



**OFFICIAL REPORT**  
AITHISG OIFIGEIL

# Scottish Commission for Public Audit

**Wednesday 21 December 2016**

**Session 5**

© Parliamentary copyright. Scottish Parliamentary Corporate Body

Information on the Scottish Parliament's copyright policy can be found on the website - [www.parliament.scot](http://www.parliament.scot) or by contacting Public Information on 0131 348 5000

---

**Wednesday 21 December 2016**

**CONTENTS**

<b>SPRING BUDGET REVISION 2016-17</b> .....	<b>Col. 1</b>
<b>BUDGET PROPOSAL 2017-18 AND FEE STRATEGY</b> .....	<b>3</b>

---

**SCOTTISH COMMISSION FOR PUBLIC AUDIT**  
**2<sup>nd</sup> Meeting 2016, Session 5**

**COMMISSION MEMBERS**

- \*Colin Beattie (Midlothian North and Musselburgh) (SNP) (Chair)
- \*Alison Johnstone (Lothian) (Green)
- \*John Lamont (Ettrick, Roxburgh and Berwickshire) (Con) (Deputy Chair)
- \*Rona Mackay (Strathkelvin and Bearsden) (SNP)
- \*Jenny Marra (North East Scotland) (Lab)

\*attended

**THE FOLLOWING ALSO PARTICIPATED:**

- Russell Frith (Audit Scotland)
- Caroline Gardner (Auditor General for Scotland)
- Ian Leitch (Audit Scotland)
- Diane McGiffen (Audit Scotland)

**LOCATION**

The Adam Smith Room (CR5)



# Scottish Commission for Public Audit

## Meeting of the Commission

*Wednesday 21 December 2016*

*[The Chair opened the meeting at 13:00]*

### Spring Budget Revision 2016-17

**The Chair (Colin Beattie):** Good afternoon and welcome to the second meeting of the Scottish Commission for Public Audit in session 5.

We are very tight for time today. I ask all members and witnesses to keep questions and answers concise and to the point. Please also make sure that mobile phones and other electronic devices are turned to silent.

The first agenda item is Audit Scotland's spring budget revision for 2016-17. Members have a copy of the proposed revision. I welcome to the meeting Ian Leitch, chair of the board of Audit Scotland; Caroline Gardner, the Auditor General; Diane McGiffen, the chief operating officer; and Russell Frith, assistant Auditor General.

I invite the Auditor General to make a brief introductory statement.

**Caroline Gardner (Auditor General for Scotland):** As in previous years, our spring budget revision request relates to pension adjustments. We have requested budget cover of £1.041 million to meet a non-cash pension charge that will arise as a result of accounting adjustments in 2016-17.

The charge is driven by the continuing impact of low discount rates used to value pension liabilities. Those low rates increase the future pension liability forecasts and, in turn, the estimates for the in-year pension service costs that we are required to account for. It is worth emphasising that those movements are notional and do not lead to cash movements.

As we have explained to the commission before, we are not able to plan for those changes in advance, because of the timing of the information that we receive from our actuaries. We get the information once a year and received this information in April 2016, well after our last budget proposal was received by the commission.

As you can see from the information in our submission, the amounts involved are very variable and unpredictable. The Scottish Government has therefore asked us to deal with them through the spring budget annually managed

expenditure process, which is why it is before the commission today.

I am sorry that this is a complicated adjustment; Russell Frith and I will do our best to answer any questions commission members may have.

**The Chair:** Have you held preliminary discussions with the Scottish Government to confirm that the previously agreed arrangements with HM Treasury remain in place? Have you advised the Scottish Government of the amount of Audit Scotland's requirements?

**Caroline Gardner:** The answer is yes to both.

**The Chair:** Do members have any questions about the spring revision?

**Alison Johnstone (Lothian) (Green):** My question is not specifically on the spring revision, but about the Lothian pension fund in general.

The Auditor General will be aware that pension funds are divesting from fossil fuels and that there are global efforts to decarbonise investments. I believe that about 5 per cent of the Lothian pension fund is invested in fossil fuels. Is Audit Scotland open to reform to better inform pension members of where their pensions are invested? More transparency about that would be helpful.

**Caroline Gardner:** In broad terms, I am in favour of more transparency on public finances, including pension arrangements. There has been a gradual movement to greater transparency about the investments of the local government schemes, which are the only ones that are funded and therefore invested.

We would be happy to give more information outside the meeting on how that is developing, if that would be useful.

**Alison Johnstone:** That would be very helpful.

**The Chair:** If no other member has a question, is there anything that the Auditor General would like to add?

**Caroline Gardner:** We are content, if the commission members have no further questions.

**The Chair:** Are members content to agree by correspondence a letter to the Finance and Constitution Committee, summing up our views on Audit Scotland's spring budget revision?

**Members indicated agreement.**

## Budget Proposal 2017-18 and Fee Strategy

13:04

**The Chair:** We move to agenda item 2. Members have a copy of the budget proposal and the fee strategy in their meeting papers. We have the same witnesses for this agenda item. I invite the chair of the board, Ian Leitch, to make a short introductory statement, to be followed by the Auditor General.

**Ian Leitch (Audit Scotland):** Good morning, members. We are pleased to present to you our planned budget for next year and our revised fee strategy.

You will be aware we have been reviewing our funding and fee arrangements in order to ensure that they are fit for purpose. We have been through a thorough process, which I have described to this commission and to previous members of it as a consultation with all the bodies that we audit. The fee strategy paper that you have today is the outcome of all that work.

We are implementing the strategy for the 2016-17 audits. The timing is important because it fits with the new round of audit appointments. The procurement exercise was carried out earlier this year and will bring considerable savings.

The review reaffirms and builds on the principles that have previously guided our fee strategy, including the need to ensure fairness and transparency. The revised strategy aims not only to recover fees for our work across the piece, but to balance better those fees in each sector and, where possible, individual bodies.

A key change that we are proposing relates to the funding of national health service performance audit work. In order to bring that into line with the other areas of the Auditor General's remit, we propose that funding for the work should come from the Scottish consolidated fund.

Details of other proposed adjustments are explained in the fee strategy paper.

High-quality audit work remains a priority for Audit Scotland. Our budget proposal supports that goal by identifying resources to implement new quality arrangements. That will help us enhance our assurance on the quality of audit work, promote continuous improvement in audit quality and support professional and technical leadership in public audit.

At the same time as we are committed to quality, we strive for value for money. Our main expenditure is on our workforce, which we continue to manage actively. Staff numbers are

smaller now than they were in 2010. Despite that, we are confident that our on-going investment in staff development, the training of professional trainees and the way that we are changing how we work together will continue to deliver cost effective, efficient world-class audit.

I will hand over to Caroline Gardner, who will give you an introduction on the detail of the budget proposal.

**Caroline Gardner:** As you will know, the budget proposal was prepared in the context of some uncertainty, in particular, the amount of work that will be required as a result of the full implementation of the Scotland Act 2016 and, of course, any further devolution of powers as a result of the impact of the referendum on the European Union.

The proposal in front of you is based on our known workload. As our audit responsibilities change in the light of those developments, we will obviously discuss further the resource requirements with the commission.

In summary, the proposal will deliver an average real-terms reduction in audit fees of 8.6 per cent for the 2016-17 audit year, which has just started; a 2.6 per cent real-terms reduction in the revenue resource requirement sought from the Scottish consolidated fund; simplified funding arrangements for the NHS performance audit, which Ian Leitch mentioned; a reduction in our gross administrative costs of just over £1 million or 6 per cent of our expenditure budget for the year; and greater transparency in our funding arrangements.

Overall, I am confident that the proposal strikes the right balance between value for money and ensuring the quality of support to the Parliament that we provide.

We are happy to do our best to answer the commission's questions.

**The Chair:** I will start off. On page 4 of your budget proposal, you note that additional work will arise resulting from the creation of the 30 integration joint boards. The boards will be audited by auditors appointed in the relevant local authorities. That is a considerable increase in work. Will you confirm the oversight arrangements for integration joint boards? In particular, what oversight role will the Public Audit and Post-legislative Scrutiny Committee have in regard to the boards?

**Caroline Gardner:** The audit arrangements for the new integration joint boards were included in the legislation that established them. They were set up as local authority bodies, and the audit appointments are made under that regime.

All the funds spent by the joint boards will come from local authorities or the NHS. At the moment, we think that that spend is about £8 billion a year, which is a significant amount of public money. The boards provide services that are key to communities across Scotland.

It is an area where the strengths of the public audit model are apparent. The Accounts Commission appoints the auditors to the bodies and can report on problems that occur in the individual bodies. However, because of the significant amount of NHS funding that comes through them, I will also have oversight and can report back to the Public Audit and Post-legislative Scrutiny Committee.

The Public Audit Committee in session four received the first of the reports that we are producing on the progress on setting up the bodies. It noted not only that progress had been made, but that risks remained around governance, budget setting and oversight. We expect to produce the second report in that series during 2017, and it will be reported to the Public Audit and Post-legislative Scrutiny Committee in the usual way, to give you that line of sight on how the money is being spent and what is being achieved with it.

**The Chair:** Given the funding's hybrid nature, will the Public Audit and Post-legislative Scrutiny Committee have full oversight of the IJBs through your reporting?

**Caroline Gardner:** It will have full oversight, to the extent that the overall process is being developed and implemented as planned, of what is being achieved by the boards. There are accountability arrangements back from a joint board to both the local authority and the NHS. That line of sight through the NHS gives the committee scrutiny through the work that I do.

We will have to see how that develops in practice over the next few years, as the boards take on their new responsibilities in full. For now, the Public Audit and Post-legislative Scrutiny Committee is being given the proper degree of oversight.

**John Lamont (Ettrick, Roxburgh and Berwickshire) (Con):** My question also relates to page 4 of your budget proposal and your assumption about the extent and timing of work required as a result of the Scotland Act 2016. You mention elsewhere that an allowance has been made for planning for the implications of the EU referendum result and that about £100,000 has been set aside for those purposes. Will you explain what the cash payments account for? What is the additional resource that you think that you will need to deal with the uncertainties?

**Caroline Gardner:** As commission members will know, the Scotland Act 2016 is being implemented over a long period. Revenue Scotland, which has been established, will administer the new devolved taxes. We audit Revenue Scotland and no new additional work is required there. We have in place the arrangements for collecting the Scottish rate of income tax—we have the second report published this week by the Comptroller and Auditor General for the UK's spending, Her Majesty's Revenue and Customs audit and my additional assurance. Those arrangements are up and running.

We are still investing in making sure that we understand the implications of the new full devolution of income tax on non-dividend, non-savings income; the assignment of VAT revenues to Scotland; and, in particular, the new social security powers, where we know that there will be a social security agency but it is not yet up and running. There will need to be a good deal of interaction between that social security agency and the Department for Work and Pensions as there will be about £2.7 billion of payments coming through those arrangements annually, which is a significant sum and a high volume of transactions. We are investing in making sure that we understand the Government's plans for delivering that and the audit work that is needed. I can come back to you with a clear picture of what that audit work will require.

The £100,000 pays for an assistant director who we have tasked with leading our thinking in the area. The money accounts for the full cost of the post and for his and his team's development. It is to ensure that we are thinking through the audit implications, managing them well, building up our expertise and coming to you with a credible plan for the resources that we need for the longer term as that thinking develops.

Since June, we have asked the assistant director to take on responsibility for the implications of the EU referendum. We do not know what that will mean for Scottish public finances—that is, what funding will be devolved to Scotland and what audit arrangements will be needed. We will do that in a joined-up way.

**John Lamont:** I want to be clear about the £100,000. You said that that is the cost of the salary of the new appointment, but you also mentioned investing in further research or investigations. Do you anticipate an additional cost beyond the £100,000 to invest in the additional research and understanding of what the referendum outcome will mean?

13:15

**Caroline Gardner:** We think, at this point, that the £100,000 covers our costs of developing and planning for it. That is the full cost of the director's post plus the associated costs for training, development and travel. We know that there will be an additional cost of audit, once it is clearer how the new social security powers and some smaller things, such as the Crown Estate, will be used. We want to come to you with a credible, properly worked-up plan, rather than guesstimates about what it might involve. That is why we are investing for now.

**John Lamont:** Will that come later?

**Caroline Gardner:** Absolutely, in future budgets.

**Jenny Marra (North East Scotland) (Lab):** I will jump back to ask a supplementary to question 1. Auditor General, you state in your budget proposal, on page 4, that the IJBs will be audited by the auditors of the relevant councils. I assume that those will be auditors of local authorities who are used to auditing councils. What experience will they have of auditing the NHS? From where I sit, the budgeting and expenditure arrangements for the IJBs are quite complex. A number of councils and health boards are still trying to get to grips with that, so the audit will be very important. Are there people who have joint experience? How can Audit Scotland, and we, be confident of their skills to do it properly?

**Caroline Gardner:** You are right that they are complex new bodies and they have significant responsibilities. The legislation that established the integration joint boards set them up as local authorities and, therefore, they are within the local authority audit regime. Most of the auditors whom the Accounts Commission appoints to carry out local authority audits also do NHS work. Russell Frith can keep me straight on the number of those.

In any case, one of the central costs of Audit Scotland is in providing guidance and support to all our audit teams, to make sure that they have access to the expertise and information that they need, to provide opportunities for them to share their experience and insights, and to make sure that we get consistency in the audit work that is carried out throughout the sector. We monitor it closely, and you will see elsewhere in the submission a reference to our investment in the quality of audits. The starting point is that all our auditors should be capable of doing this. Audit Scotland provides the extra support where it is needed.

**Russell Frith (Audit Scotland):** Of the five firms that we use in local authority work, on top of our own staff, three are also auditing the NHS in the new round of appointments. Of the other two,

one firm has previous NHS audit experience and, as it happens, so do the staff from the other one.

The other point that I would make is that, wherever possible, we have appointed the audit of the main council and the health board in a given area to the same auditor. That is not possible across Scotland, but, as an example, the auditor of Dumfries and Galloway Council is also the auditor of Dumfries and Galloway health board, and is therefore also auditing the IJB there. In that way, the external auditor has complete oversight across the IJB arrangements.

**Jenny Marra:** That will be fundamental to Parliament's ability to scrutinise the effectiveness of the IJBs, so I will watch that with interest.

On page 5, you note that "Other administrative costs" have decreased from £9,558,000 in the current year to £8,376,000 in 2017-18. Throughout the document, it is confirmed that the bulk of the estimated savings will arise from savings in fees that are paid to appointed auditors, which are the private sector firms that Russell Frith referred to, following the recent procurement project.

Although the commission welcomes such significant savings, is it possible that audit firms will conduct audits with less-qualified staff in order to accommodate the reductions in their fee income? Could that lead to an increased risk of poor audit quality for the bodies audited by the firms? I know that you have set aside £100,000 to support an enhanced quality regime but, given the adjustment to fees, can you explore that?

**Ian Leitch:** The board probed that question, because it is a matter of concern. Russell Frith will give you the detail, but we are satisfied that, by enhancing our quality regime and putting in additional resource, we can check to ensure that the competitive fees that we got in the procurement round will not result in a poorer audit service. We are bolstering that so that we can do more checks on that work.

**Russell Frith:** Our quality expectations were made clear to the firms before the tender round. As Ian Leitch said, we are investing in enhanced audit quality arrangements to ensure that we can continue to give assurance to the Auditor General, the Accounts Commission and indeed the Scottish Commission for Public Audit about maintaining and improving the quality of audit. It is absolutely right that we see the discounts that were offered as potentially posing a risk to audit quality. We are aware of that and we plan to ensure that that does not happen.

**Jenny Marra:** I am struck by the fact that Audit Scotland is having to set aside £100,000 for the quality regime, when firms such as KPMG and Ernst & Young are taking handsome fees for the audit of our public sector. Should it not be



incumbent on the firms that earn those fees to ensure quality internally, so that that does not come at the expense of the public purse?

**Caroline Gardner:** You are absolutely right to ask that question. The starting point is that all the auditors that we appoint, whether they are from the firms or our in-house teams, are required to meet the international standards on auditing, the ethical standards that apply and the code of audit practice, which the Accounts Commission and I agree for the wider scope of the audit work that we do. We are always seeking to get the balance right between the quality, which we cannot compromise, and best value for the public purse.

We have robust arrangements for quality, but they provide us with different information about the in-house teams and the firms. For the in-house teams, we commission the Institute of Chartered Accountants of Scotland to carry out an independent review of a sample of audit work every two years, and we get that information back directly. For the firms, either ICAS or, on a UK basis, the Financial Reporting Council carries out a review of their work, although not of the work that is done specifically for us. Therefore, we have less information about the firms, although we have the assurance that they are meeting the professional standards that are required.

My view and that of the Accounts Commission, after discussion with the board, is that because we are seeing continuing reductions in the tenders from the firms in the competitive market—we welcome the cost savings that come from that—we should recycle some of those savings into making sure that we have truly comparable information across all the people who are carrying out audit work for us. In that way, we will have the assurance that we need that we are fulfilling our responsibilities, as will the Scottish Commission for Public Audit.

A fine balance is involved. It is worth noting that the £100,000 that we have put into the submission this year, on which we are asking for your support, is for reviewing the arrangements. We do not necessarily expect that to be the cost going forward, but it is the cost of a project to review the position and to ensure that we have consistent information across the piece and that we are getting the balance between cost and quality right.

**Jenny Marra:** So you hope that the £100,000 figure might reduce in time.

**Caroline Gardner:** I do not want to prejudge the results of the review, but it is the one-off cost of reviewing how we assure quality and of putting in place arrangements for the future.

**Jenny Marra:** You say that the £100,000 is recycled money from cost savings in the commissioning of firms.

**Caroline Gardner:** As Ian Leitch said in his opening statement, at the beginning of 2016, we went through a significant tender round, as we do once every five years. The results of that were competitive and gave us a reduction in the amounts that we will pay to firms overall over the next five years. As I said, we think that it is appropriate to recycle some of that into the arrangements that we have for assuring and driving up quality over the piece during the five-year period.

**Jenny Marra:** Will the quality regime extend to in-house teams as well?

**Caroline Gardner:** That is one of the things that I am keen for us to do. At the moment, we have different information about the in-house teams and the firms, and there should be a level playing field. We are also looking at how we assure the quality of the performance audit work, which is what the Public Audit and Post-legislative Scrutiny Committee sees most directly. All of that will be on a common basis.

**The Chair:** To come in on the back of Jenny Marra's comments, there must be a concern, with fees going down, about maintaining the quality of service. I will share my experience of public audit, which is that there was a perception in the case of Coatbridge College, probably Edinburgh College and certainly—it appears from the information last week—NHS Tayside that internal and external auditors were not exactly on the ball in some respects, and that is a worry.

**Caroline Gardner:** That would be a significant worry for me, too. As I said, we have quality arrangements in place and I am satisfied that the auditors that we appoint are all meeting the requirements that we place on them. That is clearly not quite the same thing as the impression that you take from them when they appear before you as witnesses. There may be more that we can do to support them to perform as well as they can in that setting.

As you will be aware from your former life, chair, there is also something about the gap between expectations of what auditors might do and what they are actually appointed to do. We need to do what we can to close that gap and to explain that auditors are not there to seek out fraud or poor behaviour but to provide assurance on the way in which public money is being spent. We need to keep an eye on that. That range of issues is behind the investment that we want to make in quality assurance.

**Alison Johnstone:** Page 8 notes a new approach to best value across all 32 councils. I would be grateful if you could explain the new approach to assessing best value in our local

authorities and what has changed from the previous approach.

**Caroline Gardner:** I need to start with the caveat that the Accounts Commission is responsible for assessing best value in local authorities and that it is not my responsibility as the Auditor General. However, I have a responsibility as the accountable officer for Audit Scotland. I ask Diane McGiffen to talk about the best-value issue from the steering group's perspective.

**Diane McGiffen (Audit Scotland):** The new approach looks at the best-value auditing of local authorities and maps that out over a five-year period, which is the lifetime of the audit appointments. The previous approach, which the Accounts Commission wished to move away from, meant that on a risk-assessment basis local authorities would receive a best-value audit once every three or five years, but some authorities had not had a full best-value audit for quite some time. The Accounts Commission was seeking a regime that helps to provide on-going assurance about the achievement and delivery of best value from authorities through the audit process on an annual basis. In some years during the new five-year appointments, there will be an added element to the best-value reporting.

We have therefore remodelled a range of the work that we do in local government auditing. The Accounts Commission recently ran three roadshow events with local authorities to set out to chief executives and council leaders the new approach, and we are starting to roll out the first year of the new approach. The first reporting from the first authorities that are having the deeper best-value audit in year 1 will be later in 2017.

Over the five-year appointment, the coverage of best-value issues through local authority audits will be clearer and more comprehensive. There is on-going dialogue between the Accounts Commission and the Scottish Government about the framework for best-value principles and the guidance that the Scottish Government issues, against which we audit. Our audit teams and the firms that are appointed to deliver best-value audits have been working together to roll out the new programme.

We could certainly provide the commission with further supplementary information, if it wishes, and we could also share with it the presentations that were recently given to council leaders and chief executives.

**The Chair:** It would be good if you could do that.

**Alison Johnstone:** The new approach seems like a more efficient process that will give greater clarity.

**Diane McGiffen:** That is what we hope for.

**Rona Mackay (Strathkelvin and Bearsden) (SNP):** I will focus on Audit Scotland's business restructuring proposals, which you outline on page 8. You state that the plan is to reduce the head count of administrative support staff and to realign skills and resources. You are looking for a budget of £100,000 to fund that transition. Will you explain how the £100,000 will be paid, given that it is an additional resource and the work is not being met from existing resources?

**Caroline Gardner:** The background is the move that we made in 2015 from two offices in Edinburgh to a single office. We previously had two offices, each of which was on five floors and had lots of different rooms, but we now have one office that is all on a single footprint, with much more efficient ways of working and better use of technology. Together with the ways in which we are changing our staffing and how people work more widely in Audit Scotland, that means that we need quite different administrative support from what we needed previously.

13:30

Against the backdrop of a policy of no compulsory redundancies, we have designed the structure that we think that we need to support our business, which has involved going through a process of supporting our existing staff to apply for roles in the new structure. We are looking for the provision in the 2017-18 budget that you mentioned to enable us to redeploy the staff who were not matched into jobs in the new structure. We expect the redeployment to take place over a period, as staff move on and vacancies arise and so on. That captures the bridging point between where we are and where we hope to end up. Diane McGiffen has led on the work and might want to add something.

**Diane McGiffen:** No—you have given a pretty comprehensive account. We are pretty far down the road—

**Rona Mackay:** I was just going to ask you to give me an idea of the timescale for all this.

**Diane McGiffen:** We have completed the transferring, matching and interviewing of colleagues, and people now have their new roles. There is a supplementary team of four people who we are looking to redeploy.

**Rona Mackay:** Will you reassure us that work that used to be done by such people will not now be done by more senior staff, which would be inefficient, given the jobs that the senior people are supposed to be doing?

**Diane McGiffen:** Absolutely. As the Auditor General said, one of the biggest drivers has been

the relocation to a single floor on a single site of teams that were previously dispersed. That in itself generates lots of efficiencies. In addition, the use of technology in the business, by audit teams and support services, has made many tasks that were previously delivered by business support services redundant.

We continually look to maximise efficiency, and it would not be efficient for us to displace work so that it went to our audit teams—those teams would be the first people to tell us that. We are seeking the opportunity to have projects and support that add greater value to audit teams in delivering their work. However, what that looks like has changed significantly since the teams were established and it is time for us to resolve that.

**Rona Mackay:** You said that there will be no compulsory redundancies. Did you offer voluntary redundancy?

**Diane McGiffen:** We have offered voluntary redundancy in the process and we will offer a voluntary early release scheme later, which we expect to be pretty modest.

**Rona Mackay:** Do you have guideline figures for that?

**Diane McGiffen:** We will launch the voluntary early release scheme in the new year, and we can report back on that. The restructuring process is very recent and we are still in dialogue with colleagues but, when we get to the conclusion, we can certainly share the information with the commission.

**The Chair:** I remind people to keep their questions and answers fairly tight. I bring in Jenny Marra.

**Jenny Marra:** I note that you said that before you brought me in.

**The Chair:** That was a coincidence.

**Jenny Marra:** Auditor General, page 13 of your budget proposal says that you are putting more work to the in-house team rather than to appointed auditors, which will generate an efficiency saving of £196,000. How did that decision arise? Does it suggest that in-house teams are less expensive than firms or does Audit Scotland feel that it gets less value for money from the firms than it used to get?

**Caroline Gardner:** The reason is neither of those, in relation to that figure. As we said, we went through a large procurement exercise to make audit appointments for the next five years, and as part of that we sought tenders from the firms in each of the sectors that we audit.

Such a process starts with an indication of the audits that will go to firms in each sector, and once we know which firms have been successful by

making bids that strike the right balance between price and quality, we invariably find that there are conflicts of interest—for example, if a firm is the internal auditor for a council, it cannot also be the external auditor. At that stage, Russell Frith and his team enter into a tortuous process of discussion to ensure that we know about all the conflicts of interest and can avoid them by making audit appointments that do not generate them.

This time, at the end of that process, an additional £196,000-worth of work that we had expected to go to the firms went to the in-house teams, without any increase in those teams' resources to take it on. We are confident that they can cover that through smarter working, the use of technology, which we have talked about, and the investments that we are making in one organisation working. In effect, we are generating an extra £196,000-worth of efficiencies as a result of the fine tuning of the audit appointments at the end of the process compared with what we expected at the start of it.

**Jenny Marra:** Are conflicts such as the internal auditor being the same as the external auditor, which you mentioned, more common than they used to be?

**Caroline Gardner:** I do not know. Does Russell Frith have a view on that?

**Russell Frith:** I think that they are slightly more common, as there are probably more public bodies that have firms as their internal auditors than was the case a decade ago.

**Jenny Marra:** Was such work being done in-house a decade ago?

**Russell Frith:** More bodies were doing it in-house.

**Jenny Marra:** To follow up on Rona Mackay's question, does the situation that you have described suggest that Audit Scotland found itself with surplus capacity, which is why you have pulled some work back in-house?

**Caroline Gardner:** I would say not. Again, Russell Frith might want to comment.

As part of your lead-in to that question, you asked whether our in-house teams are cheaper than the firms. In practice, they are not—they are slightly more expensive. The commission has explored that issue in the past. That is partly because we ask more of our in-house teams. They are more closely involved, for example, in providing support to Parliament, and they provide intelligence to us about what is happening across public services.

Over the life of the audit appointment, we try to make sure that the in-house teams can demonstrate that their costs are coming down to

the average of the firms' costs or that we can quantify the added value that we are getting from having an in-house team. It is a question of having the balance of gradually increasing the efficiency and quality of the in-house team against the benchmark that we have for the firms.

**Alison Johnstone:** In appendix 1, on page 17, the budget for "Audit support—external fees" is forecast to fall by 27 per cent from £586,000 in 2016-17 to £426,000 in the following year. The actual expenditure on that was £273,000 in 2015-16 and £311,000 in 2014-15. Given the historical levels of expenditure, are you content that the proposed budget is realistic?

**Caroline Gardner:** Yes. I will ask Russell Frith to talk you through why that is the case.

**Alison Johnstone:** That would be helpful.

**Russell Frith:** The biggest significant component of the variation in the figures across the piece is the cost of the national fraud initiative. That exercise costs us approximately £200,000 and takes place every second year. The figure is £586,000 for the current year because we will make that payment this year. The figure will drop again next year and will go back up in 2018-19.

**Alison Johnstone:** That is clear and makes sense.

**The Chair:** In appendix 1, the budget for information technology is forecast to increase by 18 per cent; in fact, the entire capital budget of £200,000 relates to IT. Will you give us a bit more information about that? I seem to remember that, about three years ago, there was also a fairly stiff charge for IT.

**Caroline Gardner:** I ask Diane McGiffen to talk you through that.

**Diane McGiffen:** The resilience and reliability of our IT are critical to the business. The more our colleagues who carry out auditing in public bodies travel around and work across Scotland, the greater is the resilience that we need in the IT service to keep them able to work and to access secure networks and so on. Much of the additional cost that is shown in appendix 1 relates to on-going improvements to resilience and security.

This year, we invested a lot in achieving our ISO accreditation, to ensure that we hold data in a very secure way, and we were pleased to get that. We are continuing to invest in equipment that enables our teams to work from anywhere and at any time. The investment is the on-going investment in IT resilience and security.

**The Chair:** If members have no other questions on the budget, I will ask one or two myself.

Can you remind me what the corporation tax on page 5 is for?

**Russell Frith:** We receive a small amount of interest income from money that is in a commercial bank account, and that is taxable.

**The Chair:** On the same page and the next page, you address the proposed change to the funding of the NHS performance audit. That is quite a significant change. On the face of it, it seems reasonable if it brings the funding into line with what is happening elsewhere. However, does it constitute a technical increase in the NHS budget?

**Caroline Gardner:** I do not think so. In any case, it is a very small amount—£475,000 a year. For historical reasons, performance audit in the NHS is the only part of our performance audit work to which the audited body makes a contribution. Currently, the boards pay 40 per cent and the Scottish consolidated fund pays the other 60 per cent. As part of the review of the transparency and consistency with which we do this, we identified it as an area in which we had the chance to improve and simplify the process for you. It is, however, right at the margins and is cost neutral for us.

**Colin Beattie:** It is cost neutral for Audit Scotland, but my concern is that, if we are moving a cost away from the NHS to be met by the consolidated fund, does that technically constitute an increase in the NHS budget?

**Caroline Gardner:** I think that it would actually mark a very small—minuscule in the scheme of things—saving to NHS budgets. I do not imagine that the Scottish Government would want to reallocate the funding away from the NHS. It is one of the things that contribute to the reduction in the audit fees that you will see in the audit proposal for that sector.

**The Chair:** I suppose that the commission's concern is that, if it does constitute an increase in the NHS budget, however technically, we can recommend it if it is appropriate but we might have to get more advice on it. I will ask the clerks to clarify that and get back to commission members on it, so that we are clear about where the powers on that lie when we make our decisions.

**Caroline Gardner:** I think that that would be useful but, for clarity, I confirm that it would be a reduction in the NHS budget and absolutely at the margins. It would reduce the boards' audit fees by more than would otherwise be the case.

**The Chair:** I am just checking to see whether there is anything that the commission wants to address that has not come up already.

Is the current VAT arrangement with HMRC, which is mentioned on page 10, secure? Two or three years ago, there was a bit of correspondence and I shared some difficulties with

VAT. Is that arrangement now 100 per cent secure?

**Caroline Gardner:** The agreement that we reached with HMRC two or three years ago remains in place and we have no reason to think that it will not remain in place.

**The Chair:** How does it affect IJBs, given their hybrid funding?

**Caroline Gardner:** They are local government bodies; therefore, they fall within the local government regime.

**The Chair:** Even if the funding comes from the NHS, the VAT position is still secure.

**Caroline Gardner:** Yes, because they are local government bodies.

**Russell Frith:** Yes. The bodies themselves are local government bodies.

**The Chair:** They are not under the control of the Scottish Parliament.

**Russell Frith:** That is correct.

**The Chair:** Unless members have any other questions, I propose that we move on. Are members content that we send a letter to the Finance and Constitution Committee reporting our views on the budget proposal, subject to the clerks coming back to us on the technical question about the NHS?

**Members indicated agreement.**

**The Chair:** The next item is the fee strategy. I will start with the key messages on page 4. The fee strategy proposes a fundamental change in how performance audits in the NHS are funded. How was the 60:40 split arrived at for the funding of NHS performance audits and how does Parliament funding the work better reflect both the nature of the work and the requirements of stakeholders? In other words, why was it put in that way in the first place?

13:45

**Caroline Gardner:** It goes back to the establishment of Audit Scotland in 1999-2000, when Audit Scotland brought together the work that had previously been done for the National Audit Office in Scotland and for the Accounts Commission in Scotland—at that point the Accounts Commission covered both local government and the NHS. At that time, all the performance audit for local government and the NHS was funded through audit fees within the Accounts Commission's regime. When Audit Scotland was formed, it became clear that the local government regime would continue at arm's length but that the performance audit in the NHS would have a benefit to the Parliament as well as

to the NHS boards. Therefore, the decision was taken at that point that it made sense to share the costs between them, and 60:40 was an estimate of where the benefits might lie. As always with such things, there is nothing terribly scientific behind that.

Our experience of carrying out the fee review over the past year or so has been that it is now an outlier—it is the only area where the costs are split between the Scottish consolidated fund and audit fees—that is inconsistent with the way in which all the other audit performance work that is carried out for the Parliament is done. It is difficult to explain to people and means that the fees in different sectors move at different rates for reasons that have very little to do with the work that is done for individual bodies.

It seems to us that, if the commission is happy to support it, what is proposed would be quite a straightforward way of simplifying the funding and fee arrangements, making them more transparent and making it clear that performance audit is one of the key parts of the support that we provide to the Parliament in overseeing the use of public money.

The short answer to your question is that it happened a long way back in the mists of time.

**Alison Johnstone:** On page 7 of the fee strategy, Audit Scotland notes that

"Revised and enhanced auditing standards ... have increased the minimum amount of work required to conduct a fully standards compliant audit",

but goes on to say that

"Developments in technology in both accounting and auditing ... have streamlined audits of the largest bodies."

On the face of it, those statements appear to be contradictory. Can you explain how the increased amount of work associated with revised and enhanced auditing standards matches up with streamlined audits? How are you doing it?

**Caroline Gardner:** I will ask Russell Frith to talk you through that.

**Russell Frith:** First, the international standards on auditing were completely revised a few years ago. The International Auditing and Assurance Standards Board increased the number of mandatory steps that are required to complete any audit, which has tended to push up the costs of smaller audits. Equally, some of the changes to the standards have meant that slightly less work has to be done on some of the larger audits. Previously, the amount of work was more proportional to the size of the body—that balance has changed.

Bringing in technology has enabled us to carry out audits more consistently and efficiently. For

example, having the working papers as electronic files means that managers can access the files from anywhere, so they can carry out a review at any time and do not have to go out on site and review paper files. Furthermore, the files are accessible to the entire team. Those are some of the ways in which we are able to carry out audits more efficiently, while still meeting the higher standards.

**Alison Johnstone:** Thank you. That is clear.

**Rona Mackay:** Again on page 7, Audit Scotland notes that there are

‘increased expectations in auditing or reviewing governance statements, remuneration reports and strategic reports/management commentaries.’

Can you explain what those expectations are and how and why they have increased?

**Russell Frith:** In the private sector, partly in response to the financial crisis a few years ago and some of the earlier corporate failures—such as Enron—the standards of corporate reporting and governance increased, particularly for listed companies. Successive Governments have taken the view that they want to bring the higher standards in the corporate sector into the public sector. Over recent years, that has meant that, for example, governance statements have come in for all public sector bodies, separate remuneration reports, which did not use to exist, have been created and are subject to audit, and there have been significant developments in management commentaries and strategic reports—in other words, the front end of the annual report—which are now subject to more audit review than they were previously.

It all stems from trying to enhance standards, originally in the private sector and then by successive Governments bringing them into the public sector.

**Jenny Marra:** On page 8, Audit Scotland notes that audit fees should be set with the objective of recovering the full cost of audit in each sector. However, Audit Scotland states that some costs will be pooled within each sector.

At the commission’s meeting in December 2015, Audit Scotland was asked whether there would be a move to fees being set

“for the individual audited bodies both within and across sectors?”—[*Official Report, Scottish Commission for Public Audit*, 10 December 2015; c 5.]

At that meeting, the Auditor General advised the commission that the issue was still being considered by the board.

Again on page 8, Audit Scotland notes that it has

“reviewed and revised the costs of individual audits using information on the actual cost of delivering the audits in recent years”.

We acknowledge the improvements that arise from a closer balance between fees and related expenditure within each sector, but are there plans to ensure that individual bodies are billed only for the audit service they receive?

**Caroline Gardner:** The statutory requirement that we work under is to recover our costs each year across all of our work. We have always complied with that.

Within the fee review, the board has agreed, as we have previously discussed with the commission, that we can increase both transparency and accountability by narrowing the requirement to make sure that each sector recovers the costs of audit. The new arrangements will do that year on year.

We have looked closely at the question of individual bodies. It is not quite as straightforward as the question suggests. We have rebased the audit fees to make sure that they more closely reflect the cost of doing the audit in each body, depending on its size and complexity. We have reviewed the arrangements by which we apportion the costs that do not apply to the cost of an individual audit—the cost of the audit strategy, the support to auditors that we were talking about earlier, property and IT costs—to sectors and to individual audits. We will therefore see some rebasing of audit fees for the audit appointments that have just started.

We think that the costs would outweigh the benefits were we to go through a process at the end of each year to review how much we had spent on each audit and to refund and invoice based on the actual amounts spent for individual bodies. Instead, the audit fee will be kept under review during the life of the appointment. If there are improvements in the audited body or reductions in what they are asked to do that mean that its fee should come down, there is scope for that to happen. Equally, there is scope for an increase where we feel that that is required.

We are not looking to recover the cost at the level of the individual body each year. We have focused on doing that at sector level, matched with much greater transparency for individual audited bodies about what they are paying for. Bodies can see the breakdown in the fee strategy, where there will be four lines showing the direct cost of audit, the pooled costs, performance audit and the overhead costs for which they are making a contribution. Bodies get much more transparency. The sector will balance overall and individual fees will move across the life of the audit appointment, depending on our experience of doing that audit.

**The Chair:** I will ask one other question. We have had very substantial fee reductions over the past four or five years. This year, Audit Scotland is reducing fees again, by 6.7 per cent. On page 4, in the key messages, it states that you are expecting

“further real terms reductions in fee levels for 2017/18 and 2018/19 audits”.

Is that not a huge challenge to achieve, given the expansion of the work that is coming down the line? Are there not lots of dangers in that?

**Caroline Gardner:** I need to be very clear that the proposal relates to the work that is already known to us. As we have clear information about the new responsibilities that we will have, we expect that there will be new resource requirements. We will come back with a clear proposal for those to the commission.

We take seriously our responsibility to make sure that we are providing the best value for money that we can to the public sector in Scotland and to the Scottish consolidated fund. We have been able to make savings through the procurement round, through things such as the property moves that we have made and through our continuing efforts to ensure that our workforce is the right shape and size for the work that we do. We will carry on doing those things and passing on the benefits. That is entirely separate from the resources that we will need to take on new responsibilities. It is more appropriate to treat those separately, rather than to blur them into one, for the accountability that we owe to the Parliament.

**The Chair:** If members have no more questions, is there anything that the witnesses wish to add?

**Caroline Gardner:** If there are no more questions, we are content to leave it there.

**Ian Leitch:** I am content.

**The Chair:** In that case, I close this meeting of the Scottish Commission for Public Audit. Thank you for your attendance.

*Meeting closed at 13:55.*





This is the final edition of the *Official Report* of this meeting.

---

Published in Edinburgh by the Scottish Parliamentary Corporate Body, the Scottish Parliament, Edinburgh, EH99 1SP

---

All documents are available on  
the Scottish Parliament website at:

[www.parliament.scot](http://www.parliament.scot)

Information on non-endorsed print suppliers  
is available here:

[www.parliament.scot/documents](http://www.parliament.scot/documents)

For information on the Scottish Parliament contact  
Public Information on:

Telephone: 0131 348 5000

Textphone: 0800 092 7100

Email: [sp.info@parliament.scot](mailto:sp.info@parliament.scot)

---

