

MEETING OF THE COMMISSION

Wednesday 18 June 2008

Session 3

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SCOTTISH COMMISSION FOR PUBLIC AUDIT 2nd Meeting 2008, Session 3

CONVENER

*Angela Constance (Livingston) (SNP)

COMMISSION MEMBERS

*Robert Brown (Glasgow) (LD)

*Derek Brownlee (South of Scotland) (Con)

George Foulkes (Lothians) (Lab)

*Hugh Henry (Paisley South) (Lab)

*attended

THE FOLLOWING GAVE EVIDENCE:

Mr Robert Black (Auditor General for Scotland)

Russell Frith (Audit Scotland)

Diane McGiffen (Audit Scotland)

SECRETARY TO THE COMMISSION

Mark Brough

LOCATION

Committee Room 5

Scottish Parliament

Meeting of the Commission

Wednesday 18 June 2008

[THE CONVENER *opened the meeting at 11:03*]

Decision on Taking Business in Private

The Convener (Angela Constance): Good morning. We might as well crack on now that we are, I think, all here and present. On matters of housekeeping, I remind people to switch off their mobile phones and I advise that we have received apologies from George Foulkes.

Agenda item 1 is to seek approval from colleagues that item 4, which is a discussion on correspondence regarding Audit Scotland's corporate governance, should be discussed in private. Is that agreed?

Members *indicated agreement.*

Expenditure Proposals 2008-09 (Audit Scotland Response)

11:04

The Convener: I welcome our guests—Mr Black, Ms McGiffen and Mr Frith—who have come to give evidence to the commission this morning. Obviously, we have been having various discussions on our most recent report and Audit Scotland's response to it. Today's evidence-taking session is part of an on-going dialogue.

Mr Black will make a short introductory statement.

Mr Robert Black (Auditor General for Scotland): I will keep it brief, convener.

I recognise the extremely important role that the Scottish Commission for Public Audit plays in holding Audit Scotland to account. We look forward to working with the commission during the coming year and we will do our best to continue to supply members with whatever information they feel they need to help their understanding of our business so that they can exercise their duties appropriately.

Of course, we will be in a much better position to assist the commission with full information in September when, I understand, we will finalise our budget. At some time after that, we will perhaps have the opportunity to discuss how our budget is shaping up. By then, we will also have published Audit Scotland's annual report—it will come out before Parliament rises for the recess—which will contain as much information as we can provide about our activities and performance over the past year.

We are continuing to work on some of the issues that have, perfectly understandably, been of concern to the commission. We will do our best to give as much information as possible on those in September. At that time, we can perhaps also update members on what we are doing to continue to improve the transparency and relevance of the information that we supply.

The Convener: Do colleagues have any questions for Mr Black?

Robert Brown (Glasgow) (LD): I will kick off by asking about the budget estimate. Sorry, that is item 3—I am getting mixed up—so you had better go back to square one, convener.

Hugh Henry (Paisley South) (Lab): End-year flexibility has been a constant theme. I know that Audit Scotland's aspiration is to move away from using end-year flexibility, but it has also indicated that EYF could be used to deal with unforeseeable issues. The debate, I suppose, is whether that is a

good way to use EYF arising from any underspend, or whether the base budget should be increased to reflect what might be a trend—albeit that EYF is being used to meet unexpected demands. From a management perspective, are we now in a phase in which demands on Audit Scotland will recur year on year such that we should make a change to the base budget, or is it better to manage such demands over the next couple of years by using end-year flexibility?

Mr Black: The short answer is that we anticipate having to use end-year flexibility into the future, for reasons that we explained in previous submissions to the commission regarding the framework within which our budget operates and the cycle of audit years. However, we will endeavour to do two things: first, we will try to reduce our reliance on end-year flexibility as much as possible in accordance with the commission's wishes; and secondly, we will be as transparent as possible when presenting the budget on what the uses of end-year flexibility will be.

I know that members have had the opportunity to hear more fully from my colleagues about how end-year flexibility fits into our budget planning and the delivery of our services, but I am sure that Russell Frith would be pleased to provide more information formally on the record.

Hugh Henry: The issue is not so much the detail as the principle. Is there an issue about the base budget that should be addressed?

Mr Black: My answer to that question is that we are constrained by the statutory framework within which Audit Scotland's budget must be constructed and its spending managed. Essentially, we are required to recover our costs mainly from the bodies that we audit and to seek a balance of resources from the Parliament. We are also required to keep that budget in balance taking one year with another. However, we must not overspend at the end of each financial year, because that would be a breach. That gives rise to two related issues, the first of which is that we will always have a margin of underspend on what might be called the current budget. As with any organisation, we need to finance projects such as capital works that have a longer timescale transcending the end of the financial year.

Secondly, as I think the commission now understands, the audit year, which runs from November to November, does not tie in with the financial year, which runs from April to March, and problems with planning our resource needs arise because of that quite long business cycle.

That is a rather full response to your question. The point is that there is no problem with our base budget; I think that we can robustly cost our resource needs. However, there are some

constraints with regard to managing flexibility at the end of the financial year to cope with our business cycle and our need for resources to carry out capital works.

Russell Frith (Audit Scotland): Hugh Henry's point picks up on the very useful discussion that we had last month with the commission. Our experience over the past few years is that, although levels have varied, there has been a constant underlying volume of unforeseen developments such as, for example, the Crerar review and further activity on developing best value. As a result, we will need to consider building into our budget, which will be presented to the commission in September, a base level of resource for development-type activities. Whether that will lead to an increase in our budget request will depend on how such work interacts with our efficiency targets.

Derek Brownlee (South of Scotland) (Con): Your written response contains the helpful comment that a fee strategy will be provided along with the next proposed budget. Will that, as I presume, be the strategy on which you will base your forward plans? I also imagine that, as part of all that work, there will be discussions about alternatives and various practices that might or might not be adopted. Would it be possible to see not only your recommendations for the fee strategy but any options that you consider and reject and the reasons why you think they are inappropriate? Such a move would give us a very helpful breadth of understanding of the range of options that you have considered and your decision-making processes.

Mr Black: Absolutely. The commission must ask for whatever information it feels appropriate for a good understanding of the business. It might be helpful if the audit adviser and the external auditor could give us an indication in advance of what exactly you are looking for. After all, there are a lot of numbers flying around.

Robert Brown: I will make another attempt to ask a question, if I may.

I want to come back to the basic principles behind all this. One of the most important elements is transparency—in other words, the ability to see and understand what exactly is happening. We were concerned that the use of end-year flexibility was muddying the waters and making it difficult to compare the trends in one year with those in another, particularly when capital works, for example, were taken into account. You have said that you will do your best to indicate any significant changes in the paperwork for the budget, and that will be extremely helpful as a starting point.

11:15

However, we also highlighted one or two other issues such as the fee strategy that Derek Brownlee has mentioned and the various capital projects. I thought that we had arrived at a point at which it was recognised that things of a more ongoing nature, such as Crerar and best value—in so far as they were not things that you were incorporating anyway as you went along—required additional resources, as they went a bit beyond the norm, and that there would need to be some sort of bid for specific finance for them. I do not think that anyone has any problems with the issue of capital projects that are delayed—that is reasonably straightforward and obvious.

Is there a way of cleaning up the issue about the carrying over of fees and charges? Perhaps there could be a one-off payment or something of that sort. Personally, I am not overpersuaded about the difficulties around EYF, as it strikes me that you have more predictable fee income than many businesses have and that the position ought to be a lot clearer with regard to being able to allocate fees that are coming in to particular years and so on. Is there a way of making that clearer?

Mr Black: I am sure that Russell Frith can help you with that question. However, I should say that we differ quite fundamentally from a business as we do not have working capital. We have a requirement to operate within the resource limit each year. Our sister organisation, the Audit Commission, can carry balances, and uses that to smooth things out from one year to the other. We cannot do that, which takes me back to my answer to Hugh Henry's question about whether there is a fundamental problem. There is a structural issue that is a reflection of the legislation.

Russell Frith: The suggestion that you make about cleaning up the situation is one that we are explicitly modelling as we work on our autumn budget revision and our budget for 2009-10.

Diane McGiffen (Audit Scotland): We left our helpful discussion with you a month ago with three strands of work to consider with regard to EYF. One was the point about building scope for development work into our core budget, which might mean that there would be less reliance on the use of EYF. The second involved making a significant adjustment to the cumulative EYF position, which would create greater transparency. The third involved making less conservative assumptions, based on the evidence of past performance, in some of our budget modelling. At present, we have year-end surpluses because—due to the fact that we cannot overspend, as the Auditor General said—we have made extremely conservative modelling assumptions.

Over the summer, we will consider those three areas of the budget. You will see the results of that work when we come back in September.

Robert Brown: We also talked about time recording during our discussion. Are you likely to make progress on that?

Can you give us an idea of the timescale for activating the sort of changes that you hope to make?

Diane McGiffen: We might be able to implement some elements of the strategy in our proposals for September, but others might take one or two years to work through. We will make that explicit when we come back in the autumn.

The Convener: That was a useful summary of the three strands that you will pursue with a view to reducing reliance on EYF. Which area do you envisage being able to make most progress on soon?

Diane McGiffen: We are currently modelling the fee issue.

Russell Frith: We are ensuring that we incorporate resources for development activity into the core budget. We will definitely do that this time round. We will also probably make significant progress on cleaning up the cumulative EYF position as well, but we need to do more modelling on how that would work.

The Convener: When you speak about continuing the work over a period of years, do you mean a few years, several years or many years?

Diane McGiffen: Given that our fee year is different from the financial year, which means that any adjustments that we make will straddle two financial years, I would say that we are talking about a period of one or two years. Once we have completed our work over the summer, we will be able to be more explicit about that.

The Convener: As we have no further questions, for the record I thank you for coming to this morning's meeting. We have had a useful ongoing discussion and we appreciate the time and effort that you have put into that.

Budget Estimate 2009-10

11:21

The Convener: Agenda item 3 is a look ahead to the financial year 2009-10. We have received correspondence from Mr Black with regard to the provisional budget bid. I invite him to make a brief opening statement.

Mr Black: What we have done accords with our practice in previous years, which is to give the commission an early indicative figure at this stage. At the moment, we are working to put together a full budget for discussion in September.

Robert Brown: I will ask the question that I started to ask earlier when I got my papers mixed up.

The covering letter talks about a 2 per cent efficiency target and a 2 per cent increase in pay and non-pay costs. I probably do not understand the issue as clearly as I should, but will the 2 per cent increase cancel out the 2 per cent efficiency savings, in monetary terms? How does the £800,000 fit into the figures? I cannot follow how we get from £7.250 million for 2008-09 to £7.478 for 2009-10. I would like that to be a little clearer to me.

Russell Frith: We considered several other issues considered in preparing that submission. We referred to the 2 per cent efficiency target and a general inflationary increase of 2 per cent in pay and non-pay costs, but other things would have been built into that, such as the new international financial reporting standards. We expect them to cost us around £800,000 to implement, although we will be doing a lot of work on that over the summer, especially because the timetable has changed since we prepared that estimate.

Robert Brown: The increase in total expenditure is, roughly, 2 or 3 per cent, which means that it is going up by more than inflation, even allowing for efficiency savings that are made. Is the £800,000 an extra amount that sits on top of all that, or are you incorporating lots of savings to produce the scope for that £800,000?

Russell Frith: The £800,000 is not on top of the other elements.

Derek Brownlee: The figure of 2 per cent for pay and non-pay costs is an assumption. When will you have, if not certainty, a better steer in that regard? Obviously, across the public sector there is a lot of controversy about pay relative to inflation. Is 2 per cent a reasonable figure?

Diane McGiffen: We do not yet know the final local government pay settlements for the current year, although we have made a payment of 2 per cent to staff.

We are reviewing our overall pay and reward strategy, which is currently linked to the local government pay scheme. We are doing an exercise to review a number of aspects of our pay and rewards strategy to ensure that they comply with a number of pieces of legislation, including age discrimination legislation.

We do not yet know what the local government settlement is for this year, but we should be clearer about that in September. We will also be clearer then about any costs that might fall from ensuring that our pay scales comply with age discrimination legislation. We have a number of long pay scales, which are likely to need to be shortened. We are actively engaged in modelling work on that at the moment.

Derek Brownlee: Is the 2 per cent that is projected for 2009-10 based on the assumption that the pay award for the current year will be 2 per cent? If this year's award turns out to be 3 per cent, will there be a knock-on impact on the 2 per cent that is projected for next year?

Diane McGiffen: I think that our budget made provision for 2.5 or 3 per cent.

Russell Frith: We assumed 2.25 or 2.5 per cent as the base inflation for 2008-09.

Derek Brownlee: Will you be in a position by September to tell us whether this year's assumptions have had a knock-on effect on the budget for 2009-10?

Diane McGiffen: Yes.

Hugh Henry: You say that Audit Scotland's pay scheme is linked to public sector pay scales, which tend to be fairly rigid and do not always reflect the market conditions that exist for some professions. The skilled staff that Audit Scotland needs are often attractive to the private sector. In a period in which inflation will edge up and the private sector will not be constrained as much as the public sector, do you anticipate that Audit Scotland will be able to retain its staff? Will that put pressure on Audit Scotland to go higher than the budget estimates to ensure that it has the right staff to do the job?

Mr Black: That is an extremely important issue for us, for the reasons that Hugh Henry has outlined. Partly for that reason, over the summer months we are undertaking the review of our awards strategy. I think that we will find it difficult to give a clear answer on that until that exercise is concluded.

However, I do not want to be too pessimistic. Quite frankly, Audit Scotland is now seen to be a very good place to be trained and to get professional experience. We are doing really quite well in attracting high-calibre people into our organisation at the bottom and developing and

moving them through. Fundamentally, we are in quite a sound position.

We do not lose many people to the private sector—we occasionally lose staff, but not to the private sector; we lose some people at higher levels to other public sector bodies. There is a challenge in ensuring that we stay competitive with salaries at the most senior levels. As ever, the picture is quite complex, but I and my colleagues will be happy to share more hard facts about it at the next meeting, when we will have the results of that exercise.

Robert Brown: I have a question on the implementation of the international financial reporting standards, which I think we were told before relates in substantial measure to the accrual of untaken holidays. How much of the £800,000 relates to that aspect as opposed to other aspects?

Russell Frith: None of it relates to that aspect. All of the £800,000 relates to the additional audit work that will be involved in reviewing and auditing the restated balance sheets as at 31 March 2008 and the shadow accounts for 2008-09 that will be required by all central Government bodies.

Robert Brown: What is the impact of the holiday issue that we were told about before? Where is that issue dealt with?

Russell Frith: That is not dealt with in the bid, because we do not yet have a clear timeframe from the Scottish Government with regard to how it intends to deal with the budgetary implications of moving to the IFRS. It is currently in the process of developing a timetable for that.

11:30

Robert Brown: In budgetary terms, what does that mean for us? You indicated that you expected about £500,000 in that context.

Russell Frith: That is still our estimate of the impact of the IFRS on Audit Scotland. We expect that that will be required to be brought through one of the budget revisions during 2009-10.

Robert Brown: As far as that figure and the figure of £800,000 are concerned, does the whole amount fall on the Government bit—the bit for which we must be specifically accountable—or is it also spread across the charges that you make to local authorities and others? If so, is the total much bigger than the £800,000 and the £500,000 that we have talked about?

Russell Frith: The £800,000 is spread across the whole lot, so only a proportion of that falls on the Government. That probably partly explains the reason why the figures did not appear to gel: only the non-chargeable audits part of the £800,000 is

included in the £7.478 million estimate. A large proportion of the £800,000 will be recovered through fees and charges.

Robert Brown: There is an element of mixing ducks and drakes in the way that the letter is phrased. The problem that we have had throughout is that there is a difference between the gross amounts stated, because of the local government aspect and so forth, and the bit that falls as a charge on the Scottish exchequer. Can you further explain your figures? How much of the bits and pieces of capital, for example, will be charges on the £7.478 million, and how much will be spread across other areas? For example, the letter states that capital accounts for £533,000. Is that part of the £7.478 million, or is only a bit of it part of that figure?

Russell Frith: As the first sentence of the letter says, our total bid from the consolidated fund is £7.478 million, of which £6.934 million is revenue costs and £544,000 is capital.

Robert Brown: What is the trend, if any, in relation to the gross figures? Are you in a position to give us the gross figures as well?

Russell Frith: Not yet. That will depend on the fees strategy.

Derek Brownlee: To what extent has the delay that was announced in the implementation of the IFRS been reflected in what you plan to do and when you plan to do it? What financial impact is that delay projected to have on Audit Scotland?

Russell Frith: The impact of the delay on the amount of audit work will be relatively small because, as well as announcing the delay in producing full IFRS-based accounts, the Treasury announced that it would require shadow accounts to be produced for 2008-09 on an IFRS basis, in order to keep the momentum of the exercise going and to avoid potential qualifications in the first year of full implementation. The delay will not have a significant impact on the amount of audit work, because of the introduction of the shadow accounts. Our budget of £500,000 for holiday pay will be delayed a year.

Derek Brownlee: Is it possible to explain in simple terms the difference between the amount of work involved in producing the shadow accounts and the amount of work involved in producing the full accounts?

Russell Frith: If the Government had gone for full implementation immediately, with no shadow accounts, we would have had a significant amount of additional audit work to do in the first year of the new standards. By introducing the shadow accounts a year early, we are in effect giving audited bodies longer to make the adjustments. We will have to review an additional set of

accounts on an IFRS basis, but that is far less work than doing a full audit, because most of the underlying work on the systems is not affected by which set of accounting standards we use. We are looking at the changes from United Kingdom generally accepted accounting practice-based set of accounts to the IFRS-based set of accounts in doing the shadow accounts. Overall, the approach inevitably means that there will be a little more work, but it will probably result in a smoother and more professional changeover from UK accounts to IFRS accounts.

The Convener: Would you like to add anything, Mr Black?

Mr Black: I am conscious that we have not been able to answer all the questions as fully as you might expect, for which I apologise, but that is a reflection of the fact that the forward budget planning requires us to produce a full analysis slightly later in the year. As I endeavoured to assure you earlier, we will present a full analysis that encompasses all the issues in time for any discussion that you might wish to have in the autumn.

The Convener: We look forward to receiving the more detailed budget proposals at the end of September.

Thank you for your time this morning, which is much appreciated. Have a nice day.

11:37

Meeting continued in private until 11:54.

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