

Colin Beattie  
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12 December 2017

Dear Mr Beattie

### **Audit Scotland 2018/19 Budget Proposal**

I am pleased to submit Audit Scotland's budget proposal for the financial year 2018/19 and look forward to meeting the SCPA on 20 December to discuss it.

As public finances change and become more complex the role of public audit and independent scrutiny increases. The main strategic and financial issues affecting Audit Scotland next year and beyond will be the devolution of additional financial powers to Scotland and the uncertainty over the UK's withdrawal from the EU.

This budget proposal is based on our assessment of the risks and opportunities that Audit Scotland will face, and ensures that we will have the capacity and skills to support the Scottish Parliament and others in scrutinising the new powers, auditing the new Social Security Agency and assessing the impact of Brexit on Scotland's public services.

### **Strategic Overview**

The 2018/19 budget proposal is based on a total expenditure requirement of £24,356k. This is an increase of £837k (3.6%) in cash terms from the approved 2017/18 budget. In real terms (2017/18 prices) this represents an increase of 1.9%. The budget proposal seeks net parliamentary funding of £7,148k. This represents, an increase of £617k (9.4%) in cash terms from the 2017/18 budget, or 7.7% in real terms. This provides for an additional eight w.t.e. posts to support our work on new financial powers and constitutional change. Overall audit fees for 2017/18 audits will be reduced by 0.1% on 2016/17 in cash terms, a real terms reduction of 1.7%. Appendix 3 of the budget proposal provides more details on the fee strategy.

Our budget also re-aligns existing resources to enhance our focus on high quality audit work. This will support our vision to be a world class audit organisation by providing assurance on the quality of audit work, promoting continuous improvement and supporting professional and technical leadership.

### **Budget Assumptions**

Our people costs show a 5% increase in cash terms (3.3% in real terms) from the approved 2017/18 budget and this is mainly driven by:

- a) eight additional posts to meet new audit work arising from new financial powers and constitutional change
- b) an increase of 2% to our pay bill (1% on pay scales and 1% pay progression)

- c) an increase in pension scheme employer contributions of 0.5% following the latest triennial actuarial valuation.

**Indicative Forecast for 2019/20 and 2020/21**

We are planning a phased increase in resource requirements over the next four year period (2018/19 to 2021/22). This approach is aligned with the expected timeline for implementing new financial powers and establishing bodies that will require additional audit work. Table 3 (page 13) of the budget proposal provides an analysis of indicative revenue and capital expenditure forecasts for 2019/20 and 2020/21.

I hope this strategic overview is useful, and we would be happy to provide any further information in advance of the meeting if this would be of assistance.

Yours sincerely

**Caroline Gardner**  
**Accountable Officer**

# Budget Proposal

## 2018/19

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## Key Messages

Audit Scotland is committed to delivering value for money. The budget proposal for 2018/19<sup>1</sup> will continue to produce real cost reductions in audit fees while maintaining the quality of audit work.

In addition to delivery of our existing work programme, further resources are required to meet new audit work arising from new financial powers and constitutional change. The 2018/19 budget proposal includes funding for an additional eight whole time equivalent (w.t.e.) posts to support work in these expanding areas.

The Total Resource Requirement in the 2018/19 budget proposal is £7,148k. The new financial powers demands and the biennial National Fraud Initiative exercise are principal factors in the Total Resource Requirement for 2018/19 increasing by £617k from the approved requirement in 2017/18.

These proposals will deliver:

- increased resources to meet new financial powers commitments
- additional investment in audit quality arrangements
- the biennial National Fraud Initiative exercise
- a real terms reduction in 2017/18 audit fees by an average of 1.7% from 2016/17 levels as detailed in the fee strategy provided in Appendix 3
- further real terms fee reductions for 2018/19 audits
- continued transparency of our funding arrangements.

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<sup>1</sup> The 2018/19 Budget Proposal covers two audit years 2017/18 and 2018/19. Financial years run from April to March, audit years from November to October.

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## Introduction

Audit Scotland provides services to the Auditor General for Scotland and the Accounts Commission. We carry out annual external audits of public bodies and programmes of Performance and Best Value audits across the Scottish public sector. We audit around 220 public bodies.

Audit Scotland's vision is to be a world class audit organisation that improves the use of public money. To achieve this vision, meet relevant professional standards and maintain the independence of audit, we must balance the need for adequate resourcing with demonstrating that we deliver value for money.

Our funding comes from charges to audited bodies and from the Scottish Consolidated Fund. We are required to submit our budget proposals to the Scottish Commission for Public Audit (SCPA) for their consideration. The SCPA then make a report to the Scottish Parliament as part of the annual Budget Act approval process.

This paper presents our budget proposal for the 2018/19 financial year with the fee strategy included in Appendix 3. The budget proposal includes information on the budgeted costs for each audit sector.

We have provided updated projections of resource requirements for two further years to 2020/21.

This paper is presented in three parts.

- Context
- Resource Requirements 2018/19
- Cost projections 2019/20 to 2020/21.

Appendix 1 - Net Expenditure Statement expenditure trends

Appendix 2 - Sector cost analysis

Appendix 3 - Fee Strategy

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## Context

### 2018/19 uncertainties

The budget for 2018/19 has been prepared in the context of a number of key uncertainties:

- the publication of the Scottish budget and the Scottish Government's longer-term fiscal strategy, including public sector pay policy
- timing of some aspects of the Scotland Act 2016
- the impact of changes to the Scottish Budget process as the recommendations of the Budget Process Review Group are implemented
- the impact of the UK leaving the European Union.

### New work 2018/19

Legislative change has created new audits and additional audit requirements. This includes further work to provide assurance to Parliament on the financial aspects of the Scotland Act 2016 and the audit of new bodies being created as a result of further devolution. More details are provided in the section on *New Financial Powers and Constitutional Change* below.

### Quality

High quality audit work remains a priority for Audit Scotland and our budget proposal supports this goal by increasing resources for quality arrangements. This will increase our ability to provide assurance on the quality of audit work, promote continuous improvement in audit quality and support professional and technical leadership in public audit.

## Resource Requirements 2018/19

The total Resource Requirement for 2018/19 requested for approval by the SCPA is £7,148k. This represents an overall cash increase of £617k (+9.4%) on the approved 2017/18 budget.

The following table summarises the total Resource Requirements included in the 2018/19 budget proposal and provides a comparison with the approved 2017/18 budget. More detailed information on expenditure categories is provided in Appendix 1.

Table 1 – Summary of resource requirements for 2018/19

Resource requirements	2017/18 £000	2018/19 £000	Change	
			Actual	Real Prices
<b>Expenditure</b>				
People costs	15,143	15,900	5.0%	3.3%
Other administrative costs	8,376	8,456	0.1%	-0.7%
<b>Gross administrative costs</b>	<b>23,519</b>	<b>24,356</b>	<b>3.6%</b>	<b>1.9%</b>
<b>Income</b>				
Income from charges to audited bodies	17,168	17,383	1.25%	-0.3%
Bank interest and miscellaneous income	25	0	-100.0%	-100.0%
<b>Total income</b>	<b>17,193</b>	<b>17,383</b>	<b>1.1%</b>	<b>-0.5%</b>
Corporation Tax payable	5	0	-100.0%	-100.0%
<b>Net Operating Cost</b>	<b>6,331</b>	<b>6,973</b>	<b>10.1%</b>	<b>8.4%</b>
Capital	200	175	-12.5%	-13.9%
<b>TOTAL RESOURCE REQUIREMENT</b>	<b>6,531</b>	<b>7,148</b>	<b>9.4%</b>	<b>7.7%</b>

### Resource analysis

Our Total Resource Requirement proposals for 2018/19 are £617k (9.4%) more than provided in the 2017/18 budget. In real terms (2017/18 prices) this represents a 7.7% increase.

In the 2018/19 budget proposals people costs increase by £757k (5.0%), other administrative costs increase by £80k (1.0%) and income increases by £190k (1.1%) from the 2017/18 budget. Full details of the budget movements are provided on pages 8 to 11 of this proposal.

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## Principal budget assumptions - 2018/19 to 2020/21

The principal assumptions underlying the budget proposal for 2018/19 and our cost projections for the two following years are:

### 2017/18 Budget Revision

We have not sought any revision to our 2017/18 budget through the Autumn Budget Revision process.

We will seek an adjustment as part of the 2017/18 Spring Budget Revision to meet non-cash pension cost adjustments in line with normal practice. The 2017/18 adjustment will be dealt with through the Annually Managed Expenditure (AME) process agreed between the Scottish Government and HM Treasury. The estimate for 2017/18 is £2.8m based on information provided by the pension scheme actuary.

Our 2018/19 budget proposals have been prepared on the assumption that non-cash pension costs adjustments will continue to be funded through the Spring Budget revision process.

### New Financial Powers and Constitutional change

Our 2017/18 budget included £100k under workforce to provide support for the assessment of additional work arising from new financial powers. We have now determined our immediate resource requirements, staff and skills mix and we have a transition timetable as all powers are implemented.

Additional capacity will need to be phased in over the next four years. In 2018/19 an increase of £380k is required to the existing budget to provide eight w.t.e staff in our auditing business groups. These additional requirements will allow us to carry out new work including:

- the Scottish Fiscal Commission, where legislation does not allow us to charge a fee for this audit, so the costs need to be recovered through parliamentary support
- the Crown Estate Scotland and Scottish Land Commission, which will be funded by additional audit fees
- further work to continue to provide assurance to Parliament as all the financial and social security powers in the Scotland Act 2016 are implemented, which will be funded by parliamentary support. The full extent of this additional work will develop as legislation and implementation progresses. It will include: work on the audit of devolved social security benefits; further work supporting parliament as the complexity of the Scottish finances and links to economic performance increases; comprehensive work with the National Audit Office to provide assurance on income tax and VAT income; and the audit of further taxes as these are devolved.

As financial and social security powers transfer on a phased basis, our mid-point projection of the full additional resource required by 2021/22 is 20 w.t.e. staff at a total cost of £1,200k. By that point we expect that around £2.9 billion of social security spending will have been



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devolved and that Scottish Parliament will be responsible for raising income of £22 billion – more than half the total budget for Scotland. This is a seismic shift to the public finances.

Work continues on the implications of the UK leaving the European Union, but at this stage the impact on audit work cannot be quantified and our budget proposal makes no specific allowance for this change. This is an area we will keep under review and we hope to be able to respond flexibly where necessary.

### **Work programme 2018/19 to 2020/21**

In May 2017 we published an updated Corporate Plan for 2015 - 2018, describing our strategy and work plans for the three years from 2015. This is the final year of the current plan and the plan can be found on the Audit Scotland website <http://www.audit-scotland.gov.uk/report/corporate-plan-201718-update>.

Our core work on public audit in Scotland covers over 220 organisations including the Scottish Government, the NHS in Scotland and local councils. These organisations spend over £40 billion of public money annually.

Our work programme for 2018/19 is based on the current public sector landscape and has a strong emphasis on supporting Parliament. This includes scrutinising the implementation of Scotland's new financial powers.

We have a five-year rolling programme of national performance audits. The detailed programme for 2018/19 and the following two years are determined by the Auditor General for Scotland and the Accounts Commission for Scotland following consultation with stakeholders.

The programme is designed to reflect changes in the way public services are delivered and covers areas of major investment, the effectiveness of policy implementation and how public agencies work together.

It includes reporting on:

- implementation of Scotland's new financial powers
- the impact of health and social care integration on improving outcomes
- educational attainment, including the use of pupil equity funding
- innovative financing, such as City Deals and the use of Non-Profit Distributing (NPD) funding models
- the effectiveness of skills planning and investment in supporting economic growth
- public sector workforce planning
- the use of digital technology to improve public services.

The programme also includes overview reports on the performance of key sectors to assess how effectively those sectors perform and how well they are responding to strategic challenges; such as reducing resources, recruitment difficulties and demographic change. The programme also includes provision for statutory reports to be brought to the Parliament by the

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Auditor General for Scotland on significant issues arising from the annual financial audit process, or from the Controller of Audit to the Accounts Commission for Scotland.

We work closely with colleagues in England, Wales and Northern Ireland to extend the impact of the National Fraud Initiative (NFI), which has now identified £111 million of fraud and error in Scotland since 2004.

Audit Scotland places the highest importance on audit quality and we have robust quality control and monitoring arrangements in place. We are able to continue to enhance and assure the quality of our work through new technology and improved ways of working.

## **Pay and Pensions**

Our current pay deal ends on 31 March 2018. Audit Scotland negotiates pay awards on an annual basis and actual awards will be determined as part of this process. For the 2018/19 budget we have assumed that the new arrangements will add an average of 2% per annum to our pay bill (1% for increases in pay scales and 1% for pay progression).

For planning purposes only we have assumed that in 2019/20 and 2020/21 pay levels will continue to increase by 2% per annum.

The majority (+95%) of Audit Scotland's staff are members of the Local Government Pension Scheme. The results and implications of the next actuarial valuation are awaited from the scheme actuary and our initial budget proposal assumes an increase from 2017/18 of 0.5% for employer contributions.

Our budget proposal does not include resource to meet non-cash accounting adjustments required under International Accounting Standard 19 (IAS 19). As in previous years we will seek an adjustment as part of the 2017/18 Spring Budget Revision to meet non-cash pension cost adjustments in line with normal practice. The estimate for 2017/18 is £2.8m based on information provided by the pension scheme actuary. The 2018/19 budget proposal has been prepared on the assumption that non-cash pension costs adjustments will continue to be funded through the Spring Budget Revision process.

## **Appointed auditors (firms)**

The budget assumes that payments to appointed auditors (firms) for 2017/18 audits will be in accordance with the remuneration increases of 1% for our own staff at April 2018. For 2019/20 and 2020/21 audits it is assumed that price levels will increase by 1% per annum.

## **Quality**

The 2018/19 budget proposal and projections for 2019/20 and 2020/21 include an investment of £250k to support an enhanced quality regime. This is an increase of £150k from the 2017/18 budget and is funded by internal restructuring.

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## Property

Our budget proposals for 2018/19 and our projections for 2019/20 and 2020/21 assume continued occupation of our three offices in Edinburgh, Glasgow and Inverness which are occupied on long term leases.

## Training and organisational development

Our budget assumes we will continue to develop and restructure our business to improve the way we work and to ensure we deliver ongoing efficiencies while maintaining the quality of our work. During 2017/18 the simplification of our pay and grade structures helped us invest in and retain a skilled workforce to deliver high quality audit.

## GDP deflators

We have assumed a GDP deflator of 1.6% for 2018/19. For 2019/20 and 2020/21 the deflators are 1.7% and 1.9% respectively. This is consistent with the September 2017 rates published by HM Treasury. These are used to remove the effect of price changes (inflation) when comparing expenditure over time.

## Net Expenditure

An analysis of net expenditure by category is attached in Appendix 1. This provides information on actual net expenditure levels in 2015/16 and 2016/17 and the approved budget for 2017/18. The net expenditure budget is set after reviewing actual costs for each of the last two years and the current year's budget and taking account of any planned developments and cost reductions.

Net expenditure within the proposed budget for 2018/19 will increase by £642k (10.1%) from the levels in the 2017/18 budget in cash terms. In real terms (2017/18 prices) this represents a 8.4% increase.

Excluding the specific growth requirements for new financial powers and national fraud initiative (£580k) the cash increase is £62k (1%) and in real terms this represents a 0.6% reduction.

The table below provides an analysis of movement from the approved 2017/18 budget.

	£k	£k
<b>2017/18 Net Expenditure Requirement</b>		<b>6,331</b>
<b>Analysis of budget change</b>		
New Financial Powers	+380	
Annual pay growth	+335	
National Fraud Initiative	+200	
Enhanced Quality regime	+150	
Pension contributions increase	+56	
Establishment change	-164	
Income increase	-190	
Other administration/corporation tax reduction	-125	
<b>Total budget change</b>		<b>+642</b>
<b>2018/19 Net Expenditure Resource Requirement</b>		<b>6,973</b>

### Staff Costs

Staff costs account for 65% of our expenditure budget proposals and our 2018/19 budget is £757k (5.0%) higher in cash terms than the 2017/18 budget.

The main drivers to the 2018/19 increase are new financial powers, annual pay growth, investment in our quality regime and employer pension contributions. These additional costs are offset by savings arising from the delivery of establishment changes.

The proposed budget increases the established staffing requirement by eight w.t.e. from the 2017/18 budget, providing a total staffing of 278 w.t.e. in 2018/19. This increase is mainly attributable to new financial powers resourcing requirements.

### Other administrative costs/corporation tax

Other administrative costs inclusive of corporation tax are £75k (0.1%) higher in the proposed 2018/19 budget compared to the 2017/18 budget. The primary budget increase relates to National Fraud Initiative costs (£200k) which is a commitment we incur biennially. This increase has been reduced by the application of budget reductions to various budget categories in line with current expenditure patterns. Following a reduction in bank interest rates the budget proposal assumes no interest on balances and subsequently no corporation tax will be due.

## Income

We are required broadly to break even, taking one year with another, for that audit work which is charged to audited bodies. Money voted by Parliament funds the annual audits that under legislation we cannot charge for, together with performance audit work within the Auditor General's remit.

We have reviewed our fee and funding arrangements and a fee strategy is provided in Appendix 3.

Income from charges to audited bodies by financial year is provided below:

Table 2 – Income from charges to audited bodies

	Actual 2015/16 £000	Actual 2016/17 £000	Budget 2017/18 £000	Budget 2018/19 £000
Local authorities	11,582	11,531	11,135	11,153
NHS bodies	3,778	3,584	2,861	2,862
Further education colleges	605	540	482	492
Scottish Government depts. and sponsored bodies	2,489	2,827	2,690	2,876
<b>Total income from charges to audited bodies</b>	<b>18,454</b>	<b>18,482</b>	<b>17,168</b>	<b>17,383</b>
% cash increase in fees from 2017/18 budget				1.25%

This budget results in an average increase of 1.25% in the fees budget for the financial year 2018/19 when compared to the 2017/18 budget, an overall reduction in real terms of 0.3%. When compared to the 2016/17 actual income there is an average cash decrease of 5.9% in 2018/19, a real terms reduction of 8.9%.

Above inflation increases in the Scottish Government departments and sponsored bodies sector is attributable to new bodies requiring audit and complexity demands on European Agricultural Fund audits (EAFA).

The costs between the different sectors that pay fees and the activities funded from the Scottish Consolidated Fund have been analysed to inform the level of fees required to achieve the break-even aim. An analysis of the 2018/19 budget is provided at Appendix 2.

For the 2018/19 audit year we estimate that based on our budget assumptions average fees will continue to be set within real term (inflationary) prices.

## Capital

The proposed capital budget for 2018/19 is £175k, a reduction of £25k on the approved budget for 2017/18. The investment will continue to support Audit Scotland's rolling Information Technology programme. Details of the 2018/19 capital requirements are provided below:

	£000
IT Hardware	125
Software	25
Firewall	25
TOTAL	175

## Efficiencies and cost reductions

The table below shows the main efficiencies and cost reductions included in the 2018/19 budget proposal. These equate to 2% of gross expenditure included in the 2017/18 approved budget.

	£000
Staffing costs	164
Other administrative costs	120
In-house efficiencies arising from New Financial Powers	187
TOTAL	471

### Staffing costs

Staff costs account for 65% of our 2018/19 expenditure budgets. Savings identified in 2018/19 arise through internal restructuring.

### Other administrative costs

Combined cash releasing efficiencies have been identified as part of the budget setting process in professional fees, rent and rates, travel and subsistence, stationery and printing, training and organisational development, staff recruitment and depreciation.

### In-house efficiencies arising from New Financial Powers

Following a detailed assessment of resourcing requirements by the New Financial Powers Steering Group the estimated total cost in 2018/19 for new financial powers commitments is £667,000. This budget proposal uses the existing £100,000 budget allocated in 2017/18 and plans to absorb £187,000 (28%) of the estimated cost through in-house efficiencies. Applying these adjustments the actual increase in resource requirement for 2018/19 is £380,000.

## 2018/19 to 2020/21 Budget Projections

In addition to our budget proposal for 2018/19, projections for the following two years have been prepared.

### Principal assumptions

The principal assumptions for our 2018/19 budget proposals and projections for 2019/20 and 2020/21 are provided on pages 6 to 8 of this submission.

### Projections

The table below highlights Audit Scotland's budget projections for the period 2018/19 to 2020/21.

Table 3 – Budget Projections for 2018/19 to 2020/21

	Agreed	Proposed	Projection	
	Budget	Budget	2019/20	2020/21
	2017/18	2018/19	2019/20	2020/21
	£000	£000	£000	£000
Expenditure				
People costs	15,143	15,900	16,306	16,769
Other administrative costs	8,376	8,456	8,304	8,586
Gross administrative costs	23,519	24,356	24,610	25,355
Corporation Tax payable	5	0	0	0
Total Income	(17,193)	(17,383)	(17,569)	(17,801)
<b>Net Expenditure Requirement</b>	<b>6,331</b>	<b>6,973</b>	<b>7,041</b>	<b>7,554</b>
Capital	200	175	150	150
<b>Total Resource Requirement</b>	<b>6,531</b>	<b>7,148</b>	<b>7,191</b>	<b>7,704</b>
Annual GDP deflators		-1.6%	-1.7%	-1.9%
Net cost at 2017/18 prices		7,035	6,959	7,317
Staff Projections (w.t.e.)	270	278	279	281
Staff Change - annual w.t.e.		8	1	2
Staff Change - cumulative w.t.e.		8	9	11

In cash terms, people costs are rising in all years of the projection. Explanations of the movements in 2018/19 have been provided on page 9. The increased costs in the following years are as a result of our pay growth assumptions of 2% per annum and increased new

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financial powers resources which are then partly offset by further staffing reductions as detailed in Table 3 above.

Other administrative costs expenditure decreases in 2019/20 and then increases in 2020/21 as a result of National Fraud Initiative costs which are required every two years.

### **SCPA approved funding**

In 2018/19 our budget proposals require a cash increase of £617k in total funding from that approved for 2017/18. In real price terms (2017/18 prices) this represents a 7.7% increase. Further details are provided on page 5.

The revenue support sought from the Scottish Consolidated Fund provides funding for:

- non-chargeable Central Government audits
- performance audits
- the Auditor General
- the Accounts Commission
- a proportion of Audit Scotland senior management
- National Fraud Initiative
- New Financial Powers.



## Appendix 1 - Net Expenditure Statement expenditure trends

<b>NET EXPENDITURE STATEMENT</b>				
	<b>Actual</b>		<b>Current Budget</b>	<b>Proposed Budget</b>
	<b>2015/16</b>	<b>2016/17</b>	<b>2017/18</b>	<b>2018/19</b>
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>People costs</b>				
Salaries, pensions and temporary staff	11,644	11,930	11,538	12,172
Employers on costs	2,966	3,305	3,333	3,439
Pension adjustments	1,002	894	113	125
	15,612	16,128	14,984	15,736
Accounts Commission members	160	158	159	164
<b>Total people costs</b>	<b>15,772</b>	<b>16,286</b>	<b>15,143</b>	<b>15,900</b>
<b>Fees and expenses paid to external firms</b>	<b>5,051</b>	<b>4,987</b>	<b>3,952</b>	<b>3,991</b>
<b><u>Other operating expenditure</u></b>				
Rent & rates	950	550	550	525
Other accommodation costs	348	346	410	410
Travel & subsistence	844	853	946	894
Audit support - external fees	274	349	426	576
Legal & other professional fees	284	265	172	189
Stationery & printing	209	141	165	148
Training & organisational development	440	484	548	528
Staff recruitment	121	109	125	105
Communications (telephone, postage)	44	37	46	46
Insurance	84	72	75	79
Information technology	461	413	436	456
Internal Audit	27	29	30	30
External Audit - financial statements	29	27	30	30
Other	71	73	68	65
Depreciation	271	354	397	384
<b>Total other operating expenditure</b>	<b>4,456</b>	<b>4,102</b>	<b>4,424</b>	<b>4,465</b>
<b>TOTAL OPERATING EXPENDITURE</b>	<b>25,279</b>	<b>25,375</b>	<b>23,519</b>	<b>24,356</b>
Corporation Tax payable	8	7	5	0
<b>Income</b>				
Fees and charges payable	18,454	18,482	17,168	17,383
Bank Interest	41	36	25	0
Miscellaneous income	35	140	0	0
Other finance income - pensions related	-937	-626	0	0
<b>Total income</b>	<b>17,592</b>	<b>18,033</b>	<b>17,193</b>	<b>17,383</b>
<b>NET EXPENDITURE AFTER TAX</b>	<b>7,695</b>	<b>7,350</b>	<b>6,331</b>	<b>6,973</b>

## Appendix 2 - 2017/18 Budget sector cost analysis

Expenditure budget	Fees					SCPA Parliament £k	TOTAL £k
	Local Authorities £k	NHS Bodies £k	Further Education £k	Central Government £k	Total Fees £k		
Auditor General for Scotland	0	0	0	0	0	234	234
Accounts Commission	0	0	0	0	0	182	182
Governance	109	24	1	35	169	424	593
Audit Strategy incl. NFI	317	106	20	100	543	274	817
External Audit firms	2,000	849	406	481	3,736	255	3,991
Audit Services	4,263	1,402	42	1,562	7,269	1,865	9,134
Performance and Best Value audit	1,965	0	0	0	1,965	1,743	3,708
Corporate Services and overheads	2,499	481	23	698	3,701	1,996	5,697
<b>Total budgeted expenditure</b>	<b>11,153</b>	<b>2,862</b>	<b>492</b>	<b>2,876</b>	<b>17,383</b>	<b>6,973</b>	<b>24,356</b>
Fee income	11,153	2,862	492	2,876	17,383	0	17,383
Support from Parliament	0	0	0	0	0	6,973	6,973
<b>Total Income</b>	<b>11,153</b>	<b>2,862</b>	<b>492</b>	<b>2,876</b>	<b>17,383</b>	<b>6,973</b>	<b>24,356</b>
<b>Surplus (Deficit)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>% Surplus / (Deficit)</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>	<b>0.0%</b>

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## Appendix 3 - Fee Strategy

### Fee setting arrangements

#### Objectives of the fee setting arrangements

1. The overall aim of the fee setting arrangements is to support Audit Scotland in meeting its corporate vision of being a World Class audit organisation providing high quality independent public audit in Scotland whilst keeping charges to the minimum necessary. The objectives for the arrangements are that they:
  - comply with statute
  - maintain the independence of auditors
  - reflect the way in which public services are organised and audited
  - are transparent and easy to understand
  - are simple to operate
  - are sustainable
  - are not volatile from year to year without reason.
2. Audit Scotland is required to broadly break even on audit work that is charged for taking one year with another, either for each audit, or for classes of audits. We have determined each sector as being a class of audits.
3. Audit Scotland considers that audit fees should be set with the objective of recovering the full cost of audit work in each sector. Within sectors there may be a degree of cross subsidisation, for example where the costs of travel and subsistence are pooled across a sector.
4. Audit appointments are made by the Auditor General or the Accounts Commission rather than by audited bodies themselves thereby enhancing the independence of external audit. The identity or location of the appointed auditor could therefore affect the total cost of undertaking the audit. Audit Scotland considers that an audited body should, as far as possible, pay the same audit fee irrespective of whether the audit is carried out by an Audit Scotland team or by any of the appointed private firms. We therefore pool some costs such as travel and subsistence and savings from the audit procurement exercise and apportion them between audited bodies within the same sector in proportion to the levels of direct auditor remuneration.

#### Audit work that is subject to fees

5. Parliamentary funding pays for all performance audit work in central government, NHS, further education and Scottish Water. It also pays for the costs of supporting Parliament and its committees, the annual audits of the central government bodies that we cannot charge for, the National Fraud Initiative and the costs of the Auditor General, Accounts Commission and Audit Scotland Board.

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6. Local government has its own democratic structure and the Accounts Commission appoints auditors and oversees performance and best value audit arrangements. Local government funding includes an amount for scrutiny costs such as audit and therefore local government bodies pay for all audit work across the sector.
  7. The fee setting arrangements therefore cover all local government audit work and the costs of annual audit work in the NHS, central government, Scottish Water and further education colleges. The same principles are used to calculate notional fees for the central government audits that we cannot charge for.

### Fee setting process and governance

8. Fee setting is one part of the annual budget process. During June to August draft cost budgets are prepared for the following financial year. The implications of these for the levels of charges and Parliamentary funding are considered and draft proposals taken to the Audit Scotland Management Team for discussion. The discussions take account of new audit burdens, cost pressures, efficiency targets, outturn from the previous financial year and any potential End Year Flexibility available.
9. Following further refinement, budget proposals, including levels of charges, are presented to the Audit Scotland Board for discussion and approval, normally in mid-September before being submitted to the SCPA for their consideration as part of the Budget Bill process.
10. Because charges are set for audit years that run from approximately November to October, the fee setting process related to each financial year covers two audit years. Therefore in Autumn 2017, Audit Scotland confirmed the levels of charges for the 2017/18 audits which were provisionally set as part of the 2017/18 financial year budget in December 2016. We also indicate our plans for charges over the next two audit years.

### Calculating audit fees

11. Audited bodies will receive the following breakdown of the total audit fee from 2017/18 audits and prior year fees:
  - auditor remuneration
  - pooled costs
  - performance audit and best value (where relevant)
  - Audit Scotland costs.

### Auditor remuneration

12. The auditor remuneration element is based on our assessment of the audit input likely to be required to deliver an audit that complies with the Code of Audit Practice for a body of that size facing the normal risks for its part of the public sector. The fee assumes that the body is well governed, has effective internal controls and prepares complete draft accounts in

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accordance with the agreed timetable and takes account of actual recent costs of carrying out the audit.

13. Auditors and audited bodies can agree remuneration up to 10 per cent above the level set either where local circumstances mean that the implicit assumptions are not being met or where significant local issues require additional work to be undertaken, for example a new and complex accounting issue or a history of accounting errors. In exceptional circumstances fees can be agreed above the 10% limit with the prior agreement of Audit Scotland.
14. If the auditor and audited body agree that a permanent reduction in remuneration is appropriate then Audit Scotland will consider the proposal taking account of any potential impact on audit quality.

### **Pooled items**

15. To achieve the aim that as far as possible an audited body should pay the same fee irrespective of whether the auditor is an Audit Scotland team or any of the appointed private firms we pool certain costs which would otherwise lead to different fees being charged depending on the identity or location of the appointed auditor. These pooled costs are currently apportioned across the audited bodies in each sector in proportion to the expected level of auditor remuneration. The pooled costs are:
  - travel and subsistence costs
  - procurement savings
  - any difference between the costs of Audit Scotland teams and the auditor remuneration for their audits
  - recoverable input VAT (local government only).

### **Performance audit and best value audit costs (local government only)**

16. Local government bodies pay for the cost of all audit work carried out in the sector including national performance audits, best value audits and housing benefit audits. All councils carry out a similar range of services and therefore all can benefit from the recommendations for improvement and good practices identified in best value reports at other councils.
17. For performance audit work, including the costs of responding to correspondence from elected representatives and members of the public about issues in local government bodies, the budgeted costs are apportioned between significant local government bodies (councils, Integration Joint Boards and Strathclyde Passenger Transport) in proportion to the level of auditor remuneration.
18. For best value audit and housing benefit audit the amount of money received by councils towards the cost of this work is apportioned between the 32 councils only on the basis of relative populations in June 2015, being a proxy for the distribution of the funding through the local government settlement. We fully recognise that this approach to charging for best value

does not reflect the actual costs incurred in relation to each council but believe that it is fair when considering the way in which councils were funded for it.

## Audit support costs

19. Audit Scotland incurs costs in making audit appointments, providing assurance on audit quality, providing technical guidance and support to all appointed auditors and contributing to the development of auditing and accounting guidance within Scotland and across the UK. These costs are apportioned across all audits relative to the level of auditor remuneration.

## Audit fees for 2017/18 audits

### Fee levels

20. An overall reduction in average fees of 0.1% in 2017/18 audits leads to real terms reductions of 1.7% on 2016/17 charges.
21. As shown in Table 1 there is variation around this average between sectors. These differences arise from the agreed application of cost apportionment methods across all sectors as a result of the funding and fees review carried out in 2016. The NHS reduction includes the balance transfer of performance audit costs to the Scottish Consolidated Fund. The increase in Central Government chargeable audits excludes a significant increase for EAFA and new chargeable bodies.
22. **Table 1**

	Average change on 2016/17 charges	Real terms
Local government	+0.5%	-1.1%
NHS	-4.3%	-5.8%
Central government - chargeable audits	+1.5%	-0.1%
Further education	+1.5%	-0.1%
<b>Overall average</b>	<b>-0.1%</b>	<b>-1.7%</b>

23. The fee movements shown in Table 1 are based on achieving a break even position for the 2018/19 financial year in all sectors.
24. Within sectors there will be a range of decreases and increases which better reflect the actual costs of undertaking each audit and the consequences of implementing simpler and more transparent apportionment of pooled costs across and within sectors.
- Local government - council increases will range from 0.3% to 0.4 % and other local government bodies will see fees increase by an average of 1.5%.

- NHS - mainland health boards will see further reductions of 4.3% following the agreement to transfer the funding for performance audit to the Scottish Consolidated Fund. Island health board fees will remain at 2016/17 levels and special health boards will see fees reduce by 4.1% from 2016/17 levels.
- Central government chargeable bodies will generally see average increases of 1.5% as a result of aligning the audit fees to the actual cost of audit and the subsequent impact on the apportionment of pooled costs.
- Further education - college fees will increase on average 1.3% except for three bodies that require increases and a decrease based on alignment of resources.

## Future years

25. For 2018/19 and 2019/20 audits, at this stage we expect to continue to make real terms reductions in fees across all sectors.

## Hourly rates

26. Hourly rates are calculated for each grade of staff. The rates are based on the average direct costs of the role (such as salaries, national insurance and pension contributions) and indirect costs (such as property costs, and corporate support costs including IT, finance and human resources).
27. For the 2017/18 financial year the hourly rates used to cost audit work are:

	2016/17	2017/18
Trainees	£46	£48
Business support specialist	£22	£22
Audit/support officer	£37	£38
Auditor	£41	£43
Senior auditor	£58	£59
Manager	£68	£70
Senior manager	£86	£88
Directors and Assistant Directors	£145	£148

28. The rates for the 2018/19 financial year will be calculated once the budget has been finalised.