The scope of our audit was set out in our Annual Audit Plan agreed in April 2018. This report comprises the findings from:

- an audit of the 2017/18 NDR Account
- consideration of the four audit dimensions that frame the wider scope of public audit set out in the [Code of Audit Practice 2016](#) as illustrated in [Exhibit 1](#).

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## Exhibit 1

### Audit dimensions



Source: *Code of Audit Practice 2016*

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3. The main elements of our audit work in 2017/18 have been:

- an audit of the 2017/18 NDR Account including the issue of an independent auditor's report setting out our opinions
- a review of the governance arrangements in relation to the NDR Account

4. The Scottish Government's Local Government Finance Team is responsible for: preparing the financial statements; for the accuracy of the other information disclosed alongside the account; and for establishing effective arrangements for governance, propriety and regularity that enable the team to successfully deliver its objectives.

- 5.** Our responsibilities as independent auditors are outlined in the Public Finance and Accountability (Scotland) Act 2000 and the [Code of Audit Practice 2016](#) and supplementary guidance, and guided by the auditing profession's ethical guidance.
- 6.** These responsibilities include giving independent opinions on: the financial statements and regularity. We also review and report on the arrangements within the Scottish Government to manage its performance, regularity and use of resources. In doing this, we aim to support improvement and accountability.
- 7.** Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.
- 8.** The weaknesses or risks identified in this report are only those which have come to our attention during our normal audit work, and may not be all that exist. Our annual audit report contains an agreed action plan at [Appendix 1](#). It sets out specific recommendations, responsible officers and dates for implementation. It also includes outstanding actions from last year and the steps being taken to implement them.
- 9.** We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and therefore the 2017/18 audit fee of £10,810 as set out in our Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.
- 10.** This report is addressed to both the Scottish Government's Executive Board and the Auditor General for Scotland and will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk) in due course.
- 11.** We would like to thank all management and staff who have been involved in our work for their cooperation and assistance during the audit.

# Part 1

## Audit of the 2017/18 Non-Domestic Rating Account



### Main judgements

The independent auditor's report for the 2017/18 Non-Domestic Rating Account is unqualified.

### Unqualified audit opinions

12. We reported, within our independent auditor's report:

- The financial statements properly present in accordance with Schedule 12 of the Local Government Finance Act 1992 as amended by Schedule 13 of the Local Government etc. (Scotland) Act 1994 and directions made thereunder by the Scottish Ministers the receipts and payments of the NDR account for the year ended 31 March 2018 and the balances held at that date.
- In all material respects, the sums paid out of the NDR account for the purpose of meeting the payments shown in the financial statements were applied in accordance with Section 65 of the Scotland Act 1998 and sections 4 to 6 of the Public Finance and Accountability (Scotland) Act 2000.
- Information given in the Foreword for the financial year for which the financial statements are prepared is consistent with the financial statements and our understanding of the NDR account. Additionally, we are satisfied that there are no matters which we are required by the Auditor General to report by exception.

The 2017/18 NDR account shows the receipts and payments for the year and the balances held at 31 March 2018.

### Submission of NDR Account for audit

13. We received the unaudited financial statements on 29 June 2018 in line with our agreed audit timetable. The working papers were of a satisfactory standard and the Local Government Finance Team provided the necessary support to the audit team.

### Risk of material misstatement

14. [Appendix 2](#) provides a description of those assessed risks of material misstatement that were identified during the planning process which had the greatest effect on the overall audit strategy, the allocation of resources to the audit and directing the efforts of the audit team.

### Materiality

15. Misstatements are material if they could reasonably be expected to influence the economic decisions of users taken based on the financial statements. The assessment of what is material is a matter of professional judgement. It involves

considering both the amount and nature of the misstatement. It is affected by our perception of the financial information needs of users of the financial statements.

**16.** Our initial assessment of materiality for the annual report and accounts was carried out during the planning phase of the audit and is summarised in [Exhibit 2](#). Specifically, with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

**17.** On receipt of the unaudited account we reviewed our original materiality calculations and concluded that they remained appropriate.

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## Exhibit 2

### Materiality values

Materiality level	Amount
<b>Overall materiality</b> – This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It was set at one per cent of gross expenditure for the year ended 31 March 2018.	£26.7 million
<b>Performance materiality</b> – This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality, this would indicate that further audit procedures should be considered. Using our professional judgement, we have calculated performance materiality at 75 per cent of overall materiality.	£20.1 million
<b>Reporting threshold</b> – We are required to report to those charged with governance on all unadjusted misstatements in excess of the ‘reporting threshold’ amount. This has been calculated at one per cent of overall materiality.	£0.3 million

Source: Annual Audit Plan 2017/18

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## Evaluation of misstatements

**18.** There were no material adjustments to the unaudited financial statements arising from our audit.

**19.** International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance. Where a finding has resulted in a recommendation to management, a cross reference to the Action Plan in [Appendix 1](#) has been included.

## Other findings

**20.** Our audit identified a number of presentational and disclosure issues which were discussed with management. These were adjusted and reflected in the audited financial statements.

# Part 2

## Financial management and sustainability



### Main judgements

**The surplus for 2017/18 was £156 million resulting in a cumulative deficit balance on the account of £141 million at the end of 2017/18.**

### Financial performance in 2017/18

**21.** The NDR account operates on a receipts basis and is managed by the Scottish Government's Local Government Finance Team. All NDR income collected by local authorities in Scotland is placed in a national "pool" and distributed to the local authorities as part of the Scottish Government's funding arrangements.

**22.** The Scottish Government guarantees the combined amount of revenue grant funding and non-domestic rates distributions provided to councils each year and manages the financial risk of variances within its budget. Where variances in non-domestic rates occur, the Scottish Government adjusts the council's general revenue grant to ensure funding levels to local government align to the levels agreed in the local government finance settlement for that year. Weekly payments are made to local authorities. These payments represent total revenue funding less NDR income, and any specific revenue grants that local authorities expect to receive.

**23.** Total non-domestic rates collected in 2017/18 was £2,868.7 million of which £24.7 million related to prior years. The total amount distributed for 2017/18 was £2,713.2 million which includes £47.4 million relating to prior years. The net position for 2017/18 was therefore a surplus of £155.5 million (2016/17: deficit of £8.1 million) resulting in a cumulative deficit balance on the account of £141.1 million carried forward into 2018/19.

Financial management is about financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

### Financial planning

**24.** Last year we reported that the Scottish Government has signalled its intention to bring the account into balance over a number of years but there is no formal plan in place. In May 2018, the Scottish Government published a five-year financial strategy, Scotland's Financial Outlook. The document provides information and scenarios about Scottish Government revenue expectations for the next five years and its effect on public spend. It also outlines its broad approach to NDR as a source of funding.

**25.** From April 2017, the Scottish Fiscal Commission is responsible for providing independent five-year forecasts of non-domestic rates income. Details of both the Scottish Fiscal Commission's forecast of NDR income and the Scottish Government's planned distributable amount up to 2021/22 have been set out in the draft budget document 2018/19, showing how the Scottish Government plans to eliminate the current deficit by 2018/19, and balance the pool going forward.

**26.** The Scottish Government needs to further develop its plans of how it intends to manage the NDR account in the future. As we reported in 2016/17, such a plan

should include scenario planning or sensitivity analysis to outline the potential impact on the overall account balance of any changes in contributions or distributions as a result of revised estimates or policy decisions. Scenario planning and sensitivity analysis would provide decision makers with greater information of how any fluctuations in NDR contributions or distributions may impact on decisions about how local government is funded as part of the annual budget process or the development of longer-term financial plans.

#### [Recommendation 1](#)

### **Systems of internal control**

**27.** Scottish Government accounting and banking systems are used in the management of the NDR account. As part of our audit we identify and inspect the key internal controls in those accounting systems which we regard as significant for the production of the financial statements. Our objective is to gain assurance that the Scottish Government has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

**28.** No material weaknesses in the accounting and banking systems were identified during our audit of the Scottish Government's Consolidated Accounts which could adversely affect the organisation's ability to record, process, summarise and report financial and other relevant data to result in a material misstatement in the NDR account.

### **Prevention and detection of fraud and irregularity**

**29.** Since the NDR account works within the Scottish Government's boundaries, we assessed their arrangements for the prevention and detection of fraud. Our audit work covered a number of areas such as whistleblowing and review of the counter fraud strategy.

**30.** We concluded that the Scottish Government is proactive in promoting fraud awareness and had appropriate and adequate arrangements in place for fraud detection and prevention during 2017/18.

### **Standards of conduct and arrangements for the prevention and detection of bribery and corruption**

**31.** We have also reviewed the arrangements in place to maintain standards of conduct including the Scottish Government's Staff Handbook and Civil Service and Members' Codes of Conduct. There are established procedures for preventing and detecting any breaches of these standards including any instances of corruption.

**32.** Based on our review of the evidence we concluded that the Scottish Government has appropriate arrangements in place for the prevention and detection of bribery and corruption. We are not aware of any specific issues that we need to bring to your attention.

# Part 3

## Governance, transparency and value for money



### Main judgements

**The Scottish Government has made some progress in increasing the transparency of its financial information and reporting on NDR. There remains scope for further improvement to help provide the Parliament and the wider public with a fuller understanding of how NDR funding operates.**

### Governance arrangements

**33.** The governance arrangements for the NDR account operate within the context of the Scottish Government's overall system of corporate governance. Our judgements on the adequacy of the governance arrangements will form part of our reporting on the 2017/18 Scottish Government's Consolidated Accounts.

**34.** The Scottish Government Assurance and Audit Committee (SGAAC) confirmed governance arrangements for the NDR account at its meeting on 2 March 2017 that includes oversight of the NDR account on an exceptions basis. Any issues relating to reporting or the administration of the NDR account will now be escalated to SGAAC.

**35.** The arrangements, within which the NDR account operates, are assessed by the Scottish Government who confirmed that these arrangements comply with generally accepted best practices and relevant guidelines. Assurance is also provided by the work of internal and external audit and can be supported by SGAAC if required.

### The Annual Governance Statement

**36.** A separate governance statement is not prepared for the NDR account as it is not an entity but an extract of the Scottish Consolidated Fund. Although the Scottish Consolidated Fund sits outside the Scottish Government's internal governance arrangements, the Fund, like the NDR account, is subject to the same controls and assurance procedures that apply to the Scottish Government.

### Transparency

**37.** Transparency means that the public have access to understandable, relevant and timely information about how the Government is taking decisions and how it is using resources.

**38.** Information about how NDR operates, including budget and financial information is fragmented across a number of different financial statements and budget documents.

**39.** The Scottish Government improved the transparency of the NDR account within its 2018/19 draft budget which disclosed how the Scottish Government

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision-making and transparent reporting of financial and performance information.

planned to reduce the deficit on the NDR pool and the balance on the NDR pool going forward.

**40.** The Scottish Government should continue to increase financial transparency on non-domestic rates by:

- publishing details of how the distributable amount paid to councils is calculated and set as part of the Scottish budget including underpinning assumptions.
- undertaking, and publishing, scenario planning and sensitivity analysis to provide decision makers with greater information of how any fluctuations in NDR contributions or distributions may impact on decisions about how local government is funded.

[Recommendation 1](#)

# Appendix 1

## Action plan 2017/18

### 2017/18 follow up on prior year recommendations for improvement



No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p><b>Transparency of financial reporting</b></p> <p>The Scottish Government has made some progress in increasing the transparency of its financial information and reporting on NDR. There remains scope for further improvement to help provide the Parliament and the wider public with a fuller understanding of how NDR funding operates:</p> <ul style="list-style-type: none"> <li>• Publishing details of how the distributable amount is calculated including details on any assumptions used</li> <li>• Undertaking, and publishing, scenario planning and sensitivity analysis to provide decision makers with greater information of how any fluctuations in NDR contributions or distributions may impact on decisions about how local government is funded.</li> </ul> <p><b>Risk</b></p> <p>There is a risk that the reporting in the NDR Account does not provide sufficient information for a reader of the account.</p>	<p>The Scottish Government should use the annual account as an opportunity to enhance reporting on NDR.</p> <p><a href="#">Paragraphs 26 and 40</a></p>	<p>The format and content of the NDR account fulfils the statutory requirements for the account; it explains the processes relevant to the pooling and redistribution of NDR but there are other, more appropriate sources of explanation and information available to provide a full understanding of how NDR funding operates – most notably the Medium Term Financial Strategy and annual Budget documents which set out decisions by Scottish Ministers and Scottish Fiscal Commission outputs in relation to their role in forecasting NDR.</p> <p><a href="http://www.fiscalcommission.scot/what-we-forecast/non-domestic-rates-ndr">www.fiscalcommission.scot/what-we-forecast/non-domestic-rates-ndr</a>.</p> <p>Any fluctuations in NDR are taken into account at the overall Scottish Budget level and not at the local government funding level.</p> <p>Agreed Action: The content of the 2018-19 account will be reviewed as part of the accounts production process.</p> <p>Responsible officer: Team Leader, Local Government Finance</p> <p>By end June 2019</p>

# Appendix 2

## Significant audit risks identified during planning

The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the annual report and accounts and those relating our wider responsibility under the [Code of Audit Practice 2016](#).

Audit Risk	Assurance procedure	Results and conclusions
<b>Risks of material misstatement in the financial statements</b>		
<p><b>1 Risk of management override of controls</b></p> <p>ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls in order to change the position disclosed in the financial statements.</p>	<p>Detailed testing of journal entries.</p> <p>Review of accounting estimates.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p>	<p>The balances making up the 2017/18 NDR Account were substantively tested and the results were satisfactory.</p>
<p><b>2 Changes to processes</b></p> <p>In 2017/18 the Non-Domestic Rating Account will be prepared using revised processes. These processes will automatically populate the account rather than the previous manual process.</p> <p>With any change in approach, there is always a risk that changes may lead to errors.</p>	<p>Document and assess the new process for populating the account.</p> <p>Detailed testing of Account balances.</p>	<p>The process for populating the 2017/18 NDR Account was discussed with the Local Government Finance Team and no risks were noted.</p> <p>The balances making up the 2017/18 NDR Account were substantively tested and the results were satisfactory.</p>
<b>Risks identified from the auditor's wider responsibility under the Code of Audit Practice</b>		
<p><b>3 Financial sustainability</b></p> <p>At the end of 2016/17, the NDR account showed a cumulative deficit balance of £297 million. In December 2017, the Scottish Government published plans that indicated the deficit would reduce to £142 million at the end of 2017/18.</p> <p>There remains a risk that the planned year-end balance in 2017/18 may not be achieved. This would impact on the Scottish Government's intention to bring the account into balance by the end of 2018/19.</p>	<p>In December 2017, the Scottish Government published details of its intention to bring the account into balance by the end of 2018/19. This was based on an anticipated year-end deficit balance of £142 million in 2017/18.</p> <p>Re-performance of calculations for projected year-end balance</p> <p>Substantive testing of balances.</p>	<p>The year-end deficit for 2017/18 is £141 million which is in line with the Scottish Government's intention to bring the NDR Account into balance by the end of 2018/19.</p> <p>The balances making up the 2017/18 NDR Account were substantively tested and the results were satisfactory.</p>

# Appendix 3

## Summary of national performance reports 2017/18



		Apr	
		May	
Common Agricultural Policy Futures programme: further update		Jun	Scotland's colleges 2017
		Jul	NHS workforce planning
Self-directed support: 2017 progress report		Aug	
Equal pay in Scottish councils		Sept	
Transport Scotland's ferry services		Oct	NHS in Scotland 2017
Local government in Scotland: Financial overview 2016/17		Nov	
		Dec	
		Jan	
Early learning and childcare		Feb	
Managing the implementation of the Scotland Acts		Mar	

### Central Government relevant reports

[Common Agricultural Policy Futures programme: further update](#) – June 2017

[Transport Scotland's ferry services](#) – October 2017

[Early learning and childcare](#) – February 2018

[Managing the implementation of the Scotland Acts](#) – March 2018

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