



The Scottish Parliament
Pàrlamaid na h-Alba

SCOTTISH COMMISSION FOR PUBLIC AUDIT

AGENDA

2nd Meeting, 2018 (Session 5)

Wednesday 12 December 2018

The Commission will meet at 12.30 pm in the Adam Smith Room (CR5).

1. **Decision on taking business in private:** The Commission will decide whether to take items 4 and 5 in private.
2. **Audit Scotland's Autumn Spring Budget Revision 2018-19:** The Commission will take evidence from—

Caroline Gardner, Auditor General for Scotland;

Ian Leitch, Chair of the Board, Diane McGiffen, Chief Operating Officer, and Stuart Dennis, Corporate Finance Manager, Audit Scotland.
3. **Audit Scotland's Budget Proposal for 2019-20:** The Commission will take evidence from—

Caroline Gardner, Auditor General for Scotland;

Ian Leitch, Chair of the Board, Diane McGiffen, Chief Operating Officer, and Stuart Dennis, Corporate Finance Manager, Audit Scotland.
4. **Consideration of evidence:** The Commission will consider the evidence heard at agenda items 2 and 3.
5. **Work programme:** The Commission will consider its work programme.

Jane Williams
Secretary to the Scottish Commission for Public Audit
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The Scottish Parliament
Edinburgh
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The papers for this meeting are as follows—

Agenda item 2

Note from the Clerk

SCPA/S5/18/2/1

Agenda item 3

Note from the Clerk

SCPA/S5/18/2/2

Agenda items 2 and 3

PRIVATE PAPER

SCPA/S5/18/2/3
(P)

Agenda item 5

PRIVATE PAPER

SCPA/S5/18/2/4
(P)

Scottish Commission for Public Audit

2nd Meeting, 2018 (Session 5), Wednesday 12 December 2018

Audit Scotland Spring Budget Revision 2018/19

1. Audit Scotland has submitted its proposed Spring Budget Revision 2018/19 for the consideration of the Scottish Commission for Public Audit. A copy of the Spring Budget Revision 2018/19 can be found in Annexe A for members consideration.
2. The Commission is invited to consider the Spring Budget Revision 2018/19 and then write to the Finance and Constitution Committee with its views.

**Secretary to the Scottish Commission for Public Audit
7 December 2018**

Spring Budget Revision

2018/19

Introduction

1. In accordance with Scottish Government advice this paper details Audit Scotland's 2018/19 Spring Budget Revision (SBR) proposal which relates to pension charges.

Background

2. Bodies funded by Parliamentary Vote, such as Audit Scotland, only have authority to spend the resources voted to them in one financial year. Any request for additional resources in-year must be requested as part of either the Autumn Budget Revision (ABR) or Spring Budget Revision (SBR) and approved by Parliament.
3. Audit Scotland is required under the Public Finance and Accountability Act broadly to break even taking one year with another. Audit Scotland is not able to carry forward reserves, and the Budget Revision process is the only mechanism available to allow Audit Scotland to access unutilised resources from prior years to help balance one year with another.
4. Certain types of expenditure requiring budget revisions, including pension charge adjustments, are treated for budget purposes as Annually Managed Expenditure (AME) rather than falling within the Departmental Expenditure Limit (DEL). The overall AME cover for Scotland is re-determined once a year in late autumn, with the changes agreed with HM Treasury then available for inclusion in the SBR.
5. The timetable for the completion of the SBR process has been published by the Scottish Government's finance department and Audit Scotland is required to submit its proposed budget amendments by 9 January 2019.

Spring Budget Revision proposal

6. Our SBR proposal requests £2,918k to meet an increased non cash pension accounting charge that will arise in 2018/19.
7. Audit Scotland operates two pension schemes. Our main pension scheme is the Local Government Pension Scheme in Scotland administered by the Lothian Pension Fund. All new employees are enrolled in this scheme as part of the auto enrolment pension legislation.
8. The second scheme is the Principal Civil Service Pension Scheme (PCSPS). Audit Scotland operate this scheme as a closed scheme – the members of the scheme are employees who have legacy terms and conditions following their transfer to Audit Scotland from the National Audit Office on the establishment of Audit Scotland in 2000. The numbers of staff in this scheme have been reducing as staff retire or leave Audit Scotland – currently there are six members of staff who are part of this scheme. In addition to those staff who have legacy rights, the Auditor General for Scotland is separately enrolled in the PCSPS as part of the terms and conditions of appointment.

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9. The PCSPS is an unfunded multi-employer defined benefit pension scheme. The liability for payments under this scheme rests with the Government and Audit Scotland is not required to disclose or record information in respect of this scheme. These arrangements are consistent with those applying to the Scottish Government and many Government Agencies and NDPB's. As a result these organisations do not have pension accounting issues to address as part of the annual budgeting and financial reporting processes.
 10. The Local Government Pension scheme is a funded, defined benefit pension scheme and the assets and liabilities of our section of the scheme are separately recorded. As a result Audit Scotland has to meet the accounting and disclosure requirements of International Accounting Standard 19 (IAS 19). This requires the preparation of actuarial reports at each year-end that value assets and liabilities of the scheme as well as identifying the in-year costs of providing the pension service earned during the year.
 11. A key factor in determining the values and costs is the discount rate used in the calculations. The rate used is driven by interest rates and bond returns and low interest rates push up the costs of providing pension service. The calculated values are very sensitive to small movements in the rates – 0.5% of a movement in the real discount rate is estimated to add 12% to the liabilities of the scheme.
 12. Information provided from our actuaries to meet year-end accounting and disclosure requirements includes a projection of pension cost items for the following year. The report on the projection for 2018/19 was available in April 2018, well after the submission of our budget proposals for 2018/19 in December 2017. As a result it is difficult to predict the impact of pension accounting adjustments as part of the annual budgeting process.
 13. Pension accounting adjustments required in respect of IAS 19 from 2006/07 have generated favourable and unfavourable variances in our accounts:-

| | £k |
|-------------------|----------------------|
| 2017/18 | (2,724) unfavourable |
| 2016/17 | (1,407) unfavourable |
| 2015/16 | (1,826) unfavourable |
| 2014/15 | (1,518) unfavourable |
| 2013/14 | (1,089) unfavourable |
| 2012/13 | (11) unfavourable |
| 2011/12 | 289 favourable |
| 2010/11 | 6,516 favourable |
| 2006/07 - 2009/10 | 1,857 favourable |
| Total | 87 favourable |

14. The accounting adjustments are notional and do not generate cash movements. The large favourable adjustment recorded in 2010/11 was as a result of the UK Government's decision to revise the basis of annual pension uplifts from RPI to CPI.

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15. In previous submissions we have advised the possibility of adverse adjustments and the consequent need to request additional budget cover through the AME process to balance our accounts. This was the case in the last five years when based on the scheme actuary's report pension charges were estimated to be £1,045k (2013/14), £1,716k (2014/15), £1,966k (2015/16), £1,041k (2016/17) and £2,826k (2017/18) more than the pension charges assumed in the budgets for those years. With the agreement of the SCPA and the Scottish Government's Finance department additional cover was provided for those years SBR's through the AME arrangement.
 16. For 2018/19 we anticipate that the IAS 19 pension adjustment will again be adverse and will require an additional charge over and above the budget provision held for the contributions we will make for the year. Based on the Actuary's report presented in April 2018 the estimated costs for 2018/19 are £2,918k higher than the available budget. As a result we request that our 2018/19 budget is increased by £2,918k in the 2018/19 SBR. On the advice of the Scottish Government Finance department this adjustment will be dealt with through the Annually Managed Expenditure (AME) process agreed with HM Treasury.
 17. The increased charge is driven by the continuing impact of low net discount rates used to value pension liabilities which increase future pension liability forecasts and in turn the estimates for in year pension service costs – this rate was 0.3% at March 2018.
 18. There is an element of risk to the amount of funding required as it is based on financial assumptions used by the actuary for the previous year's annual accounts. Every effort is made to minimise this risk, however, as the AME funding is agreed in December each year there is a 3 month period subject to uncertainty where financial assumptions could change as they are subject to market volatility. Any changes in financial assumptions will result in additional costs with no matched funding available.
 19. The expectation of continuing low interest rates in the next few years may require similar large accounting charge adjustments in 2019/20 and beyond. In such circumstances further requests for budget revisions to meet additional pension charge adjustments will be required in the future.

Conclusion

20. The Spring Budget Revision proposals presented in this paper will:
 - provide non cash AME funding of £2,918k to allow Audit Scotland to meet increased non cash pension charges that will occur in 2018/19 as a result of accounting adjustments required under IAS 19.

Scottish Commission for Public Audit

2nd Meeting, 2018 (Session 5), Wednesday 12 December 2018

Audit Scotland Budget Proposal 2019/20

1. Audit Scotland has submitted its Budget Proposal for 2019/20 for the consideration of the Scottish Commission for Public Audit. A copy of the Budget Proposal for 2019/20 and a covering letter from the Auditor General for Scotland, as Accountable Officer, can be found in Annexe A.
2. The Commission is invited to consider Audit Scotland's Budget Proposal 2019/20 and report its views to Parliament.

**Secretary to the Scottish Commission for Public Audit
7 December 2018**

Colin Beattie
Chair
Scottish Commission for Public Audit
T3.40
Scottish Parliament
Edinburgh
EH99 1SP

04 December 2018

Dear Mr Beattie

Audit Scotland Spring Budget Revision 2018/19 and Budget Proposal 2019/20

I look forward to meeting the Scottish Commission for Public Audit on 12 December 2018 to present the enclosed Spring Budget Revision 2018/19 and our Budget Proposal 2019/20.

Strategic Overview

The budget proposal is being submitted prior to the Scottish Government budget announcement on 12 December and any potential impact on our budget will be assessed following that announcement.

The main strategic operational and financial issues affecting Audit Scotland next year are the continued devolution of new financial powers to Scotland, public sector pay policy and uncertainty over the UK's withdrawal from the EU.

Public finances are becoming more complex, with implications for the role of public audit and independent scrutiny. As indicated in our 2018/19 budget submission, we have developed a four-year plan to increase our resources accordingly. This should provide us with the capacity, skills and knowledge to support the Scottish Parliament and others in scrutinising the new powers, auditing new agencies and assessing the impact of the UK leaving the EU. The second year of that plan is included in the 2019/20 budget proposal.

In addition to these challenges high quality audit remains a priority. We introduced a new Audit Quality Framework in 2017/18 and our budget continues to support enhanced quality review and reporting.

Budget proposal 2019/20

Our 2019/20 budget proposal to the SCPA is based on a total resource requirement of £7,564k, an increase of £416k (5.8%) in cash terms from the 2018/19 budget. In real terms (2018/19 prices) this represents an increase of 4.2%.

Indicative Forecast for 2020/21 and 2021/22

Our plan coincides with the timeline for implementing the new financial powers and associated audit work. To date, expenditure in these areas is in line with the funding projections set out in our 2018/19 budget submission. Over the three-year period to 2021/22 we plan a phased increase in resource requirements. Table 3 (Page 15) provides an indicative projection of staffing, revenue and capital requirements for 2020/21 and 2021/22.

I hope this overview of our proposal is useful; we would be happy to provide any further information in advance of the meeting.

Yours sincerely

A handwritten signature in black ink that reads "Caroline Gardner". The script is cursive and fluid.

Caroline Gardner
Accountable Officer

Budget Proposal

2019/20

Key Messages

Audit Scotland is committed to delivering value for money. The budget proposal for 2019/20 continues to focus on maintaining the quality of audit work to support the Auditor General for Scotland and the Accounts Commission in providing independent assurance to the people of Scotland that public money is spent properly and provides value for money.

Budget summary

Total Expenditure Budget

2019/20 £25,394k

(2018/19 £24,618k)

Cash terms +3.2%

Real terms +1.5%

Parliamentary funding

2019/20 £7,564k

(2018/19 £7,148k)

Cash terms +5.8%

Real terms +4.2%

Fee income

2019/20 £17,980k

(2018/19 £17,645k)

Cash terms +1.9%

Real terms +0.3%

Audit Scotland's proposed expenditure of £25,394k represents 0.06% of the £40 billion total expenditure on which we provide assurance. Audit fees to audited bodies contribute 70% towards the total costs for Audit Scotland and 30% is funded by the Scottish Parliament.

The Total Resource Requirement in the 2019/20 budget proposal is £7,564k, an increase of £416k from the approved requirement in 2018/19. This is a 4.2% increase in real terms at 2018/19 prices. This increase largely relates to people costs. These are explained in more detail throughout this submission.

These proposals will:

- deliver core work on public audit in Scotland covering over 220 organisations including the Scottish Government, the NHS in Scotland, local councils, police and fire authorities, integrated joint boards and further education colleges. These organisations spend over £40 billion of public money annually
- provide support for the Scottish Parliament, including investment in scrutiny and audit of Scotland's new financial powers
- deliver the rolling programme of performance audits on behalf of the Auditor General and the Accounts Commission
- provide enhanced audit quality review and reporting
- limit 2018/19 audit fee increases to an overall average increase of 1.6% from 2017/18 charges, a real terms increase of 0.1% (more detail on the fee strategy is provided in Appendix 3)
- continue to enhance our capacity for audit work arising from new financial powers
- increase management contingency to 1.2% of total expenditure budget to cover significant uncertainties in expenditure and income
- continue to provide transparent funding arrangements.

Introduction

1. 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.
2. 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 retain the independence of audit it is important that appropriate resources are available for our work and that we deliver value for money.
3. This paper presents our budget proposal for the 2019/20 financial year with the Funding & Fee Strategy included in Appendix 3. The budget continues the planned investment in auditing new financial powers and audit quality.
4. The budget proposal for 2019/20 includes information on the budgeted costs for each audit sector.
5. We have provided updated projections of resource requirements for two further years to 2021/22.
6. This paper is presented in three parts.
 - Context
 - Resource Requirements 2019/20
 - Cost projections 2020/21 to 2021/22

Appendix 1 - Net Expenditure Statement expenditure trends

Appendix 2 - Sector cost analysis 2019/20

Appendix 3 – Funding and Fee Strategy

Context

2019/20 uncertainties

7. The budget for 2019/20 has been prepared in the context of a number of significant uncertainties:
 - the impact of the UK autumn budget statement on Scottish budgets
 - public sector pay policy
 - timing of the implementation of the financial aspects of the Scotland Act 2016
 - the impact of the UK leaving the European Union
 - financial assumptions used to estimate International Accounting Standard 19 (IAS 19) defined benefit pension costs.

Audit work 2019/20

8. Core public audit work in Scotland covers over 220 organisations that spend around £40 billion of public money annually. Our work programme will continue to focus on supporting parliament in scrutinising the use of public money and we will deliver national performance audits in line with our five-year rolling programme. Details of our core work programme are described on page 9. We will continue to support the Accounts Commission to deliver its comprehensive programme of best value assurance, financial and performance audit across local government.
9. In addition to the core work programme, legislative change has created new audits and additional audit requirements including:
 - Social Security Scotland began operating as an executive agency on 1 September 2018 and will be responsible for delivering ten devolved benefits totalling around £3.3 billion of spending annually. The agency will take on operational responsibility for devolved benefits on a phased basis through to the end of the current Parliamentary session in 2021. Audit Scotland is the appointed auditor for the agency and the payments it administers, and we have established a new team to lead on all financial and performance audit work on social security.
 - Scotland's public finances are fundamentally changing, with the Scottish budget becoming increasingly complex and directly linked to economic performance. We plan to build capacity to assess and report on overall fiscal management and financial sustainability to inform and support Parliamentary scrutiny.
 - A share of VAT is scheduled to be assigned to the Scottish budget from April 2019. During 2019/20 we will work with the National Audit Office (NAO) to develop arrangements to provide additional assurance to the Scottish Parliament on VAT assignment.
 - Our work with the NAO on Scottish income tax is expected to increase in 2019/20. This will allow us to provide additional assurance to the Scottish Parliament on HMRC's administration of different tax bands and rates for Scottish taxpayers.

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- The UK is expected to leave the European Union on 29 March 2019. During 2018/19 we have been working to understand the potential implications and risks of EU withdrawal for the public sector and how public bodies are responding to this. Work in 2019/20 will increase as the outcome of withdrawal negotiations becomes clearer.
10. High quality audit work remains a priority for Audit Scotland. We continue to invest in a programme of independent external review to assure the Auditor General and the Accounts Commission of the quality of audit. This investment also allows us to promote continuous improvement in audit quality and provide professional and technical leadership.

Resource Requirements 2019/20

11. The total Resource Requirement for 2019/20 requested for approval by the SCPA is £7,564k. This represents an overall cash increase of £416k on the approved 2018/19 budget. This is a 4.2% increase in real terms at 2018/19 prices.
12. The following table summarises the total Resource Requirements included in the 2019/20 budget proposal and provides a comparison with the original and approved 2018/19 budget. More detailed information on expenditure categories is provided in Appendix 1.

Table 1 – Summary of resource requirements for 2019/20

| Resource requirements | | | | Movement | | |
|--|---------------------|---------------------|---------------------|------------|-------------|----------------|
| | Original 2018/19 | Approved 2018/19 | Proposed 2019/20 | Actual | Actual | Real Prices |
| | £000 | £000 | £000 | £000 | % | % |
| Expenditure | | | | | | |
| People costs | 15,900 | 15,919 | 16,819 | 900 | 5.7% | 4.0% |
| Other administrative costs | 8,456 | 8,699 | 8,575 | -124 | -1.4% | -3.0% |
| Gross administrative costs | 24,356 | 24,618 | 25,394 | 776 | 3.2% | 1.5% |
| Income | | | | | | |
| Income from charges to audited bodies | 17,383 | 17,645 | 17,980 | 335 | 1.9% | 0.3% |
| Bank interest and miscellaneous income | 0 | 0 | 0 | 0 | 0.0% | 0.0% |
| Total income | 17,383 | 17,645 | 17,980 | 335 | 1.9% | 0.3% |
| Net Operating Cost | 6,973 | 6,973 | 7,414 | 441 | 6.3% | 4.6% |
| Capital | 175 | 175 | 150 | -25 | -14.3% | -15.6% |
| TOTAL RESOURCE REQUIREMENT | 7,148 | 7,148 | 7,564 | 416 | 5.8% | 4.2% |

Resource analysis

13. Our Total Resource Requirement proposals for 2019/20 are £416k more than provided in the 2018/19 budget, a real terms (2018/19 prices) increase of 4.2%.

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14. The 2019/20 budget proposal increases people costs by £900k; other administrative costs decrease by £124k and income increases by £335k from the approved 2018/19 budget. Full details of the budget movements are set out below.
 15. Legislation does not allow us to hold reserves and we are required to break even each financial year, which limits the flexibility to meet unexpected budget pressures. A key factor in budget preparation is the timing of budget statements from the UK and Scottish Governments and the potential impact these announcements will have on the budget assumptions used in preparing our proposal.

Principal budget assumptions - 2019/20 to 2021/22

16. The principal assumptions underlying the budget proposal for 2019/20 and our cost projections for the two following years are set out below.

2018/19 Budget

17. During 2018/19 the total resource requirement remained at the original budget estimate of £7,148k. However, following the submission and approval of our 2018/19 budget proposal we reviewed and updated our budget following the assumptions announced in the Scottish Government budget statement. We identified adjustments that required the application of increases in base expenditure and income budgets of £262k, leading to a revised total expenditure budget of £24,618k and a revised total fee income budget of £17,645k. These budget adjustments were approved by Audit Scotland Board on 28 March 2018 and were managed within existing resources.
18. In line with usual practice, we have provided a separate proposal for Spring Budget Revision 2018/19, which seeks an adjustment to meet non-cash pension cost adjustments. This will be dealt with through the Annually Managed Expenditure (AME) process agreed between the Scottish Government and HM Treasury. The estimate for 2018/19 is £2.9m, based on information provided by the pension scheme actuary.

New Financial Powers and Constitutional change

19. As indicated to the Commission in our Budget Proposal 2018/19, we have planned a phased increase in resources to respond to the Parliament's new financial powers. The 2019/20 budget includes an increase of £285k to fund people costs (estimated at 4.5 w.t.e. staff). As financial powers transfer on a phased basis the full projected funding requirement (subject to implementation uncertainty) remains at £1,273k by 2020/21, equivalent to 20 w.t.e. staff.
20. We are continuing to work on the implications of the UK leaving the European Union and we expect this activity to increase in 2019/20 once we know the outcome of the withdrawal negotiations. This budget assumes continuity in the bodies and accounts we will audit in 2019/20 and in our responsibilities.

Work programme 2019/20 to 2021/22

21. In July 2018 we published a Corporate Plan for 2018 - 2021, describing our strategy and work plans for the three years from 2018. The plan can be found on the Audit Scotland website <http://www.audit-scotland.gov.uk/report/corporate-plan-2018-21>.
22. Our work programme for 2019/20 has a strong emphasis on supporting Parliament to implement Scotland's new financial powers and the recommendations of the Budget Process Review Group (BPRG).
23. We have a five-year rolling programme of national performance audits which is determined by the Auditor General for Scotland and the Accounts Commission for Scotland. The plan is risk based and refreshed following consultation with stakeholders.
24. 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.
25. The programme for 2019/20 includes audits on:
 - Scotland's new financial powers, including audit work on the implementation and operation of Scotland's new Social Security arrangements
 - Health and social care integration
 - Improving educational outcomes
 - 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
 - Higher education finances
 - Workforce planning
 - The use of digital technology to improve public services
 - The impact of the UK's decision to leave the EU on Scotland's public finances and public services.
26. The programme includes overview reports on the performance of the NHS, local government and colleges, 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.
27. The programme also includes provision for statutory reports to be brought to the Parliament by the Auditor General for Scotland on significant issues arising from the annual financial audit process, or to the Accounts Commission for Scotland from the Controller of Audit.

Pay and Pensions

28. Our current pay deal ends on 31 March 2019. Audit Scotland negotiates pay awards on an annual basis and actual awards will be determined as part of this process. For the 2019/20

budget we have assumed that the new arrangements will add 3% per annum to our pay bill (2% for increases in pay scales and up to 1% for pay progression).

29. For planning purposes only we have assumed that in 2019/20 and 2020/21 pay levels will continue to increase by 2% per annum based on the assumption in the Scottish Government Medium Term Financial Outlook.
30. The majority of Audit Scotland's staff are members of the Local Government Pension Scheme and employer contributions have increased by 0.5% in line with the scheme actuary recommendations reported in the 2017 actuarial valuation.
31. 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 Spring Budget Revision to meet non-cash pension cost adjustments. The estimate for 2018/19 is £2.9m based on information provided by the pension scheme actuary. The 2019/20 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)

32. Payments to appointed auditors (firms) for 2018/19 audits will be in accordance with the remuneration increases applied to our own staff at April 2018. For 2019/20 and 2020/21 audits it is assumed that auditor remuneration will increase by 2% per annum.

Management contingency

33. Given the current level of uncertainty we have increased the management contingency by £150k to £300k, which is 1.2% of the total expenditure budget. This will be used to meet reasonable adverse movements including any relating to the uncertainties listed on page 5 of this proposal.
34. If there are significant changes to the budget assumptions on which this proposal is based, we will do our best to manage within the overall budget, but it may be necessary to seek in-year discussions with the SCPA.

Quality

35. The new [Audit Quality Framework](#) published in 2017, provides assurance that work is to be of the highest standard, meeting international audit standards and the requirements of the Auditor General and the Accounts Commission as set out in the Code of Audit Practice. Our 2019/20 budget proposal and projections for 2020/21 and 2021/22 continue to invest £250k to support enhanced audit quality inspection and reporting. The [Audit Quality Annual Report 2017/18](#) sets out the results from last year.

Property

36. Our budget proposals for 2019/20 and our projections for 2020/21 and 2021/22 assume continued occupation of our three offices in Edinburgh, Glasgow and Inverness which are occupied on long-term leases. Property costs in 2019/20 are planned to be £31k (3.3%) less than the 2018/19 budget due to savings in business rates and utilities.

Training and organisational development

37. We will continue to develop our business to improve the way we work and to ensure we deliver efficiencies while maintaining the quality of our work. Our Learning & Development strategy guides our budget allocation and is updated annually to support our corporate plan. We remain committed to our graduate trainee, modern apprentice and student placement programmes which support our workforce planning and long-term talent development.

GDP deflators

38. We have assumed a GDP deflator of 1.6% for 2019/20. For 2020/21 and 2021/22 the deflators are 1.7% for each financial year. This is consistent with the September 2018 rates published by HM Treasury. These are used to remove the effect of price changes (inflation) when comparing expenditure over time.

Net Expenditure

39. An analysis of 2019/20 net expenditure by category is attached in Appendix 1 which also provides information on actual net expenditure levels in 2016/17 and 2017/18, the original budget for 2018/19 and the approved budget for 2018/19.
40. Net expenditure increases in cash terms by £441k from the 2018/19 budget, a real terms increase of 4.6%.
41. Excluding the budget for new financial powers, management contingency and the National Fraud Initiative, the cash increase is £206k, a real terms increase of 1.3%.
42. The table below provides an analysis of the movement from the net approved expenditure in the 2018/19 budget to the proposed 2019/20 net expenditure resource requirement.

| | £k | £k |
|---|------|--------------|
| 2018/19 Net Approved Expenditure | | 6,973 |
| Analysis of budget change | | |
| New Financial Powers | +285 | |
| April 2019 pay growth | +528 | |
| Pension contributions increase | +87 | |
| Increase in People Costs | | +900 |
| National Fraud Initiative | -200 | |
| Management contingency | +150 | |
| Other administration budget savings ¹ | -138 | |
| Approved Auditors | +64 | |
| Other administrative costs decrease | | -124 |
| Income increase | | -335 |
| 2019/20 Net Expenditure Resource Requirement | | 7,414 |

¹ Main budget savings relate to business rates, travel & subsistence and depreciation

People Costs

43. People costs represent 66% of our expenditure budget proposals and our 2019/20 budget requirement is £900k higher in cash terms than the approved 2018/19 budget. In real terms this is an increase of £635k (4.0%).
44. The main drivers of the increase are annual pay growth, employer pension contributions and staffing for new financial powers.
45. The proposed budget increases the established staffing requirement by 4.5 w.t.e. from the 2018/19 budget, providing a total staffing of 282.5 w.t.e. in 2019/20. This increase is attributable to new financial powers resourcing requirements.

Other administrative costs

46. Other administrative costs are £124k lower in the proposed 2019/20 budget compared to the approved 2018/19 budget. The main changes are an increase of £150k in the management contingency and a reduction of £200k for the biennial National Fraud Initiative. The balance of £74k from 2018/19 is attributable to various identified budget reductions and increases.

Income

47. Audit Scotland is funded by fees and the Scottish Consolidated Fund, approved by Parliament. 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.
48. Our funding and fee arrangements are set out in our Funding and Fee Strategy at Appendix 3.
49. As highlighted on page 8, we revised our approved SCPA budget for 2018/19 to recognise in-year agreed base fee increases from £17,383k to a revised figure of £17,645k. Taking cognisance of this budget adjustment the actual increase to the proposed fees budget for 2019/20 is 1.9%, an overall increase in real terms of 0.3%.

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

Table 2 – Income from charges to audited bodies

| | Actual | Actual | Original | Revised | Proposed |
|---|---------------|---------------|---------------|---------------|---------------|
| | 2016/17 | 2017/18 | Budget | Fee | Budget |
| | £000 | £000 | £000 | Budget | £000 |
| | | | 2018/19 | 2018/19 | 2019/20 |
| Local authorities | 11,531 | 11,565 | 11,153 | 11,372 | 11,636 |
| NHS bodies | 3,584 | 2,999 | 2,862 | 2,862 | 2,866 |
| Further education colleges | 540 | 515 | 492 | 522 | 540 |
| Scottish Government depts. and sponsored bodies | 2,827 | 2,811 | 2,876 | 2,889 | 2,938 |
| Total income from charges to audited bodies | 18,482 | 17,890 | 17,383 | 17,645 | 17,980 |
| % cash increase in fees from approved 2018/19 budget | | | | | 1.9% |

51. For 2018/19 audits the proposed average fee increase is 1.6%, a real terms increase of 0.1% on 2017/18 fees.

52. Appendix 2 provides an analysis of the 2019/20 budget by sector and funding source.

Capital

53. The proposed capital budget for 2019/20 is £150k, a reduction of £25k on 2018/19. The investment will continue to support our rolling information technology programme. Details of the 2019/20 capital requirements are provided below:

| | £000 |
|--------------|------------|
| IT Hardware | 75 |
| Software | 75 |
| TOTAL | 150 |

Cost savings and efficiencies

54. Our gross expenditure, excluding IAS 19 pension costs, has reduced by 7.5% in real terms from 2012/13. We have delivered a £5.6 million cumulative reduction in expenditure in real terms over the 5-year period 2013/14 to 2017/18.
55. We have delivered significant savings and efficiencies in respect of audit firm contract costs, property rationalisation, travel & subsistence, energy efficiency and business re-structuring.
56. These savings have enabled us to reduce the fees charged to audited bodies at a time when they have been required to make substantial savings to meet increased service demand.
57. In this budget proposal we continue to deliver those longer-term reductions in respect of payments to audit firms, capital investment, property costs and other administration costs.
58. In addition to these tangible savings we continue to identify opportunities to deliver efficiencies where we can meet additional demands from within our existing resources.

Cost projections 2020/21 to 2021/22

59. In addition to our budget proposal for 2019/20, we have prepared projections for the following two years.

Principal assumptions

60. The principal assumptions for our 2019/20 budget proposals and projections for 2020/21 and 2021/22 are set out on pages 8 to 11 of this submission.

Projections

61. The table below highlights Audit Scotland's budget projections for the period 2019/20 to 2021/22.

Table 3 – Budget Projections for 2019/20 to 2021/22

| | Original | Approved | Proposed | Projection | |
|------------------------------------|--------------|--------------|--------------|--------------|--------------|
| | Budget | Budget | Budget | 2020/21 | 2021/22 |
| | 2018/19 | 2018/19 | 2019/20 | 2020/21 | 2021/22 |
| | £000 | £000 | £000 | £000 | £000 |
| Expenditure | | | | | |
| People costs | 15,900 | 15,919 | 16,819 | 17,633 | 18,346 |
| Other administrative costs | 8,456 | 8,699 | 8,575 | 8,866 | 8,704 |
| Gross administrative costs | 24,356 | 24,618 | 25,394 | 26,499 | 27,050 |
| Corporation Tax payable | 0 | 0 | 0 | 0 | 0 |
| Total Income | (17,383) | (17,645) | (17,980) | (18,322) | (18,670) |
| Net Expenditure Requirement | 6,973 | 6,973 | 7,414 | 8,177 | 8,380 |
| Capital | 175 | 175 | 150 | 150 | 150 |
| Total Resource Requirement | 7,148 | 7,148 | 7,564 | 8,327 | 8,530 |
| Annual GDP deflators | | | -1.6% | -1.7% | -1.7% |
| Net cost at 2018/19 prices | | | 7,445 | 8,059 | 8,117 |
| Staff Projections (w.t.e.) | 278 | 278 | 282.5 | 286.5 | 290 |

62. People costs are rising in cash terms in all years of the projection. Explanations of the movements in 2019/20 have been provided on page 13. The increased costs in the following years are due to pay growth assumptions and increased resources for new financial powers work.

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63. Other administrative costs increase in 2020/21 and then decrease in 2021/22 mainly from the National Fraud Initiative costs which occur every two years.

SCPA approved funding

64. In 2019/20 our budget proposals require a cash increase of £416k in total funding from that approved for 2018/19. In real price terms (2018/19 prices) this represents a 4.2% increase.
65. Revenue support 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
 - management contingency
 - auditing related to the new financial powers, fiscal framework and social security
 - assuring the quality of public audit in Scotland.

Appendix 1 - Net Expenditure Statement expenditure trends

| | Actual | | Original | Approved | Proposed |
|---|--------------|--------------|----------------|----------------|----------------|
| | 2016~17 | 2017~18 | 2018-19 Budget | 2018-19 Budget | 2019-20 Budget |
| | £k | £k | £k | £k | £k |
| People Costs | | | | | |
| Salaries and temporary staff | 11,930 | 11,861 | 12,172 | 12,128 | 12,821 |
| Employers on costs | 3,305 | 3,421 | 3,439 | 3,496 | 3,699 |
| Pension adjustments | 894 | 1,858 | 125 | 125 | 125 |
| | 16,129 | 17,140 | 15,736 | 15,749 | 16,645 |
| Accounts Commission members | 157 | 153 | 164 | 170 | 174 |
| Total people costs | 16,286 | 17,293 | 15,900 | 15,919 | 16,819 |
| Fees and expenses paid to external firms | 4,987 | 4,355 | 3,991 | 4,125 | 4,189 |
| Other operating expenditure | | | | | |
| Rent & Rates | 550 | 519 | 525 | 525 | 511 |
| Other accommodation Costs | 346 | 420 | 410 | 410 | 393 |
| Travel & Subsistence | 853 | 855 | 894 | 894 | 852 |
| Legal & Professional Fees | 615 | 474 | 765 | 921 | 879 |
| Stationery & printing | 141 | 121 | 148 | 148 | 131 |
| Training & organisational development | 484 | 429 | 528 | 483 | 481 |
| Staff recruitment | 109 | 128 | 105 | 105 | 130 |
| Communications (telephone, postage) | 37 | 26 | 46 | 44 | 38 |
| Insurance | 72 | 80 | 79 | 79 | 79 |
| Information technology | 413 | 414 | 456 | 458 | 444 |
| Internal Audit | 29 | 28 | 30 | 30 | 30 |
| External Audit - financial statements | 27 | 27 | 30 | 30 | 30 |
| Other | 72 | 35 | 65 | 63 | 65 |
| Depreciation | 354 | 371 | 384 | 384 | 323 |
| Total other operating expenditure | 4,102 | 3,927 | 4,465 | 4,574 | 4,386 |
| TOTAL OPERATING EXPENDITURE | 25,375 | 25,575 | 24,356 | 24,618 | 25,394 |
| Corporation Tax payable | 7 | 1 | 0 | 0 | 0 |
| Income | | | | | |
| Fees and charges payable | 18,482 | 17,890 | 17,383 | 17,645 | 17,980 |
| Bank Interest | 36 | 7 | 0 | 0 | 0 |
| Miscellaneous income | 140 | 58 | 0 | 0 | 0 |
| Other finance income - pensions related | -626 | -893 | 0 | 0 | 0 |
| TOTAL | 18,032 | 17,062 | 17,383 | 17,645 | 17,980 |
| NET EXPENDITURE AFTER TAX | 7,350 | 8,514 | 6,973 | 6,973 | 7,414 |

Appendix 2 - Sector cost analysis 2019/20

| Expenditure budget | Fees | | | | | Total Fees £k | SCPA Parliament £k | TOTAL £k |
|---|----------------------------|---------------------|----------------------------|-----------------------------|---------------|------------------|--------------------------|---------------|
| | Local Authorities £k | NHS Bodies £k | Further Education £k | Central Government £k | | | | |
| Auditor General for Scotland | 0 | 0 | 0 | 0 | 0 | 0 | 236 | 236 |
| Accounts Commission | 0 | 0 | 0 | 0 | 0 | 0 | 184 | 184 |
| Governance | 114 | 24 | 1 | 33 | 172 | 172 | 442 | 614 |
| Audit Quality and Appointments, Professional Support incl. NFI | 333 | 109 | 21 | 104 | 567 | 567 | 78 | 645 |
| External Audit firms | 2,102 | 878 | 432 | 512 | 3,924 | 3,924 | 264 | 4,188 |
| Audit Services | 4,452 | 1,372 | 61 | 1,633 | 7,518 | 7,518 | 2,254 | 9,772 |
| Performance and Best Value audit | 2,060 | 0 | 0 | 0 | 2,060 | 2,060 | 1,827 | 3,887 |
| Corporate Services and overheads | 2,575 | 483 | 25 | 656 | 3,739 | 3,739 | 2,129 | 5,868 |
| Total budgeted expenditure | 11,636 | 2,866 | 540 | 2,938 | 17,980 | 17,980 | 7,414 | 25,394 |
| Fee income | 11,636 | 2,866 | 540 | 2,938 | 17,980 | 17,980 | 0 | 17,980 |
| Support from Parliament | 0 | 0 | 0 | 0 | 0 | 0 | 7,414 | 7,414 |
| Total Income | 11,636 | 2,866 | 540 | 2,938 | 17,980 | 17,980 | 7,414 | 25,394 |
| Surplus (Deficit) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| % Surplus / (Deficit) | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% | 0.0% |

Appendix 3 – Funding and Fee Strategy

Objectives of the funding and fee setting arrangements

1. The overall aim of the funding & fee setting arrangements is to support Audit Scotland to provide high quality independent public audit in Scotland whilst keeping audit fees 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 aim to 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.
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 the location or identity of the audit provider. 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.

Parliamentary funding of audit work

5. Parliamentary funding pays for all financial audits of central government bodies that we cannot charge for and 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 national fraud initiative and the costs of the Auditor General, Accounts Commission and Audit Scotland Board.

Audit work subject to fees

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 best value 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, including integrated joint boards, 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, including new audit burdens, cost pressures, efficiency targets, outturn from the previous financial year and any potential End Year Flexibility available.
9. Budget proposals, including levels of charges, are presented to the Audit Scotland Board for discussion and approval, 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 September 2018, Audit Scotland confirmed the levels of charges for the 2018/19 audits which were provisionally set as part of the 2018/19 financial year budget in December 2017. 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 2018/19 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 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, 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 identity or location of the auditor 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 appropriate when considering the way in which councils were funded for it.

Audit support costs

19. Audit Scotland incurs costs in making audit appointments, reviewing, reporting and providing assurance on audit quality, providing technical guidance and professional 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 2018/19 audits

Fee levels

20. An overall increase in average fees of 1.6% for 2018/19 audits leads to a real terms increase of 0.1% on 2017/18 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 set in the funding and fees review carried out in 2016.

Table 1

| | Average change on 2017/18 charges | Real terms |
|--|-----------------------------------|--------------|
| Local government | +2.0% | +0.5% |
| NHS | 0.0% | -1.5% |
| Central government - chargeable audits | +1.9% | +0.5% |
| Further education | +2.0% | +0.5% |
| Overall average | +1.6% | +0.1% |

Fee movements

22. The fee movements shown in Table 1 are based on achieving a break-even position for the 2019/20 financial year in all sectors.
23. Within sectors there will be a range of decreases and increases which 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 1.7% to 2.0% and other local government bodies will see fees increase by an average of 3.0%.
 - NHS – except for two bodies that require an increase to reflect audit resource costs the remaining mainland, island and special health boards will see no change in fees.
 - Central government chargeable bodies will generally see average increases of 1.9%.
 - Further education - college fees will increase on average 2.0%.

Future years

24. For 2019/20 and 2020/21 audits we aim to keep increases across all sectors at levels no higher than the average increase applied to the 2018/19 audits.

Hourly rates

25. 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).
26. For the 2018/19 financial year the hourly rates used to cost audit work are:

| | 2017/18 | 2018/19 |
|--------------------------------------|----------------|----------------|
| Trainees | £48 | £44 |
| Business support specialist | £22 | £20 |
| Audit/support officer | £38 | £39 |
| Auditor | £43 | £43 |
| Senior auditor | £59 | £63 |
| Manager | £70 | £76 |
| Senior manager | £88 | £93 |
| Directors and Assistant Directors | £148 | £155 |

27. The rates for the 2019/20 financial year will be calculated once the budget has been finalised.