

# Consultation on the Budget Process Review Group's interim report

## Submission from the Auditor General for Scotland, Accounts Commission and Audit Scotland

### Introduction

1. The Auditor General for Scotland, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:
  - The Auditor General for Scotland is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit central government, health and further education bodies and report to Parliament on their financial health and performance.
  - The Accounts Commission for Scotland is an independent public body appointed by ministers to hold local government to account.
  - Audit Scotland provides services to the Auditor General and the Accounts Commission.
2. Public audit provides independent assurance that public money is spent properly and is providing value for money. We carry out this work through the annual audits of public bodies, performance audits on specific themes and subjects, and best value audits of councils and partnerships.
3. The Auditor General, Accounts Commission and Audit Scotland welcome the work of the Budget Process Review Group. We value the opportunity to respond to this consultation.

### Overall comments

4. Management of the Scottish public finances is fundamentally changing as a result of new tax and spending powers set out in the Scotland Act 2016 and the accompanying fiscal framework. Scotland's budget is increasingly complex, and subject to greater uncertainty and volatility than when the block grant from the UK Government was relatively fixed. The new powers give more control over public finances and bring new opportunities and challenges. The Scottish Government and Parliament have more choice over tax and spending, and more decisions to make about how and when to use new borrowing and reserve powers. The performance of the Scottish economy relative to the rest of the UK will have a greater influence on public finances than ever before.
5. We agree that this requires a transformational change to the Scottish Parliament's existing budget process. This is needed to support both Parliament and Government to operate effectively in a public financial system that has more inherent uncertainty, greater links to the economy and more moving parts. There is also an opportunity for

Parliamentary financial scrutiny processes that are world class, reflecting international best practice in a manner appropriate to the Scottish context.

6. Our view is that it is important to move toward a whole cycle approach, extending the thrust of Parliamentary scrutiny from an annual set-piece event focussed around a draft budget toward sustained Parliamentary engagement throughout all stages of the budget cycle: from broad budget strategies, through detailed formulation and approval, to execution and evaluation. Such an approach, which builds on recent approaches of some Parliamentary committees, is essential if the future timing of the UK budget compresses the time available for scrutiny of the detailed budget figures for the financial year ahead.
7. A more strategic approach to public financial management is also needed. This requires a good understanding of the economic and fiscal context in both Scotland and the UK as a whole. It also means joined-up thinking across different components of the budget - revenues, spending, borrowing and reserves - understanding the manner in which they interact with each other and with economic performance. Finally there will be a need for longer-term thinking and planning, and the development of clear financial strategies and principles for decision making. A critical aspect of this will be balancing the need for short-term flexibility with longer-term direction, clarity and resilience. This will require the Scottish Government to set out its financial analysis and policies, including a medium-term financial strategy, and for the Parliament to scrutinise these effectively.
8. Government policies are delivered through public bodies and in partnership with local government and the third sector. A longer-term approach to finances, looking ahead five to ten years, is also important within each of these organisations. It provides a context for their decisions and creates an overall framework for their own financial decision-making and sustainability. Providing indicative funding levels for three to five years ahead through the budget process would help public sector bodies to update their medium-term planning and strategies.
9. There are some important distinctions between councils and other public bodies in relation to the budget process. Councils, and other local government bodies, have their own democratic mandate and are directly accountable to the public through locally elected members. They are held to account for their spending and performance by the Accounts Commission. Councils also have continuing tax raising, borrowing and reserve powers. The revised budget process needs to reflect these distinctions and fiscal powers, considering the contribution of local government to national priorities while recognising the local policy choices and accountability of individual bodies.
10. Overarching principles of financial sustainability, transparency and accountability should drive the revised budget process. There will be an overriding need to balance the books in the context of greater financial risk and a more complex financial environment. Through the Finance and Constitution Committee, Parliament should have a clear locus on scrutinising the financial sustainability of the devolved public finances. It will also be important that the financial position, prospects and pressures are clearly understood, and for the Parliament to be able to hold Government to account for its overall management of the public finances.

11. Finally, more effective performance planning, reporting and scrutiny would improve clarity over what public spending is aiming to achieve, how this contributes to the Government's overall purpose and outcomes set out in the National Performance Framework. This would be an important part of a whole-cycle approach, with ongoing scrutiny informing development and consideration of detailed budget proposals. Audit reporting is a key component of this cycle, providing objective information on the public finances, performance and value for money. We agree there is scope for this to be more widely used as part of the Parliament's financial scrutiny. Effective coordination and liaison between parliamentary committees will help to ensure a coherent approach to outcomes-based financial scrutiny.
12. We provide more detailed comments on each of these areas and on the specific consultation questions that we consider relevant to our role below. As the Group's interim report recognises, careful consideration will need to be given to capacity considerations within key organisations including the Scottish Government, Parliament and its committees. Ultimately it will be for the Scottish Parliament and Government to decide how best to balance aspirations for what the process might achieve and the practicalities of implementation. This will need both ambition and realism.

## Theme 1: How effective is the existing budget process?

### *Principles Based Approach*

**Q1.** What adjustments do you consider are required to the existing FIAG principles to support a world class financial scrutiny process for Scotland in 2017?

13. The FIAG principles of openness and accessibility continue to be relevant, but these and the existing budget process were designed for a spending budget, with limited tax varying powers. Scotland's budget is now very different as outlined above and the underlying principles need to be developed to reflect this.
14. Ensuring a world class scrutiny process for this new financial environment means looking towards international norms and principles, including those of the International Monetary Fund (IMF) and the Organisation for Economic Co-operation and Development (OECD), as highlighted in Professor Wehner's report for the Group.<sup>1</sup> In doing this, it will be important to ensure that the principles underpinning the revised budget process will work in the Scottish context and align with the 'vision' of the Parliament and Scottish Government for the process, building on the FIAG principles. Where this means a departure from international best practice, the rationale for this should be clear and convincing.
15. The new budget process should give the Parliament time and space to scrutinise tax as well as spending proposals, and include clear and robust information on the most important issues. Financial sustainability, transparency and accountability should be an integral part of financial scrutiny in Scotland.

<sup>1</sup> *Good practice in parliamentary budget scrutiny: international comparisons*, Professor Wehner, February 2017.

16. These changes to the budget are happening alongside continuing financial pressures on public bodies and an ambitious programme of public service reform in areas such as health and social care, education and communities. A clear picture of the public finances, and the prospects and pressures facing them, is more important than ever, to enable the Parliament to hold the Scottish Government to account.

### *Full Year Approach*

**Q2.** Should the Parliament pursue a full-year approach to budget scrutiny, and what are the challenges and opportunities of this approach?

17. We are very supportive of a full-year or whole cycle approach to budget scrutiny. Audit Scotland provided the Budget Process Review Group with an illustrative example of such an approach ([Exhibit 1](#)). In designing a revised process for the Scottish Parliament there is the potential to combine some of the elements included in this illustration - for example elements of the budget strategy and formulation phases. Some elements do not necessarily need to be undertaken every year or linked to the budget of a particular financial year.
18. It is our strong view that parliamentary scrutiny of budgets and use of resources should happen as part of a continuous cycle, rather than an annual event. This is particularly important where the time available to scrutinise detailed draft budget documents is curtailed as a result of changes to the UK budget timing and a wish to await key information affecting the Scottish budget before detailed proposals are published.
19. A whole cycle approach would provide more space and time for scrutiny of the value for money of budget decisions, with this informing the development and consideration of specific budget proposals. We provide further comments on outcome based scrutiny under [theme five](#).
20. It will be important to integrate evidence-based assessment of equality impacts and considerations throughout all stages of a whole cycle budget approach. This would make an important contribution to mainstreaming equality considerations in Government decision making, given the importance of taxation and resource allocation to this. The issues associated with considering the equality dimension to public policy and resource allocation are illustrative of some of the wider challenges in the budget process— having clear multi-dimensional budgetary impact analysis and evaluation that feeds back into future policy and budget setting. The Draft Budget has been accompanied by an Equality Budget Statement (EBS) for the last eight years. There are opportunities to build on this approach, particularly to widen it consider the equality implications of tax measures alongside spending plans.
21. The Scottish Government has significant discretion over when and how it responds to financial developments throughout the year. For example, Barnett consequential that arise between the draft budget and the start of the financial year have often been applied in formal budget revisions rather than by adjusting the initial budget bill. We anticipate that the greater level of uncertainty and volatility in the budget will mean the

Scottish Government is likely to need to actively manage the overall budget position during a financial year to a greater extent than previously. An effect of this is that, to understand the overall budgetary position in any one financial year, scrutiny is required over each of the components: draft budget and budget bill, budget revision regulations and outturns.

## Exhibit 1

### Whole cycle approach to budget scrutiny

Strategy	→	Formulation	→	Approval	→	Execution	→	Audit & evaluation
State explicitly the government's long-term economic and fiscal policy objectives/intentions.		Support debate on the budget aggregates and how they interact with the economy.		Provide a detailed commentary on each revenue and expenditure programme.		Track aggregate spending and revenues.		Confirm robustness of financial reporting and compliance with legislation/ regulation.
Set out expectations and broad financial plans for a number of years ahead (5-7), making link to economic performance and consequences for public finances.		Create appropriate expectations for the budget.		Provide non-financial performance plans, including performance targets.		Determine whether initial budget is in need of review or fine-tuning as a result of economic or other changes.		Provide objective commentary on financial position and performance.
Assess LT sustainability of public finances.		Show how revenue and expenditure will develop during, at least, the two years beyond the next fiscal year.		Make the budget accessible to the public.		Outline performance of budget as executed relative to plan.		Report on significant issues of concern.
				Provide Parliamentary authority for expenditure and revenue raising measures.		Cover finance, performance, outputs & outcomes.		Consider whether those organisations raising and spending public money provide value for money.
➤ <b>Medium Term Financial Strategy</b>	➤	<b>Pre-budget statement</b>	➤	<b>Draft budget</b>	➤	<b>In-year reporting &amp; review</b>	➤	<b>Audit certification</b>
➤ <b>Fiscal policies &amp; principles (devolved tax, borrowing, reserves)</b>	➤	<b>Multi-year spending review</b>	➤	<b>Citizen's budget</b>	➤	<b>Budget revisions</b>	➤	<b>Audit reporting on individual accounts</b>
➤ <b>Fiscal rules</b>			➤	<b>Equality budget statement</b>	➤	<b>Outturn statements</b>		
➤ <b>Scenario planning</b>			➤	<b>Budget Bill/ Act</b>	➤	<b>Performance reporting</b>	➤	<b>Audit reporting on performance &amp; VFM</b>
			➤	<b>Tax resolutions</b>	➤	<b>Annual reports &amp; accounts</b>		

Source: Audit Scotland

### Public Engagement

**Q3.** How effective is current public engagement in the budget process and how can this be improved?

**Q4.** What examples are there of good practice in delivering meaningful public engagement in budget scrutiny and/or the formulation of government spending proposals?

**Q5.** What should be the purpose of public engagement on the Scottish budget?

22. The work of the Accounts Commission and Auditor General regularly highlights the importance of consulting with the public on their priorities and involving communities in funding decisions. This can help to influence where public funds are spent and manage expectations by improving public understanding of the resources available and the need to balance competing priorities. Strengthening public engagement in the budget process could help build trust in the Parliament and involve the public in holding the Government to account for its spending. Engaging with taxpayers can help the government to make informed decisions about public finances and prioritisation of resources. It can also provide critical evidence on how well public services are performing, to support the Parliament in its scrutiny role.
23. Various innovative approaches to public participation in both budget setting and parliamentary scrutiny have been taken in countries such as Australia, Brazil, Canada, Denmark, Estonia, Finland and Ireland. These have included citizens juries and assemblies, deliberative polls and stakeholder partnerships. Clearly, any of these developments would need to be adapted to reflect the specific context of the Scottish Parliament and what it is trying to achieve. But they provide potential ways in which the Parliament's commitment to public engagement could be further developed.
24. The International Budget Partnership notes that citizens budgets can be one way of giving the public the information they need to participate as informed stakeholders and hold the government to account for how it manages public money.<sup>2</sup> The Scottish Government published a short guide to Scotland's public finances alongside the publication of its 2017/18 draft budget.<sup>3</sup> Using helpful infographics, this explained how the budget is funded, what money is spent on and the timeline for new tax and spending powers. The Scottish Government could develop this further as part of a revised budget process to include:
- economic assumptions underlying the budget, such as forecasts of economic growth
  - key policy initiatives and the reasons for any significant increases or decreases in revenue or spending
  - performance data and medium-term projections of its planned objectives and outcomes, including the anticipated resources needed to deliver them.
25. Moving to a whole cycle approach to budget scrutiny may provide more opportunities, and time, to engage with the public in different ways on the Scottish budget. Such engagement is likely to be more meaningful, informative and influential where it reflects a multi-year perspective and takes place in advance of the formulation of specific spending proposals.

---

<sup>2</sup> International Budget Partnership: <http://www.internationalbudget.org/opening-budgets/citizens-budgets/>

<sup>3</sup> *Scotland's finances: key facts and figures*, Scottish Government, December 2016.



## Stage 2 (Draft Budget Scrutiny Phase)

- Q6.** What should be the core objectives of parliamentary scrutiny of the draft budget?
- Q7.** How effective is the existing parliamentary scrutiny of the draft budget and how can it be improved?
- Q8.** How does the new UK Autumn budget process affect the timing of the draft budget?
- Q9.** In what ways can the level of transparency of the draft budget and other budget documents be improved?

- 26.** Effective Parliamentary scrutiny is critical to ensure that decisions being taken by government are thoroughly tested and independently reviewed. This improves decision-making and contributes to public trust and confidence in our democratic system of government. As the Scottish Government implements new tax and spending powers, the Parliament's role in scrutinising its policies, budgets and performance has never been more important. To fulfil this role, the Parliament must get comprehensive, reliable and timely information about the Scottish Government's objectives, plans and progress. This includes comprehensive information about how it intends to use the money available to it, how it was spent and what was achieved as a result.
- 27.** Time is one of the most important dimensions of good Parliamentary scrutiny. The UK Government now plans to publish its budget in autumn each year. We recognise the implications of this for the timing of the Scottish draft budget, as the UK budget determines the size of the block grant to Scotland. As the annual Scottish budget needs to be agreed by Parliament by the start of each financial year, there will need to be a trade-off between clarity over the size of the block grant and time for detailed scrutiny.
- 28.** Given the increased uncertainty inherent in the Scottish budget, whenever detailed proposals are published these will rely on a degree of forecasting and estimation, and there will be a limit to which spending plans might be considered absolutely firm at any stage. Nevertheless we recognise that awaiting the outcome of each year's UK budget has practical benefits. In particular, in providing better information about the immediate effects of Block Grant Adjustments and enabling Scottish Fiscal Commission forecasts to be prepared on a basis consistent with these. Given that this would necessarily curtail the time available for scrutiny of the detailed draft budget, in our view it is essential that any such decision is accompanied by both a year-round whole cycle approach and the introduction of a medium-term financial strategy. We would also note that this may mean a greater availability of formal amendment powers over the budget bill and tax resolutions are appropriate.
- 29.** Clear, transparent and consistent reporting on all parts of the budget cycle is important; from the budget itself to reporting on outturn and performance. This will enable the Parliament and wider public to scrutinise the Scottish Government's decisions in a more complex financial environment. This includes seeing and understanding the basis on which decisions are made and the assumptions underlying changes in revenues and spending from one year to another.

30. We agree with the view of the Group (paragraph 87) that it is important to more clearly separate the objective, factual content of budget proposals from that which is policy driven or political in nature. The introduction of objective standards for financial information included in budget documents would support this. We would suggest that such standards should be prepared by the Finance and Constitution Committee and agreed with the Scottish Government. This might usefully include standard templates for key budget tables.
31. Key features of such standards would include:
- clarity over key budget aggregates, showing how anticipated spending is funded from anticipated revenues and any use of borrowing and reserve powers
  - consistent presentation of revenue and expenditure classifications (for example between RDEL, CDEL, AME and Financial Transactions)
  - comprehensive time series information, looking at least two years backward and three to five years forward, linked to the period covered by any spending reviews and medium-term financial strategies
  - public data availability based on relevant open government standards.
32. The Auditor General recently reported that the Scottish Government is taking steps to enhance financial reporting to provide a more comprehensive picture of Scotland's public finances, but more work is required.<sup>4</sup> Her report highlighted the importance of providing a clear overall picture of Scotland's public finances. This includes reporting clearly on:
- how anticipated spending is funded from anticipated revenues
  - movements in the Scottish block grant arising from the application of the Barnett formula, baseline adjustments and indexation for each element of the block grant
  - revenue and spending forecasts, and reconciling these to actual amounts when they are known
  - actual spending against budget and the reasons for variations
  - the impact of any capital and revenue borrowing, and movements and balances in the Scotland Reserve
  - what has been achieved from public spending
  - other commitments, guarantees or potential liabilities that may impact on future budgets.
33. The Scottish Government reports this information in a variety of documents including budget documents, audited annual accounts, and economic and performance reports. It is important this information is presented in such a way that is easy to understand and navigate. This provides a basis for ongoing engagement with taxpayers and helps the Parliament to build a comprehensive picture of Scotland's public finances. This allows

---

<sup>4</sup> [Managing new financial powers: an update](#), Audit Scotland, March 2017.



the potential consequences of policy choices and decisions on long-term financial sustainability to be better understood.

34. The interim report (paragraph 86) raises the question of whether the increasingly dynamic nature of the Scottish Budget, with greater volatility and uncertainty, means that there is a need for some form of in-year reporting. We anticipate that the Scottish Government is likely to need to actively manage the overall budget position, making decisions during the year about use of the available flexibilities including reserves and potentially resource borrowing, and changes to public spending. It is important, therefore, that there is prompt and transparent reporting of any significant in-year financial management activity, and that the Finance and Constitution Committee has the opportunity to scrutinise this.
35. Such reporting is necessary where there is a significant amendment to or departure from previously published plans, policies or strategies. This would include, for example, where the Scottish Government makes use of resource borrowing powers where this was not previously anticipated in budget documents.
36. There may be value in introducing a mid-year report, whereby any significant changes to plans might be reported. This would include any significant in-year variances in devolved tax revenues or demand-led spending, for example on social security. This might usefully sit alongside existing formal budget revision procedures (particularly the Spring Budget Revision), providing a rounded view of expectations alongside the specific changes to formal budget limits that are proposed. In our view, given the likely costs and benefits, it is not necessary to introduce more frequent (monthly or quarterly) reporting during the year alongside existing updates on devolved tax collection.
37. A thorough understanding of how much money has been committed across government to long-term investment such as borrowing, public private partnerships and public sector pensions is important when taking decisions about future tax and spending. It is also important to have a good awareness of the financial implications of wider policy commitments (such as those in health and social care) and the full range of other potential financial commitments which depend on events in the future, such as contingent clinical negligence claims. This needs to be set within the context of what the Scottish public sector owns, that is assets acquired from taxes. Taken together, such information would help provide a more complete understanding of the Scottish public finances.
38. In evidence to the Finance and Constitution Committee in November 2016, the Auditor General highlighted areas for continued development, including:<sup>5</sup>
  - the draft budget and materials to support in-year budget revisions, so that these show how the key components of the budget have been established and how planned expenditure is expected to be funded overall

---

<sup>5</sup> [Written submission from the Auditor General for Scotland on Scotland's fiscal framework](#), Finance and Constitution Committee, November 2016.

- the suite of annual accounts that contain detailed outturn information on the different components of the budget, so that the information provided is set in the context of the budget as a whole, and the overall position is clear
- accompanying performance reporting, so that it is clearer what spending is aiming to achieve and how this contributes to the Government's overall purpose and specific outputs and outcomes
- consolidated accounts for the whole of the Scottish public sector.

### *Stage 3 (Budget Bill Phase)*

**Q10.** How effective is the existing Budget Bill process and what, if any, changes are required?

**Q11.** Should the Parliament have the opportunity to lodge amendments to the Budget Bill or should non-Government amendments still only be proposed at the pre-legislative stage?

**Q12.** If the former what, if any, should be the limits on the power of the Parliament to lodge amendments?

- 39.** In revising the budget setting and scrutiny process it will be important to agree the 'vision' for the process. This needs to be a decision reached between the Parliament and the Scottish Government and it needs to be one that works in the Scottish context. This will then inform the mechanics of how it will work in practice, such as the legislation required and details of parliamentary procedure. The nature and extent of amendment powers will be a key feature of this. Any changes to these should be considered alongside the virement powers available to the Government, which determine the flexibility it has to depart from the established budget without formal amendment.
- 40.** As highlighted above, budget documents should include as much information to provide a full understanding of the overall financial position. Whatever the legislative process for approving the draft budget, it is important that it allows for consideration of revenues and spending together, within the context of longer-term financial commitments.
- 41.** The existing Budget Bill process is based on there being a significant degree of up-front scrutiny. We would note that where the opportunity for scrutiny of a detailed draft budget or other budget review is curtailed this may mean a greater availability of formal amendment powers over the budget bill and tax resolutions is appropriate.

## Theme 2: What is the impact of the Fiscal Framework?

**Q13.** What information should be provided, and when, to ensure full transparency of how the following elements of the Fiscal Framework operate:

- the adjustments to the block grant
- the reconciliation process, including interim outturn information
- borrowing powers
- the Scotland Reserve.

**Q14.** How should parliamentary scrutiny of these new aspects to the budget process operate? For example, should these new aspects be carried out as part of the budget process, or as a separate scrutiny process focusing on the operation of the Fiscal Framework?

42. The fiscal framework sets out agreed rules and limits within which the Scottish Government will manage its finances and the related economic and funding risks. They include rules for block grant adjustments, reconciliations, annual and overall limits for borrowing and the Scotland Reserve. Working within this framework, the Scottish Government will need to make choices on how it uses its new tax and spending powers and its fiscal policies more generally. Decisions will need to be made based on a good understanding of the consequences for future years and how these sit alongside existing commitments, ensuring the financial sustainability of Scotland's public finances over time. It will be important that these decisions, and the policies and assumptions underpinning them, are clearly articulated in a way that enables effective Parliamentary scrutiny.
43. Decisions about the use of the provisions in the fiscal framework will affect the extent to which they are available in subsequent years and impact on other aspects of the budget, such as the need to accommodate borrowing repayments. It will be critical for the Scottish Government to provide clear information on how all parts of the fiscal framework operate in practice, and for this to be scrutinised as part of the budget process.
44. The operation of the fiscal framework is now an essential component of the Scottish budget and, as such, will need to be integrated into the revised budget and scrutiny process throughout the budget cycle. In doing so, the following issues should be considered:
- The fiscal framework is complex and includes a number of separate but interrelated elements, such as block grant adjustments and reconciliations. For a full understanding of their impact on the Scottish budget, all the components should be considered together.
  - The volatility of tax revenues and social security spending means there is likely to be variance between actuals and forecasts. This increases the importance of in-year monitoring and reporting, more detailed explanations of differences between budgets and outturns, and clear explanations of reconciliations.

- Access to data to support in-year monitoring, reporting and scrutiny relies on a number of organisations across the UK working together and sharing information. This includes the Scottish and UK Governments, Scottish Fiscal Commission, Revenue Scotland and HM Revenue and Customs. The availability and timing of the data needed to support effective scrutiny of the fiscal framework will need to be factored into any new process.
45. Effective scrutiny of the operation of the fiscal framework will require an understanding of how the provisions in the fiscal framework are being managed. This will involve looking across the different components - revenues, spending, borrowing and reserves - and understanding how they interact with each other and with economic performance. It will also require clarity over the policies, principles and parameters that the Scottish Government is working to. For example:<sup>6</sup>
- under what conditions the Scottish Government will use capital and revenue borrowing
  - how the Scottish Government will demonstrate decisions are affordable and sustainable
  - what processes the Scottish Government will put in place to assess and respond to forecasting errors or a Scotland-specific 'economic shock'
  - how the Scottish Government will report borrowing and use of its reserve against the limits set in the fiscal framework
  - any additional limits or targets, other than those in the fiscal framework, the Scottish Government puts in place to ensure there is scope to deal with unexpected economic events.
46. The Scottish Government may set out its plans for some of these areas in advance, for example the anticipated level of capital borrowing. In others, most notably in relation to resource borrowing, the provisions may be utilised largely in response to conditions that arise during the year.

### Theme 3: How effective is the current approach to Multi-Year Budgeting?

**Q15.** What should be the core objectives of Scottish Government Spending Reviews, how often should they be carried out and when?

**Q16.** What level of information should the Scottish Government publish?

**Q17.** What should be the role of the parliament's committees in scrutinising Spending Reviews?

47. Spending reviews are a way for the Scottish Government to consider and set out publicly its public spending priorities and plans for a number of years ahead. This is an important component of a whole cycle and longer-term budgeting approach. Spending reviews should include details of what the Scottish Government aims to achieve with the money it expects to have available, and how it will achieve best value for money of

<sup>6</sup> [Managing new financial powers: an update](#), Audit Scotland, March 2017.

public expenditure. This includes any planned savings or reductions in funding. Although setting out these issues is always important, it is particularly helpful to clarify them when working within financial pressures.

48. In future, spending reviews will need to be conducted in the context of forecast tax revenues and demand-led social security payments, given the impact on spending plans. These new features of Scottish public financial management introduce an underlying uncertainty to multi-year budgeting. To support effective scrutiny of spending reviews, by parliamentary subject committees and the public, the Scottish Government should outline the extent of this uncertainty and what that might mean for the overall financial position and its spending plans. This includes setting out forecasts, projections and models and the assumptions underpinning them.
49. Government policies are delivered through public bodies and in partnership with local government and the third sector. Multi-year budgeting helps these organisations to plan better over the longer-term (five to ten years). A longer-term approach to finances is also important within each of them. It provides a context for their decisions and creates an overall framework for their own financial decision-making and sustainability. While the absence of indicative funding should not prevent organisations projecting future income, and planning accordingly, providing this for three to five years ahead through the budget process would help them to update their medium-term planning and strategies. This would also support a better understanding of public financial management and sustainability across the public sector.
50. There is scope to develop spending reviews to focus more on the outcomes the Scottish Government is aiming to achieve through its spend. This is explored more under [theme five](#).

#### **Theme 4: How effective is the current approach to Medium-Term Financial Planning?**

**Q18.** Should the Scottish Government publish a medium term financial strategy?

**Q19.** If so, what should it include, what should be the role of the SFC in its preparation and how frequently should it be updated?

51. The new financial powers require a more strategic approach to public financial management and reporting. This should include an overarching, medium-term financial strategy underpinned by clear policies and principles for managing the public finances. A longer term approach would support decision-making and financial sustainability.
52. [Exhibit 2](#) sets out the main components of strategic financial management. The Scottish Government should publish a medium-term financial strategy for Parliamentary and wider public scrutiny. This should set out the expectations and broad financial plans/projections for the next five years. It should make the link to anticipated economic performance and the consequences for the block grant, and devolved and assigned revenue and spending. It should also be underpinned by clear policies and principles for using, managing and controlling the available powers. Scenario planning based on

economic forecasts and financial information will be increasingly important in assessing the range of potential impacts on the Scottish budget and in turn aid financial planning, management and decision making.

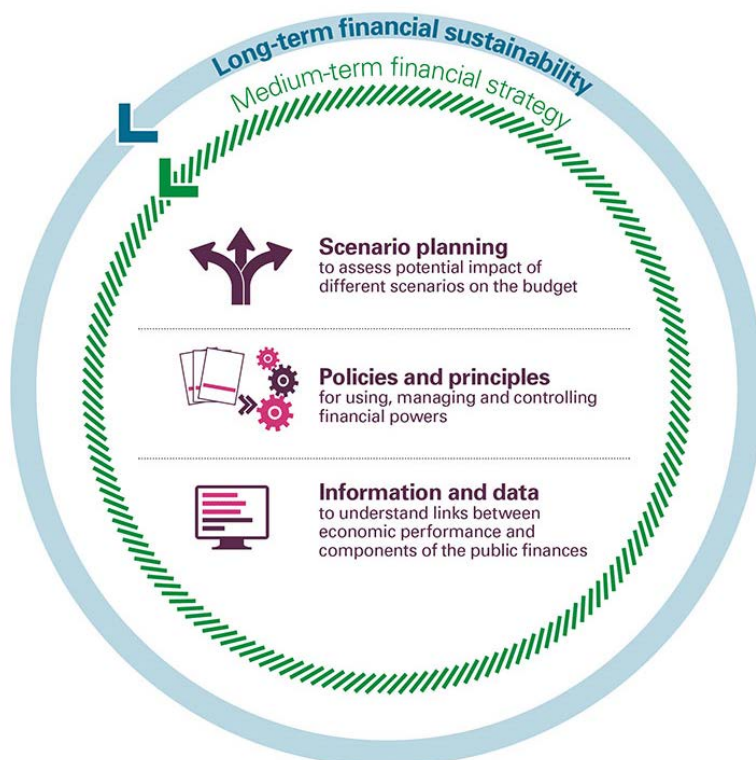
53. Potential components of a medium-term financial strategy are set out in the Budget Process Review Group's interim report (at paragraph 167). We would support the inclusion of this information, including projected levels of revenues and funding, indicative spending and investment levels, and anticipated borrowing and reserves.
54. Making the medium-term financial strategy and any related policies, principles and underpinning assumptions publicly available will enhance financial transparency. Publishing medium and longer-term models, projections and plans will provide the Parliament, public bodies, councils and the wider public with the information they need to have a fuller understanding of the overall financial position. More clarity about overall financial expectations and plans would in turn encourage improved financial planning by public bodies.
55. A medium-term financial strategy is by its nature based on forecasts, projections and estimates. These will need to be as soundly based and unbiased as possible, but will always be subject to inherent uncertainty. In setting out central financial forecasts and projections it will be important to outline the extent of this uncertainty and what that might mean for the overall financial position. This might usefully include:
  - scenario planning, assessing a range of potential impacts on the Scottish budget
  - relevant technical information about statistical forecasts that have been prepared and used, such as confidence levels and assessments of historical forecasting errors
  - sensitivity analysis covering the main variables used in forecasts, estimates and projections.



---

## Exhibit 2

### Key components of strategic financial management



Source: Audit Scotland

---

56. Publication and Parliamentary scrutiny of a medium-term financial strategy and associated material would be an important component of a whole cycle approach to the budget. Publishing this well before a more detailed draft budget would enable consideration of the overall picture and the fiscal context prior to scrutiny of detailed budget proposals, which would be set within the framework of the overall strategy.
57. In determining the period covered by a medium-term financial strategy and the timing of its preparation and scrutiny, it will be important to balance a range of considerations including the following:
- The robustness of the forecasts, projections and estimates that underpin a financial strategy. Generally, the later a strategy is prepared the better such information is likely to be. But given the underlying volatility and complexity to which the Scottish budget is now exposed there will always be a significant degree of uncertainty inherent in annual budgets and any medium-term financial plans. Such information should be fit for purpose, but its underlying nature should be clearly understood.
  - The extent to which observed or anticipated changes in economic or fiscal conditions, including the fiscal policy and spending decisions of the UK Government, potentially require a significant revision to the financial strategy. In general, where significant changes to underlying economic and fiscal conditions are experienced, it is likely to be necessary to review and revise any financial strategy

more frequently. This will be less important where the underlying conditions are more stable.

- The extent to which the Scottish Government makes changes to its underlying fiscal policies. This is particularly pertinent immediately following a Parliamentary election as a new government is established and there is potentially a change of political administration. But it may also be the case that fiscal policies are reviewed and revised substantially during a Parliamentary session for other reasons. Generally any significant change can be expected to lead to a revised financial strategy being published.
58. In evidence to the Finance and Constitution Committee in November 2016, the Auditor General provided her view that a medium-term financial strategy would not be set in stone for the next five years. She noted that it could be refreshed and updated in response to circumstances during the life of the parliamentary session and used to inform annual budgets.<sup>7</sup>
59. The Scottish Fiscal Commission (SFC) will play a key role in the provision of economic and fiscal forecasts, covering Scottish onshore GDP, Scottish tax revenues and social security spending. It is also required to undertake and publish assessments of the reasonableness of the Scottish Ministers' projections as to their borrowing requirements. The SFC has discretionary powers to prepare further forecasts, assumptions or projections of other funding or revenues contributing to the Scottish budget and to report these publicly. It also has the power to assess such forecasts, assumptions or projections where these are prepared by the Scottish Government.
60. The SFC will therefore have a critical role in providing information to enable the preparation of a medium-term financial strategy, by providing forecasts and assessing the reasonableness of Scottish Government projections. Its work will help to support the assessment of revenues and funding available over the medium term, and social security spending as this comes on stream. The SFC is required to prepare a number of forecasts for a five-year ahead period but has discretionary powers to widen its contribution, both to other areas of funding and to cover longer periods.
61. A key issue to consider, if a medium-term financial strategy is prepared, is how the timing of this sits with the preparation of forecasts by the SFC. The SFC is required to prepare forecasts twice a year, and it was previously envisaged that this would be at draft annual budget stage and to support any revision necessary for the annual budget bill. If a financial strategy were to be prepared outwith these times, then either the most recent SFC forecasts would need to be used or the timing of their preparation realigned.
62. The SFC is required to base its forecasts, assumptions and projections on the current policies of the Scottish Government and may not consider what the effect of an alternative policy would be. This approach is similar to the way in which the OBR operates. This makes it important that fiscal and other relevant policies are clearly

---

<sup>7</sup> [Official report](#), Finance and Constitution Committee, 23 November 2016.

understood and transparently stated. This is likely to be important for both the work of the SFC and to support Parliamentary scrutiny.

63. A key issue will be assessing and keeping under review the long-term sustainability of the Scottish public finances, considering the long-term implications of policy decisions, the extent of financial commitments and anticipated changes in the economy, revenues and spending. The independent economic and tax revenue forecasts that will be prepared by the SFC will contribute to such an approach. Audit Scotland's response to the Scottish Government's consultation on the draft Scottish Fiscal Commission (Modification of Functions) Regulations 2017 highlighted that extending the functions of the Scottish Fiscal Commission to include a duty or ability to examine and report on the sustainability of the Scottish public finances would help demonstrate the objectivity of any such assessment.<sup>8</sup>
64. In our view it is important that such an assessment is undertaken and published. It could be integral to or published alongside the Scottish Government's medium-term financial strategy or could be prepared on a standalone basis. We would suggest that there is a critical role for the Parliament's Finance and Constitution Committee in scrutinising the financial sustainability of the Scottish public finances, and this should be formalised. The Scottish Government and the SFC would each have a role in providing the information necessary to support such scrutiny.

## Theme 5: How effective is the current approach to outcomes-based scrutiny?

**Q20.** How effective is the emphasis on prioritisation and value for money in delivering a more outcome-based approach and how could it be improved?

**Q21.** What should be the role of public bodies in supporting a more outcomes-based approach to financial scrutiny?

65. The Scottish Government's National Performance Framework (NPF) sets out the purpose, objectives and national outcomes that it aims to achieve, and indicators that track progress towards these outcomes. The Community Empowerment (Scotland) Act 2015 ensures that the current outcomes approach to government will continue in the longer term. The Scottish Government continues to refine the NPF, which provides a firm basis for its outcomes-based approach to policies. This approach has implications for the way in which the Parliament exercises its budget scrutiny role. The move to a more outcomes-based approach to budgeting and service delivery should be reflected in a greater focus on scrutinising what is being achieved from public spending. This includes how spending is contributing to the Scottish Government's overall purpose and specific output and outcome measures.

---

<sup>8</sup> [Response](#) to consultation on the draft Scottish Fiscal Commission (Modification of Functions) Regulations 2017.

- 66. An outcomes-based approach to scrutiny will require a clearer focus across parliamentary committees on 'big picture' strategic issues that will outlast any single parliamentary session. This is essential if the Parliament is to effectively hold the Scottish Government to account for the delivery of its long-term ambitions. For example, addressing inequality of outcomes, delivering more sustainable public services, improving health and social care services and addressing climate change.
- 67. The committees of the Parliament are increasingly working together to promote a coordinated and joined-up approach to significant cross-cutting issues. But the volume of business that committees are dealing with can affect their ability to deal with more complex, longer-term issues. There is an opportunity to develop greater coordination of budget scrutiny while respecting the particular areas of focus pursued by each committee.
- 68. Public bodies and councils have a key role in delivering government policy and priorities, with their funding being a key aspect of the budget process. There are expectations that they contribute to the Government's outcomes and the measures set out in the NPF. Through their own plans and annual reports they have a responsibility to articulate the contribution that they are making. This should be a key aspect of the scrutiny undertaken by Parliamentary committees, as part of a whole cycle approach.
- 69. It is important to recognise the distinction in accountability arrangements between local government and other public bodies in considering this area. Councils and other local government bodies have their own democratic mandate, and are directly accountable to the public through locally elected members. Councils also have separate tax raising, borrowing and reserve powers. They are held to account for their spending and performance by the Accounts Commission.
- 70. Local government bodies establish their own local priorities but also make a critical contribution to the Scottish Government's outcomes. The requirement for this is being strengthened through partnership working arrangements, such as the introduction of integrated health and social care bodies. The revised budget process needs to reflect these distinctions, considering the contribution of local government to national priorities while recognising the legitimacy of local policy choices and statutory accountability of individual bodies.

### *Performance and Reporting*

**Q22.** What information should the Scottish Government provide in its budget documents to show the links between its budget allocations and the NPF?

**Q23.** What level of performance information should Scotland's public bodies publish against the National Performance Framework?

**Q24.** What should be the role of parliament in scrutinising the performance of Scotland's public bodies in delivering outcomes?

- 71. More effective performance planning and reporting would improve clarity over what spending is aiming to achieve, how this contributes to the Government's overall purpose

and outcomes, and what is being achieved. This should sit alongside formal budget documentation.

72. The Scottish Government expects all public bodies and councils to align their own objectives and spending plans with the NPF. The boards of public bodies, local councillors, the Scottish Government and subject committees in the Scottish Parliament all play an important role in scrutinising the outcomes delivered by public bodies. It is important that public bodies are held to account for the value for money they are providing.
73. A common theme in our performance audit reports is the potential for greater alignment of resources and actions, including those of public organisations, to the NPF. The NPF measures overall progress towards economic targets and outcomes but it does not measure the specific contribution of policies and initiatives to delivering these outcomes. Our work has found that policy implementation plans often lack indicators or measures to monitor progress towards improving long-term outcomes. There is a role for government in setting out performance plans up front, including milestones and indicators of planned progress, and reporting annually against these.
74. The primary responsibility for reporting on the outcomes delivered by public bodies and councils rests with the bodies themselves. Many of which are either subject to statutory public performance reporting obligations (including those contained in the Community Empowerment Act) or are required to participate in national performance reporting frameworks such as Scotland Performs. The Accounts Commission and Auditor General have highlighted the need for public bodies to improve the quality of their performance reporting.
75. The Auditor General for Scotland has reported that a more rounded account of the Scottish Government's overall performance would enhance reporting to the Scottish Parliament and the public, and help strengthen accountability and scrutiny.<sup>9</sup> A key challenge in managing performance is aligning financial and performance information in a meaningful way, so that the impact of spending decisions on performance and outcomes can be better understood. More strategic alignment between spend and outcomes is important at both a national level and for individual bodies.
76. The Accounts Commission and Auditor General have reported that the way in which public bodies report performance, and are held to account, does not always reflect the Scottish Government's policy of promoting outcomes.<sup>10</sup> They recommended that the Scottish Government should streamline national performance management frameworks and create a better balance between short-term measures of individual service performance and the delivery of longer-term local outcomes through effective partnership working.

---

<sup>9</sup> [The 2015/16 audit of the Scottish Government consolidated accounts](#), Audit Scotland, September 2016.

<sup>10</sup> [Community planning: an update](#), Audit Scotland, March 2016.

77. The Scottish Government published an update setting out how it is performing against national outcomes and performance indicators, alongside its 2017/18 draft budget.<sup>11</sup> Outcomes are often, by their nature, longer term. There are opportunities for budget documents to make more systematic use of output measures that describe in more specific terms progress towards desired outcomes. These are more able to be aligned to specific budgets and help support scrutiny of budget proposals for the year ahead. This should not be restricted to the draft budget, but can be reported in various ways throughout the whole budget cycle. Public audit has an important role in objectively and transparently reporting on progress towards outcomes.
78. Much of the focus of budget transparency and scrutiny is on the Scottish Government's plans for public spending and revenue raising. Equally important is what has actually been spent and raised, and what it has achieved in practice. Increased volatility and uncertainty mean that a clear understanding of annual outturns and the overall financial position has never been more important. This helps Parliament to hold government to account for what has been achieved through taxation and spending, and helps inform future budgets and plans. This is a key aspect of a whole cycle approach to budget scrutiny.
79. There is a well-developed approach to outturn reporting through the published accounts of individual public bodies, councils and the Scottish Government's consolidated accounts. The receipts and payments flowing through the Scottish Consolidated Fund are also reported in published accounts. Revenue Scotland publishes devolved tax accounts and HM Revenue and Customs accounts will report on Scottish income tax revenues. This system of annual financial reporting reflects the individual accountabilities of all those organisations involved in spending and raising public money. A key issue is reporting clearly on the overall financial performance and position each year and how each of these individual accounts fit together. This is needed to support Parliamentary scrutiny of the Scottish public finances overall.
80. The Scottish Government is further developing its financial reporting in the context of the new powers, building on existing outturn reporting arrangements and addressing the commitments it has made in this area. Its plans for improvements to financial reporting include the following important components:
- information explaining how the Scottish public finances now work
  - outturn statements providing high-level information on actual spend across the Scottish Administration as a whole
  - tailored for Scotland consolidated accounts that show a more aggregated picture of the Scottish public finances – including what is owned and owed alongside spending and revenues.
81. The budget process that is developed should give sufficient prominence to outturn information as part of a whole cycle approach. This should include opportunities for scrutiny of the overall picture and of the individual elements of most significance or

---

<sup>11</sup> *Scotland performs update*, Scottish Government, December 2016.



Parliamentary interest. Reporting by the Auditor General and the work of the Public Audit and Post-legislative Scrutiny Committee will remain an important avenue for this. The Finance and Constitution committee is also well placed to lead scrutiny of the overall position.

82. The annual provisional outturn statement by the Cabinet Secretary for Finance is an important aspect of the current arrangements, providing an opportunity for scrutiny currently in June each year. It is important that this statement and supporting material is clearly presented in a manner that is consistent with other budget documentation, and meets any standards that are established (see [theme one](#)).

### *Public Audit*

**Q25.** In what ways can the work of Audit Scotland be used more effectively in supporting a more outcomes based approach to financial scrutiny within the Parliament?

83. Public audit in Scotland is informed by the priorities of the Auditor General and the Accounts Commission and delivered by Audit Scotland on their behalf. *Public Audit in Scotland* sets out the shape, principles and themes of public audit.<sup>12</sup> We are committed to supporting the Parliament in developing world-class arrangements for holding government to account and improving the use of public money.
84. The independence of the Auditor General, Accounts Commission and Audit Scotland is essential. Audit should not have a role in budget setting or any involvement in policy decisions. There is an important role for audit in reporting independently and informing and supporting Parliament's responsibilities for the oversight of the public finances. This helps create a strong and effective system of accountability and transparency which supports the best use of public money in the public interest.
85. Audit reporting is a key component of the budget cycle, providing objective information and independent assessment on the public finances, performance and value for money. Auditor General reports are considered by the Public Audit and Post-legislative Scrutiny Committee in the first instance. There are opportunities for the subject committees to make more use of Auditor General and Accounts Commission reports. There is an ongoing programme of work that can be drawn from at different stages of the budget cycle to support scrutiny by subject committees. Effective coordination and liaison between the Public Audit and Post-legislative Scrutiny Committee and subject committees will help to ensure a coherent approach to outcomes-based financial scrutiny.
86. There is scope for the Parliament to strengthen its focus on the extent to which policy outcomes are being delivered in the most efficient manner possible. Parliamentary committees can take a more strategic approach to scrutinising spending within and across key policy areas, by examining how it is being used to deliver agreed policy outcomes. For example, by tracking how major policy commitments are being

---

<sup>12</sup> [Public audit in Scotland](#), Accounts Commission, Auditor General and Audit Scotland, May 2015.

implemented across government. We are keen to ensure that our audit work supports Parliamentary committees in this way.

87. We place a particular emphasis on the execution and evaluation of policy and the extent to which public resources are being used to best effect. Much of our audit work looks at the effectiveness of implementation of key government policies and the impact of significant programmes of public service reform. A key priority for our work is ensuring that public money is being used to best effect to support the delivery of improved outcomes. This includes reporting on the progress that is being made in improving the quality of public performance reporting across the public sector. In particular, how improved outcomes are linked to the use of increasingly scarce public resources.
88. We hope that you find our comments helpful. We would be happy to expand on any points contained within our submission if you would find that useful. In the meantime, should you require any further information please contact Mark Taylor, Assistant Director, at [mtaylor@audit-scotland.gov.uk](mailto:mtaylor@audit-scotland.gov.uk).

April 2017