



The Scottish Parliament  
Pàrlamaid na h-Alba

## Official Report

# MEETING OF THE COMMISSION

Thursday 27 October 2011

Session 4

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**Thursday 27 October 2011**

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**SCOTTISH COMMISSION FOR PUBLIC AUDIT**  
**3<sup>rd</sup> Meeting 2011, Session 4**

**CONVENER**

\*Colin Beattie (Midlothian North and Musselburgh) (SNP)

**DEPUTY CONVENER**

\*John Pentland (Motherwell and Wishaw) (Lab)

**COMMISSION MEMBERS**

\*Hugh Henry (Renfrewshire South) (Lab)

\*Alex Johnstone (North East Scotland) (Con)

\*Angus MacDonald (Falkirk East) (SNP)

\*attended

**THE FOLLOWING ALSO PARTICIPATED**

Mr Robert Black (Auditor General for Scotland)

Russell Frith (Audit Scotland)

Diane McGiffen (Audit Scotland)

**SECRETARY TO THE COMMISSION**

Fergus Cochrane

**LOCATION**

Committee Room 5



## Scottish Commission for Public Audit

### Meeting of the Commission

*Thursday 27 October 2011*

[The Convener *opened the meeting at 12:49*]

### Decision on Taking Business in Private

**The Convener (Colin Beattie):** Good afternoon and welcome to the Scottish Commission for Public Audit's third meeting in 2011, in session 4. I remind everybody to ensure that mobile phones and other electronic communication devices are switched off. No apologies for absence have been received.

The first agenda item is to ask the commission to consider taking in private agenda item 4, which is consideration of a draft report on Audit Scotland's budget proposal for 2012-13, and consideration of the draft report at future meetings. Do members agree?

**Members** *indicated agreement.*

## Audit Scotland Budget Proposal 2012-13

12:49

**The Convener:** Agenda item 2 is consideration of Audit Scotland's detailed budget proposal for the financial year 2012-13. The commission will report to the Parliament on the proposal and will forward for consideration a copy to the Finance Committee as part of its wider scrutiny of the Scottish Government's 2012-13 draft budget.

I invite the Auditor General for Scotland to make an opening statement.

**Mr Robert Black (Auditor General for Scotland):** I start with an apology for being a couple of minutes late, convener. We have been in the building for some time, but on the other side of the security screen; a lot of people are visiting and taking an interest in the Parliament's work today.

I will be brief because I am conscious of the time pressure on the commission. In essence, the budget proposal for 2012-13 says that we can accelerate our plan to reduce the costs of audit. Members will see that we are undertaking to deliver a reduction in audit fees of 7.75 per cent for the 2011-12 audits, which start in November this year. As I am sure members will recall, our financial year does not tie in with the audit year.

In respect of parliamentary funds, the revenue resource requirement in the budget is reduced by 4.2 per cent. The proposal describes the plans to reduce running costs by 6.2 per cent from the 2011-12 budget. This is the second year of our longer-term plan to drive down the costs of our work. We are still on track to reduce in real terms the costs of audit by at least 20 per cent—and possibly a bit more—over four years.

We have provided an update on the projected requirements to 2014-15, which takes us to the end of the spending review. To echo the point that I made earlier, we will be able to continue to reduce the budget over the next three years through planning and efficiency measures, some of which started back in 2010. The main measures that we are taking are a targeted freeze on recruitment, a continuing programme of internal efficiency savings and best-value reviews, restructuring of some of our business, and rationalisation and reduction of our property requirements. Of course, we have also had significant benefits from a tender exercise for the external audit providers.

As members will imagine, I am conscious of the absolute need to ensure that we continue to deliver robust independent audit that addresses all the issues out there. However, at the same time,

we must commit to reducing costs where possible. I am grateful to my colleagues in Audit Scotland for the good work that they have done on that.

My final point is that the budget that the commission is considering has been scrutinised in considerable detail by the non-executive members of the board of Audit Scotland, who support the submission that the commission has received. Members can take a degree of assurance from that.

**The Convener:** Thank you. I will begin our questions with one about the ambitious and obviously welcome savings targets that have been presented. Mr Black said that retention of the robustness of the audit process is a priority. I seek further assurance that the scrutiny of Scotland's public finances will not be affected and that the quality of audit will not deteriorate because of reduced resources.

**Mr Black:** I can give an absolute assurance on that, and I will offer a comment or two, if I may. We did not start the efficiency programme in the near past; we have taken quite a long run at it. For example, investment in information technology and redesign of our systems and processes has been taking place for a few years. We have been getting the benefit of that last year and this year. For example, we have adopted a new suite of programmes that allow electronic working for much of the audit work, which is a significant saving to us.

We have also increased the focus on risks in the public sector; that is the other main audit area in which we have made changes. Russell Frith can answer questions about that if members wish. In outline, the audit process is now very much driven by an initial risk assessment of every public body, and that has helped us to ensure that we are streamlined and targeted. In other areas of work, such as our partnership work with the other scrutiny bodies, the scrutiny burden on the public bodies has been reduced by well over 30 per cent.

The indicative fees that are set for individual bodies are based on the assumption that the auditors will do the work well—that is a reasonable assumption—and on the assumption, which is not entirely in our control, that the public bodies are well managed. The fee-charging system permits the auditor to undertake further work and to charge more if he or she feels that that is necessary. The body therefore has a direct financial incentive to manage its business well. If those extra fees are above a certain threshold, they must be referred to Russell Frith, as the assistant auditor general, for his agreement.

**The Convener:** The second-bottom paragraph on page 3 of the budget proposal states:

“we have reduced the time spent in councils on corporate scrutiny work by 39%”.

That is quite a substantial reduction. Are we relying more heavily on internal audit processes in councils than we have hitherto?

**Mr Black:** All the scrutiny bodies have been working on that in partnership on behalf of the Accounts Commission, and Audit Scotland co-ordinates the whole process. All the scrutiny bodies have been attempting to reduce the scrutiny burden that they place on audited bodies. There are two or three elements to that. There is an expectation and requirement that the self-assessment processes that are used in local authorities, say, are adequate, and that the scrutiny bodies share information better so that duplication is reduced and—this is related to that—the reporting is streamlined. There is nothing certain in this world, and it is distinctly possible, of course, that risks might arise that will require extra resources.

**Russell Frith (Audit Scotland):** The 39 per cent relates to the time that was spent with the councils. It should not necessarily be taken that there has been a 39 per cent reduction in the total amount of scrutiny, because more is being done through self-assessments, as the Auditor General said, and through better co-ordination with the other scrutiny bodies. There is perhaps less duplication than there was in the past, particularly around assessments of the corporate elements of each inspection exercise.

**Hugh Henry (Renfrewshire South) (Lab):** I want to follow on from the convener's line of questioning and to ask for clarification. On page 4 of the budget proposal, under the heading “Restructuring Provision”, you say that there will be a staff reduction of five whole-time equivalents in 2012-13

“followed by a further reduction of 18 w.t.e. in 2013/14.”

What mix of staff is involved? What will the impact be of the loss of those specific staff skills on different areas of work?

**Diane McGiffen (Audit Scotland):** We have been looking at the mix of skills and grades in the organisation for some time. As we have invested in new technology, introduced new audit practices and streamlined our work, we have been able to consider using people's skills differently. If the volume of our work stays the same, we are confident that we can with fewer people cover our annual audit work, the best-value work, the support for scrutiny improvement work, and the performance audit programme work, because we are specialising in different areas, developing career paths for colleagues, and getting the benefit of a sharper focus on the core areas of work.

We have also benefited from the end of the development periods of some significant areas of work in the past few years. Three or four years ago, we had a peak of work as we developed the best-value approaches that we now use. That development work has ended and we now have a streamlined process that we continue to improve. Similarly, we have been implementing international financial reporting standards in the past few years, which has been resource intensive. That is now under way so we can release some resources from that work as well.

There is a continuing mix of work. We look to change the skills mix in the organisation all the time and we are particularly looking at using fewer higher-grade staff, where appropriate, with different mixes across the organisation.

13:00

**Hugh Henry:** On the 23 staff, what mix of posts is involved?

**Diane McGiffen:** The posts will cover different grades across the organisation.

**Hugh Henry:** Can you give us details? You could send them at a later date.

**Diane McGiffen:** I can let you know our plans to restructure the business. We have not at this stage earmarked post X or post Y for the reductions. We are still reshaping the workforce. However, we know the target that we need to reach.

**Hugh Henry:** Does that not beg a question? If you know that you want to shed 23 posts but you do not know which ones, how can you guarantee that the work will be done? You have no idea whether it will be 23 people in policy, 23 people in audit or 23 people in administration. How do you know that you will be able to achieve your targets when you do not know who will be leaving?

**Diane McGiffen:** It is not that we do not know what our targets are, but we are not yet at a point where we have said, "These particular posts are the ones that we will delete from the establishment." We are going through a process of refining our structures and changing their shape. We know what resourcing we need to deliver the work under the model of resourcing that we would like to get to, and we know the difference between that model and the current establishment. We are working through a variety of means to make that shift, including the targeted recruitment freeze, the voluntary early release scheme that we have run this year and the benefits of the turnover that we have.

**Mr Black:** To build on what Diane McGiffen said, what this means in reality is that we are running a recruitment freeze for any posts that

become vacant and we do not know exactly where those posts will be because future turnover is uncertain. The senior management has a grip on that and will release posts only if there is a case for them to be filled because of business need. That is one element.

Another element is the importance of the voluntary early release scheme, under which we permit staff to go, again if a good business case and value-for-money case can be made for that. We know the age profile of our staff so we can be reasonably sure—on a probability basis—of where people might come from who will be interested in voluntary early release, but we are not in a position to give names because it is all in the future and those people are entitled to make their own decisions nearer the time.

**Hugh Henry:** The situation does pose some questions. If you do not know which posts will be deleted and if people are entitled to make up their own minds, as you said, how do you know that you will be able to achieve the target? I return to the thrust of my original question. If you do not know where the skills are that will be going, how can you assess what the impact will be on your ability to deliver on your targets?

**Mr Black:** We do not know 100 per cent, but we have a pretty good idea.

**John Pentland (Motherwell and Wishaw) (Lab):** When you were here previously you said that one of the first things that happen when efficiencies are required is the knee-jerk reaction of restructuring and getting rid of staff. I note from your introductory remarks that you are thinking seriously about doing that.

You also said that you have considered Audit Scotland's efficiency for a number of years. However, page 15 of your operating costs statement shows that most of your budget lines, with the exception of a pension adjustment in 2010-11, have increased. Can you explain that?

My third question is similar to what Hugh Henry asked about and is on the staff vacancy factor, which you intend to reduce from 4 per cent to 2 per cent and which will increase your budget by £155,000. I am trying to match that figure to the figure on page 7 on staffing costs. It is probably clear, but I cannot understand it. You state:

"The cost savings generated from these reductions together with the effect of grade mix changes from business restructuring total £540k. These savings are partly offset by increased costs arising from pay growth, £245k and the effects of reducing our vacancy factor, £155k."

Does reducing your staff vacancy factor give a saving of £155,000, or has that been used to balance another bit of the budget?

**Mr Black:** Those are points of some detail, so I ask Diane McGiffen to go through them.

**Diane McGiffen:** I will take the people costs element first; if what I say does not answer your question, please let me know and we will explore it further. The staff numbers are going down and our people costs are going up, and Mr Pentland is looking to understand what the impact is of things such as the adjustment of our staff vacancy factor.

In the people costs area of our budget, we have the benefit of reductions through savings that we have made so far, but there are underlying increasing costs, which we have outlined. We have been running with a vacancy factor of 4 per cent, which means that when we plan our budget we calculate 100 per cent of the staffing costs. Because there is always turnover in the organisation, we have in the past taken 4 per cent off the headline budget figure to account for the fact that we will not have 100 per cent of people in post 100 per cent of the time.

Last year, our staff vacancy factor was about 8 per cent. However, we have deleted posts from the establishment since then and a number of people will leave the organisation later this year. Further, the first two quarters of the year have shown us that our turnover has slowed right down. If we continued to take 4 per cent off our staffing budget, it is likely that in reality we would exceed the staffing budget. Adjusting the vacancy factor down therefore reflects reality, which is that we have fewer posts and turnover has slowed. Although we will get some benefit from turnover because there will be some vacancies through the year, we do not expect it to be at the level it was at before. If we did not make an adjustment to the vacancy assumption, we would run the risk of overshooting the staff costs budget. Does that help to answer your point, Mr Pentland?

**John Pentland:** I have heard the same comments from staff back at the local authority when they do that kind of analysis. It is obviously something that I will have to sit down and try to understand. However, I am quite sure that your answer is proper and correct. If it is not, I will come back to you.

**Mr Black:** I will build on that with regard to some of the numbers that you mentioned earlier. The savings from five posts is £540,000. We have had to put in an element for pay growth because we entered the pay freeze earlier than other parts of the public sector and, in line with Government policy, we have made a modest provision that would allow us—I cannot say too much in public at this early stage—to accommodate a small element of pay growth. The other element of pay growth arises from the structure of the organisation.

I think we mentioned earlier—it was certainly mentioned on previous occasions—that as a result of voluntary early release we have often lost senior staff towards the end of their careers and replaced them with people at more junior grades. Contractually they are entitled to contribution-based pay—or increments, in the old language that I understand—so the £245,000 allows for those elements of pay growth. We have put in a requirement for the restructuring provision, which echoes the conversation that we had a moment ago with Mr Henry. We will need to make provision for future restructuring, which includes funding for voluntary early release.

There is also a reduced staff vacancy factor. We simply cannot assume, as Diane McGiffen has outlined, that the same number of posts will be vacant for as long as they were in the past, and therefore we cannot strip out that money at an early stage. I think that I am right in saying that we must take all those factors together to get to the actual staff costs.

**John Pentland:** Efficiency has not just happened: you have been working on it for a number of years. However, most of the budget lines in your budget proposal have been increasing. Can you explain that?

**Mr Black:** Russell Frith is a master of the detailed budget lines, so perhaps he can take us through one or two of the elements.

**Russell Frith:** Some of the budget lines have been increasing, but the actuals have not been going up by as much. For example, the total administrative cost line on page 15 started out at £11,935 in 2009-10, and has fallen to £11,355. There is a slight increase in that budget, although whether we will spend it all is yet to be seen. The total then comes further down to just over £10,000 in 2012-13, so overall there is a downward trend.

**John Pentland:** The biggest efficiency—I do not know whether it is through effort—is the pension adjustment.

**Mr Black:** Do you have a question about the pension adjustment?

**John Pentland:** No, I was just summing up my own question.

**Russell Frith:** We have never regarded the pension adjustment as an efficiency. It was a one-off reduction in costs in 2010-11 that came about only as a result of a change in Westminster Government policy that impacted on our accounts. We do not count it as a cost reduction or an efficiency.

**Mr Black:** None of the numbers that we provide on efficiency includes the pension adjustment because it is an external factor that we cannot control.



**John Pentland:** That may be the case, but it is still part of your balance sheet in the end.

**Mr Black:** It has to be accounted for.

**John Pentland:** Yes. On page 7 of your budget proposal you identify a further £1.2 million of savings from fees that are paid to external firms for contracted audit work that is done on Audit Scotland's behalf. How does Audit Scotland monitor the work of external firms and assure itself that the quality of their audits is of an appropriate standard?

**Russell Frith:** All the firms are required—as our staff are—to follow international auditing standards. Some of them relate specifically to quality and to the systems that all auditors must have in place to assure themselves of quality, not only as each audit progresses but in the form of cold reviews after the event to ensure that audits were conducted in accordance with the required standards.

We work closely with those firms, not only on specific quality arrangements but on planning the audits, so that we are all aware of the risks and key issues that are likely to arise.

We get all the auditors for, say, local government or health together in one room to talk through the issues early on at the planning stage and again at the final audit stage, so that we get consistency of judgment and understanding across the sector. That approach has served us very well for the past five or six years.

13:15

On top of that, the firms all have their own cold-review processes. We get to see the results of those processes and, in some cases, we have input into which audits are the subject of those reviews. We also review the external quality inspections of the firms that are conducted by the audit inspection unit on a United Kingdom-wide basis, so we have a clear understanding of what independent inspectors are saying about those firms.

We have pretty robust arrangements in place to ensure that firms produce the quality of work that we expect, both in a technical sense through the inspections and cold reviews, and in the sense of getting everybody together to get common understanding and consistency.

**Angus MacDonald (Falkirk East) (SNP):** I turn to the principal budget assumptions on page 4 of the budget proposal, in which you advise that Audit Scotland intends to continue making “contribution-based payments” to staff in 2012-13, which would equate to 0.83 per cent of the pay budget. Will you explain contribution-based

payments, how they are determined and which staff members are eligible?

**Mr Black:** A few years ago we moved to a policy, with the approval of the Audit Scotland board—we talked about this with the SCPA in the previous session of Parliament—whereby we do not give people automatic increments, so they do not automatically move through pay scales. Contractually, we are obliged to recognise that expectations of performance have to be met before people can get what used to be called in old language an increment. By moving from the blanket increment model to contribution-based pay, which is more fine-tuned to reflect the contribution that people make, we have saved some money and, more important, we have a management tool that allows us to performance manage people more effectively. As I think I might have remarked in answer to Mr Pentland's question earlier, we now have a skill mix with a greater portion of people towards the bottom end of the grades, and those people are entitled to a contribution-based pay element as they go through the system.

**Diane McGiffen:** We introduced our current pay system because our previous pay system was not compliant with age equality legislation and we needed to move away from it. This discussion will be very familiar to those of you with local authority backgrounds, as there has been an on-going change in this regard in public sector employment. We have target rates for all the roles that we have. The expectation is that when someone joins the organisation they will join at a pay level below that target rate, but if their performance and progress are satisfactory they will progress to the target rate within around five years. Progress is based on contribution, which is assessed through the performance appraisal system that we introduced, which we assess continually to ensure that it is robust.

Once colleagues are at the target rate for a job, there is no automatic progression. If someone was assessed as having made an outstanding contribution in their area of work, borne out in their performance assessment with robust evidence—that goes through a fairly robust process—occasionally they would be eligible for a contribution-based payment beyond the target rate for the role. Previously we had a scenario in which it would have taken an employee in one of our main grades 11 years to move from the entry point to the ceiling point. Progression was time-bound—it happened annually.

When people come in now they have an expectation of reaching a target rate for the role within about five years. They stay there unless their contribution in any given year is outstanding, in which case there is a contribution-based

recognition for that, but it has to be earned, and re-earned in subsequent years. It is therefore quite a different pay system and one that we discussed with the previous SCPA, because it was part of the change to our employment terms and conditions, pay structure and grading structure to ensure that we complied with our business needs and equality legislation.

**Angus MacDonald:** Thank you. That was a helpful answer.

**The Convener:** I was going to ask a question about the number of expected leavers among the staff, but that has been covered.

Just below the resource requirements box on page 5 of the budget proposal, there is an indication of quite a large increase in capital expenditure—£190,000 in real terms—which is a fairly sensitive subject at this time. Can you share a little bit more information about what is behind that?

**Diane McGiffen:** You will recall from previous discussions that we are intending to rationalise the property that we have. We have the opportunity to exit at no cost—at a break point in the lease—a lease that we hold in East Kilbride. We are exploring our options for relocation and the assumption in the budget proposal is based on an estimate of the fit-out costs for moving to new premises. We would make the decision to move only on the basis of a business case based on the cost of new accommodation and its business benefits. Unless we request a provision for the capital cost, we would not be able to seize the opportunity to make a rationalisation and get into a property that is a better fit for us and our business needs when the break point comes up.

We have traditionally entered into long leases with our landlords and we are at a point where, over the next four-year period, we will be able to make better choices across all the property that we hold about where we are located.

**Hugh Henry:** I will ask a supplementary on capital expenditure. The proposal indicates that part of the extra £190,000 for 2012-13 is £60,000 for a mobile phone refresh. How many mobile phones does that represent?

**Diane McGiffen:** Our current staff number is about 260, but not all staff have a mobile phone. I stress that £60,000 is a budgetary provision. The last time that we refreshed the mobile phones, we got the handsets for free. We have a very mobile workforce and we probably have about 100 or so mobile phones, but I do not have the exact number to hand.

**Hugh Henry:** How many mobile phones does £60,000 represent?

**Diane McGiffen:** That represents the scenario in which we issue the maximum number of mobile phones; it is based on our planning assumptions about staffing levels.

**Hugh Henry:** Why would you have to refresh all the mobile phones in the same financial year? Usually, they last a few years and are replaced incrementally. Why, in this financial year, do you have to plan for the renewal of all the mobile phones, at an average of well in excess of £200 each, excluding rental and usage?

**Diane McGiffen:** Because all our handsets are reaching the end of their life. We replaced all the mobile phones at the same time when we refreshed them a few years ago. We made a budget assumption at that point to fund their replacement but we were able to get a very good deal in the marketplace, whereby we got all the handsets at no cost.

**Hugh Henry:** Up until the recent freeze, in any organisation in which there has been an organic refresh of staff, when people joined they tended to be given a new phone rather than a phone that someone else had been using. I find it strange that a few years ago everyone got a phone at exactly the same time and that, in the next financial year, everyone will have to have their phone replaced at exactly the same time.

**Russell Frith:** There are other issues. First, we give second-hand laptops and phones to new staff, if someone has left. We have done that for many years. However, the other issue is that most of the mobile phones are also used for accessing e-mail systems and data in connection with work—they are not just used for making phone calls. It is extremely expensive and cumbersome in terms of time for our IT support team if they have to support many different types or generations of mobile phone. In relation to efficiency and maintenance, replacing the whole lot of mobile phones with the same model is quite an effective thing to do.

**John Pentland:** Page 13 of the budget proposal identifies that a further headcount reduction of 18 whole-time equivalents will be required in 2013-14. A total restructuring provision of £600,000 has been set aside in the years 2012-13 to 2014-15—£300,000 in 2012-13 and £150,000 in both 2013-14 and 2014-15.

How have those provisions been calculated? Is the £300,000 that is set aside in 2012-13 intended to cover the entire target reduction of 18 whole-time equivalents in 2013-14? Are the further sums of £150,000 in 2013-14 and 2014-15 intended to cover further staff reductions?

**Mr Black:** I will invite Diane McGiffen to endeavour to answer that question. One point that I would venture to make is that we are now talking beyond the next financial year, which means that

we are looking some way ahead. The SCPA is, quite reasonably, asking us for a broad indication of our likely resource needs going forward.

As I think that I indicated earlier, we are committed to continuing to reduce the costs of our activity by at least 20 per cent in real terms, through to the end of the spending review period. That will certainly require us, at some stage, to think again about reducing staffing levels, probably through a voluntary early release scheme. Some provision needs to be made for that. Nearer the time, the exact sums of money will be clear. I am sure that Diane McGiffen will be able to give you more of an indication of what is in those numbers.

**Diane McGiffen:** In our four-year plan, which we published last year, we recognised that, to reduce the cost of audit by 20 per cent over four years in real terms, we would likely need to identify funds to help with the restructuring of the business.

We started the process in 2010, and our 2011-12 budget proposals included plans to reduce staff numbers by 16. We are now on target to deliver those reductions and, in order to continue to follow the plan through, we expect that we would need to be able to offer some form of early release scheme in 2013-14, and we need to budget for that in 2012-13 so that we can make the scheme available in advance of the year in which the reductions need to take place. That will allow us to work at the reshaping for as long as possible.

The £300,000 business restructuring money would be used to fund the early release scheme. As previously planned, we have used parts of the benefits that we have generated in efficiencies and so on to set up that provision of £300,000. Any scheme that we run would be run on the same principles as the voluntary early release scheme that we have been running in this financial year. Any approved departures would be based on business reviews that clearly demonstrate value for money on a post-by-post basis and on an aggregate level.

13:30

At this stage, we have to base our calculation of the figure on averages. We know the principles of our scheme, we look at the lengths of service and staff profiles, and we make a best guess of the likely resource requirement. Any funding that had not been used for restructuring would be used to reduce audit fees further. If we could reshape the business with less use of voluntary early release arrangements, any savings generated below the £300,000 figure would be used to reduce audit fees. That is, at this stage, our best estimate of the resources that we might need, based on the costs

of the scheme that we have just been running and the target numbers that we are likely to need.

**Hugh Henry:** Does that mean that in 2011-12 and 2012-13 no one will join Audit Scotland?

**Diane McGiffen:** No. We have committed to a targeted recruitment freeze. There are certain one-off and specialist roles or posts in the organisation that we might not be able to do without, and we have committed to advertise all vacancies internally in the first instance to ensure that our existing staff have the opportunity to apply for any vacant role. Only if that process is unsuccessful and we cannot identify anyone with the appropriate skills to fill those vacant posts will we consider advertising externally.

Although we have achieved a lot with the recruitment freeze, we would be reluctant to commit indefinitely to having no new members of staff join the organisation. During the freeze, we have continued with our recruitment of graduate trainees from outwith the organisation but we think that an absolute freeze that continued for ever would start to have disbenefits. As I have said, our existing internal staff are able to apply for any vacancies in the first instance, and some of those moves might help with the restructuring.

**Hugh Henry:** I commend you on your commitment to graduate recruitment because it is important for public and private sector organisations to give young graduates the opportunity to gain experience. Our society would be the poorer if that did not happen. Are you able to give any examples of the type of skills that you do not have at the moment and for which you might have to recruit this or next year?

**Diane McGiffen:** I can give you a hypothetical example. If our human resources manager left and we advertised the post internally it would be unlikely that we would find in our pool of professional, primarily audit-related, staff someone with the skills or experience to take on the role. There are certain specialist roles that we need.

**Hugh Henry:** Presumably, though, an HR person or someone with very specific skills would not be allowed to leave under the voluntary scheme if those skills were not otherwise available in the organisation.

**Diane McGiffen:** Absolutely. All the voluntary release arrangements are subject to a business plan that is tested in each case to see whether such a move would have significant business benefits; we must also feel that we can release that individual's skills and experience. There would be a very high threshold for the very unique roles that I highlighted.

**Angus MacDonald:** Page 13 of the budget proposal states that it is

“based on the assumption of no changes in the volume of work required.”

Has Audit Scotland set aside any contingency funding to deal with unforeseen section 23 reviews or other matters that might arise and which would require detailed audit scrutiny or review? If not, how would the organisation resource a significant audit review requiring immediate attention?

**Mr Black:** That is an entirely fair question to which it is difficult to give anything other than a hypothetical answer, because we are talking about unforeseen events. This will become a more challenging area of work as the organisation reduces in size and takes out costs.

Generally speaking, if there is a need for a special report—a section 23 report or even a section 22 report to accompany an organisation’s accounts, one of which was taken to the Public Audit Committee only yesterday—we would always endeavour in the first instance to use our existing resources. That would, in general, involve reprofiling other work—in other words, we would reprogramme other work to allow that special piece of work to go ahead. So far, we have managed to operate on that basis.

Occasionally, we might have to bring in specialist support and advice for pieces of work, depending on the nature of the issue. We hold in the budget a relatively small contingency fund to cover such things and we would use that in the first instance. It is not beyond the bounds of possibility that in future years we might have to come back to the Parliament with a special resource request for a very significant piece of work, but I would not say that the likelihood of that is high and we have not had to do so up until now.

**Angus MacDonald:** It clearly is hypothetical, but should that situation arise could you envisage, for example, slippage on the deadlines for on-going work?

**Mr Black:** The deadlines for the on-going work would be revised and adjusted accordingly, yes.

**Hugh Henry:** Could you explain your fee arrangements in a little more detail? What factors do you place on risk, the size of the authority and the complexity of the work? How well are the bodies you are auditing able to enhance their internal audit arrangements and what support do you give them?

**Russell Frith:** For financial audits—the annual audits of individual bodies—the indicative fees we set are based on a reasonably well-run organisation of that size in that sector. However, the auditors have the flexibility to agree the final fee with the audited body—initially in the range of plus or minus 10 per cent—based on the auditors’ assessment of the specific risks to that body in

discussion with the body concerned. If they want to go outside the plus or minus 10 per cent, they need to come and discuss it with us first. That provides a safeguard against either an auditor or an audited body trying to place undue pressure on the other. That is how we set the indicative fees. We leave it to the auditor and the audited body to discuss and set the final fees. Clearly, if things happen after the fee has been agreed—for example, if a set of accounts turns up that is not fit for purpose and which costs the auditor more because of the time it takes to audit the accounts and get the corrections put through—they will go back and seek an additional fee.

Internal audit is one part of the assessment of how well run an organisation is. By and large, we do not encourage the external auditors to step in for any deficiencies in internal audit. They would be encouraged to report those to the relevant board or members of the body to encourage improvement in the quality of internal audit. We place reliance on the work of internal audit wherever we can, but we must also recognise that the function of internal audit is primarily to support management. If internal audit diverts a lot of its time into doing what could be external audit work, it might well not be carrying out the work that needs to be done for the purposes of the organisation itself.

**Hugh Henry:** If you detect that an organisation is performing well, that it is competent and that there are no audit issues arising from the audit function, can you reduce the audit input and therefore the fees by more than 10 per cent?

**Russell Frith:** Yes, it is equally possible that the auditor and the audited body can agree that. It has not happened terribly often, but it does happen.

**Alex Johnstone (North East Scotland) (Con):** I get the last shot at the questions because I was late in turning up. Do not worry—my question is not a severe one.

On page 10, the fee strategy states that

“costs of travel and subsistence ... are pooled and shared across all audited bodies.”

How was that decision taken? Has that arrangement been agreed with the audited bodies?

**Russell Frith:** It is certainly known to all the audited bodies, because we have told them our primary assumptions. The origins of the arrangement are quite old—in fact, it predates Audit Scotland, because it came through from the Accounts Commission, our predecessor body.

As I understand it, the thinking behind the arrangement was that it was unreasonable to expect individual audited bodies to pay additional amounts for the consequences of a decision to

appoint a particular auditor by a third party—at that time, the Accounts Commission, but now the Accounts Commission or the Auditor General. It was a way of trying to be fair, particularly to the more remote bodies, for which the location of the auditor was quite a significant factor in the total cost of carrying out the audit.

**Alex Johnstone:** Is that arrangement sustainable or does it require to be reviewed?

**Russell Frith:** I think that it is sustainable; equally, I accept that there are alternative approaches that could be taken, the result of which it is clear would be a significant increase in the costs of the audits of the most remote bodies. The island councils and health boards would be the organisations that would see a significant increase if we changed the policy.

**Alex Johnstone:** No complaint, no action.

**The Convener:** Do members have any other questions that they would like to put to Audit Scotland? Do the Audit Scotland representatives have any other points that they would like to make?

I think that most people around the table are aware that Mr Black has indicated that at some point he intends to retire. Given the commission's cycle, I am not 100 per cent clear whether this is your last appearance before us but, given what you said yesterday to the Public Audit Committee, you could be around until the spring, at least.

**Mr Black:** I may well have the pleasure of a conversation with the commission again. I am entirely in the hands of the Presiding Officer and the Parliament on the process. As I think I remarked to the Public Audit Committee, we all recognise that, in general, it takes quite a few months to fill a senior post such as mine. I have indicated to the Presiding Officer that I will stay fully in action until a suitable date is agreed, which is unlikely to be this year and may well be a little bit into next year. Thank you for your comment.

**The Convener:** On the assumption that you will be here for our next meeting, we will save the valedictory comments until then.

**Mr Black:** That provides me with an incentive to come back.

**The Convener:** Thank you for your attendance.

## Budget Process (Written Agreement)

13:44

**The Convener:** Item 3 is consideration of the revised written agreement on the budget process between the commission and Audit Scotland. A paper from the secretary is attached. A separate written agreement between the commission and the Finance Committee was agreed at our most recent meeting. Are members content to agree the document?

**Members indicated agreement.**

**The Convener:** In that case, the secretary will contact Audit Scotland to confirm that the commission is content with the terms of the written agreement and a copy of it will be published on our web page.

As agreed earlier, we will now move into private session, so I ask any members of the public to leave.

13:44

*Meeting continued in private until 13:51.*



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