



The Scottish Parliament  
Pàrlamaid na h-Alba

**SCOTTISH COMMISSION FOR PUBLIC AUDIT**

**AGENDA**

**1st Meeting, 2020 (Session 5)**

**Wednesday 15 January 2020**

The Commission will meet at 11.45 am 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 Spring Budget Revision 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.

3. **Audit Scotland's Budget Proposal for 2020-21:** 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.

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

**Agenda item 2**

Note from the Clerk

SCPA/S5/20/1/1

**Agenda item 3**

Note from the Clerk

SCPA/S5/20/1/2

PRIVATE PAPER

SCPA/S5/20/1/3  
(P)

**Agenda item 5**

PRIVATE PAPER

SCPA/S5/20/1/4  
(P)

**Scottish Commission for Public Audit**

**1st Meeting, 2020 (Session 5), Wednesday 15 January 2020**

**Audit Scotland Spring Budget Revision 2019/20**

1. Audit Scotland has submitted its proposed Spring Budget Revision for 2019/20 for the consideration of the Scottish Commission for Public Audit. A copy of the Spring Budget Revision for 2019/20 can be found in Annexe A for members consideration.
2. The Commission is invited to consider the Spring Budget Revision 2019/20 and then write to the Finance and Constitution Committee with its views.

**Secretary to the Scottish Commission for Public Audit  
10 January 2020**

# Spring Budget Revision

2019/20

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## Introduction

1. In accordance with Scottish Government advice this paper details Audit Scotland's 2019/20 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. 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 being available for inclusion in the SBR.

## Spring Budget Revision proposal

4. Our SBR proposal requests £10 million to meet increased non-cash pension accounting charges that will arise in 2019/20 and to provide sufficient cover to meet additional pension charges following the outcome of the McCloud case.
5. 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.
6. 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 five 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.
7. 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 NDPBs.
8. 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

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value assets and liabilities of the scheme as well as identifying the in-year costs of providing the pension service earned during the year.

9. 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; 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.
10. 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 2019/20 was available in April 2019 well after the submission of our budget proposals for 2019/20 in December 2018. This means it is very difficult to predict the impact of pension accounting adjustments as part of the annual budgeting process.
11. Pension accounting adjustments required in respect of IAS 19 can generate favourable and unfavourable variances. The accounting adjustments are notional and do not generate cash movements.
12. In previous submissions we have advised the possibility of adverse adjustments in future and the consequent need to request additional budget cover through the AME process to balance our accounts. In 2018/19 the scheme actuary's estimate was £2.9 million more than the pension charge assumed in the budget for the year. With the agreement of the SCPA and the Scottish Government's Finance Directorate additional cover was provided in the SBR 2018/19 through the AME arrangement.
13. For 2019/20 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 2019 the estimated pension service cost for 2019/20 is £4.1 million higher than the available budget.
14. 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 – the rate reduced to -0.1% at March 2019 compared to a rate of 0.3% at March 2018.
15. The second factor affecting the SBR proposal is the impact on pension liabilities of the McCloud case.
16. Audit Scotland's 2018/19 annual report and accounts included a contingent liability for the potential impact on Local Government Pension Scheme member benefits following the ruling of the McCloud case in December 2018. The Court of Appeal judgement was that the transitional protection offered to some members as part of the reforms of the judicial and fire fighter pension schemes amounted to unlawful discrimination. At the time of finalising our accounts the UK Government was seeking to appeal this decision.

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17. Following the publication of our annual accounts it was announced that the UK Government was unsuccessful in being able to appeal this decision and a compensation agreement now needs to be offered to affected employees.
  18. Initial estimates by the actuary indicate that the potential past service cost for Audit Scotland is in the region of £2 million; however, this is prior to any formal agreement discussions and the figure therefore has the potential to increase or decrease significantly. It is also expected that the in-year pension benefit cost will increase from the original forecast prepared by the actuary.
  19. Due to the significant uncertainty in respect of pension liabilities the advice received from the Scottish Government Finance Directorate is to request sufficient non-cash AME budget cover to meet the anticipated significant movement in IAS 19 pension charges.
  20. Our proposal is that, in addition to the £4.1 million pension charge forecast by the Actuary in April, we include a further £5.9 million to ensure we have sufficient budgetary cover to meet the impact of significant non-cash pension liability adjustments linked to the McCloud case and also any changes to the financial assumptions used by the actuary in their April forecast. This additional request brings our total non cash AME requirement in 2019/20 to £10 million.
  21. It is essential that Audit Scotland has sufficient budget cover to meet the unpredictable non-cash charge arising from the IAS 19 pension adjustments required under the FReM. Audit Scotland is unable to carry forward reserves and any significant shortfall would leave us in the unacceptable position of a final outturn deficit.
  22. The expectation of continuing low interest rates in the next few years will mean large accounting charge adjustments in 2020/21 and beyond. In such circumstances further requests for budget revisions to meet additional pension charge adjustments will be required in the future.

## Conclusion

23. The Spring Budget Revision proposals presented in this paper will provide non-cash AME funding of £10 million to allow Audit Scotland to meet increased non-cash pension charges that will occur in 2019/20 and provide sufficient budget cover to meet any significant additional IAS19 pension charges in respect of the ruling of the McCloud case.

**Scottish Commission for Public Audit**

**1st Meeting, 2020 (Session 5), Wednesday 15 January 2020**

**Audit Scotland Budget Proposal 2020/21**

1. Audit Scotland has submitted its Budget Proposal for 2020/21 for the consideration of the Scottish Commission for Public Audit. A copy of the Budget Proposal for 2020/21 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 2020/21 and report its views to Parliament.

**Secretary to the Scottish Commission for Public Audit  
10 January 2020**



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

8 January 2020

Dear Mr Beattie

**Audit Scotland Spring Budget Revision 2019/20 and Budget Proposal 2020/21**

I look forward to meeting the Scottish Commission for Public Audit on 15 January to present the enclosed Spring Budget Revision 2019/20 and our Budget Proposal 2020/21.

The proposals are made in the context of the main strategic, operational and financial issues affecting Audit Scotland: the continued devolution of new financial powers to Scotland, the establishment of new audit bodies, public sector pay policy and the UK's withdrawal from the EU.

If you require any further information in advance of the meeting, we will be happy to provide this.

Yours sincerely



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

# Budget Proposal

2020/21



Prepared for the Scottish Commission for Public Audit  
January 2020

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively.

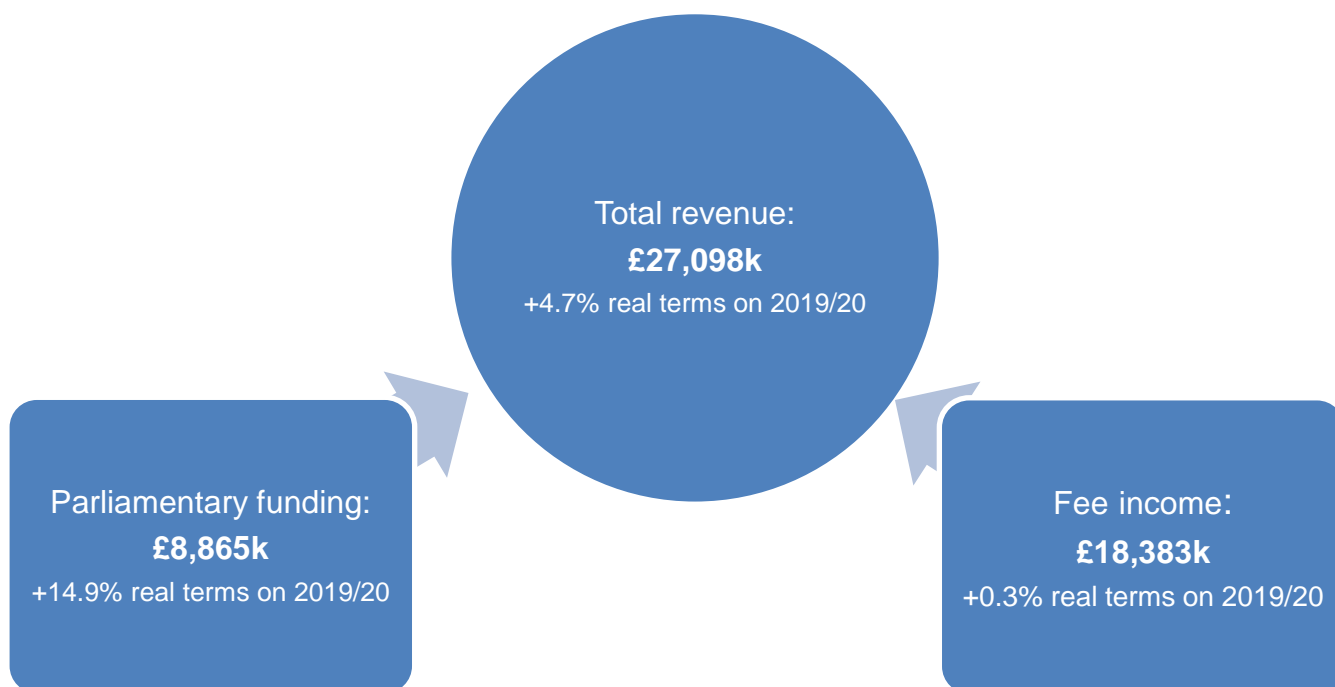
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# Key messages

## 2020/21 Budget Proposal



Audit Scotland is committed to delivering high quality, effective audit to support the Auditor General for Scotland and the Accounts Commission for Scotland in providing independent assurance to the people of Scotland that public money is spent properly and provides value for money.

The Audit Scotland 2020/21 budget proposal focuses on both maintaining the quality of existing audit work and ensuring effective audit of devolved resources and new public bodies. It will mean we can also deliver a programme of work to support parliamentary scrutiny as Scotland's fiscal framework becomes more complex.

The proposed revenue expenditure budget for 2020/21 of £27,098k equates to 0.06% of the £42.4 billion public sector budget.

The total Parliamentary funding is £8,865k, an increase of £1,273k from 2019/20, or 14.9% in real terms. This includes revenue funding of £8,715k and capital funding of £150k.

Just over half of the increase arises from:

- additional audit responsibilities for Scotland's New Financial Powers (NFP), £425k
- and the biennial National Fraud Initiative, £220k.

The remaining £628k includes:

- the cost of other new audits

- pay awards
- and increases in employer pension contributions following the 2017 actuarial valuation.

This equates to an increase of 6.5% in real terms.

The 2020/21 budget has been prepared in line with the indicative forecast assumptions advised to the SCPA in our 2018/19 budget proposal. We are in the third year of planned growth to meet our increasing audit responsibilities in a sustainable way. We expect growth to conclude in 2024, subject to ongoing uncertainties in the environment in which we operate.

# 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 2020/21 financial year with the Funding and Fee Strategy included in Appendix 3. The budget continues the planned investment in auditing further financial devolution for 2020/21.
4. The budget proposal for 2020/21 includes information on the budgeted costs for each audit sector. We have provided updated projections of resource requirements for two further years to 2022/23.
5. This paper is presented in three parts.
  - Context
  - Resource Requirements 2020/21
  - Cost projections 2021/22 to 2022/23

Appendix 1 - Net Expenditure Statement expenditure trends

Appendix 2 - Sector cost analysis

Appendix 3 - Funding and Fee Strategy

# Context

## 2020/21 uncertainties

6. The budget for 2020/21 has been prepared in the context of significant uncertainties:
  - timing of budget statements from the UK and Scottish Governments
  - public sector pay policy
  - timing of the implementation of the remaining 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.

## Our work 2020/21

7. This budget proposal will enable us to continue to deliver audits of over 220 public sector organisations including the Scottish Government and its public bodies, NHS boards, police and fire services, councils, integration joint boards and colleges. These organisations spend more than £42 billion of public money annually.
8. We will continue to support the Scottish Parliament to scrutinise the use of public money. This includes additional audit requirements arising from the devolution of new powers such as social security and income tax, the increased complexity of the Scottish budget, and the creation of new public bodies such as Scottish Commission on Social Security and the Independent Living Fund Scotland:
  - Social Security Scotland began operating in September 2018 and by the end of 2019 was delivering seven devolved benefits. Fiscal responsibility for all remaining devolved benefits will transfer to the Scottish Government in April 2020, with total annual spend of around £3.3 billion. Audit Scotland is the appointed auditor for the agency and the payments, and we have established a new team to lead on all social security financial and performance audit work
  - The Scottish budget is increasingly complex and directly linked to economic performance. Our Scottish budget team have a year-round work programme to assess and report on overall fiscal management and financial sustainability to inform and support Parliamentary scrutiny.
9. We will also deliver our [five-year rolling programme of national performance audits](#) for the Auditor General and the Accounts Commission. Our programme is risk based and refreshed each year following consultation with stakeholders.
10. The programme for 2020/21 includes audits on:
  - Scotland's new financial powers, including social security
  - Educational outcomes



- Affordable housing
  - Supporting economic growth
  - Improving outcomes for children with additional support needs
  - Waste management
  - Social Care sustainability
  - The use of digital technology to improve public services
  - Commonwealth Games legacy
  - and our annual overview reports on the performance of the [NHS](#), [local government](#) and [colleges](#).
11. The programme also provides for statutory reports on significant issues arising from the annual audits to be brought to the Parliament by the Auditor General for Scotland or to the Accounts Commission for Scotland from the Controller of Audit.
  12. In 2020/21 we will co-ordinate and complete the biennial National Fraud Initiative on behalf of Scotland's public sector. On completion of the 2016/17 NFI, we reported that it had found £129.2M of potential fraud and error in Scotland's public bodies over the previous 10 years.
  13. The budget proposal will also enable us to:
    - limit 2019/20 audit fees for public bodies to a real terms increase of 0.1% from 2018/19 (more detail is available in Appendix 3)
    - continue working with the National Audit Office (NAO) to develop assurance to the Scottish Parliament in other future devolved areas, such as VAT assignment
    - continue to monitor issues and potential risks to Scotland's public bodies, and our own organisation, as the UK withdraws from the European Union
    - provide rigorous audit quality review and reporting, and continue investing in staff learning and development and the professional trainee, modern apprentice and student placement programmes.
  14. High quality audit work is a priority for us and is the focus of significant scrutiny, with reviews of the Financial Reporting Council (FRC) and the audit market underway. The independent Brydon Review on quality and effectiveness of audit was published on 18 December 2019. Our investment in Audit Quality and Appointments (AQA) allows us to assure the Auditor General, the Accounts Commission and the Scottish Parliament of the quality of work provided by auditors and to promote continuous improvement. AQA carries out a broad programme of work under our Audit Quality Framework, including commissioning independent reviews by the Institute of Chartered Accountants Scotland (ICAS) and surveys of audited bodies.

### **New Financial Powers and constitutional change**

15. Our 2017/18, 2018/19 and 2019/20 budget proposals advised the SCPA of our need to plan for a phased budget increase to respond to the Parliament's new financial powers. The 2020/21 budget includes an increase of £425k to fund people costs (estimated at 6.6 w.t.e.

staff). This is within the range originally presented to the Commission. As financial powers transfer on a phased basis the full projected requirement (subject to implementation uncertainty) will be £1,655k by 2024/25, equivalent to 24.5 w.t.e. staff.

16. The additional resources will allow us to continue to respond effectively to the growing demands on us.
17. It will also allow us to respond to the emerging impacts of EU withdrawal on the Scottish public sector and the resulting growth or reduction in our work. At this stage, it has not been possible to make assumptions about these.

## Value for money

18. Our 2020/21 expenditure budget proposal totals £27,098k; this is 0.06% of the £42 billion total expenditure that is audited.
19. Most of our expenditure is on staff costs (66%), with the balance split between payments to external firms for undertaking audit work (16%) and administration costs (18%).
20. In line with the Funding and Fee Strategy, our proposals result in 68% funding from audit fees for audited bodies, with the 32% balance funded through the Scottish Consolidated Fund.
21. Since 2014/15 we have delivered significant real terms cumulative savings and efficiencies of £6.437M. These include savings in audit firm contract costs, property rationalisation, travel and subsistence, energy efficiency and business re-structuring.
22. Legislation requires us to broadly break even each year and does not allow us to hold reserves. The savings generated have reduced our funding requirement from the Scottish Consolidated Fund and have also enabled us to deliver real terms reductions in the fees for audited bodies over this period.
23. The 2020/21 budget proposal continues to benefit from savings generated from audit procurement, property rationalisation and business re-structuring. The budget aims to absorb as much of the cost increases arising from pay settlements, general inflation and other unplanned financial pressures as possible. We achieve this through medium term financial planning, reviewing audit approaches, continuous review of staffing levels/skills mix and the use of technology.

# Resource Requirements 2020/21

24. The total Resource Requirement for 2020/21 requested for approval by the SCPA is £8,865k. This represents an overall cash increase of £1,273k on 2019/20, or a 14.9% increase in real terms at 2019/20 prices.
25. Table 1 summarises the total Resource Requirements and provides a comparison with 2019/20. More detailed information is in Appendix 1.

Table 1 – Summary of resource requirements for 2020/21

Resource requirements	Budget 2019/20 £000	Proposed 2020/21 £000	Movement		
			Actual £000	Actual %	Real Prices %
<b>Expenditure</b>					
People costs	16,847	17,971	1,124	6.7%	4.8%
Other administrative costs	8,575	9,127	552	6.4%	4.5%
Gross administrative costs	25,422	27,098	1,676	6.6%	4.7%
<b>Income</b>					
Income charges from audited bodies	17,980	18,383	403	2.2%	0.3%
Net Operating Cost	7,442	8,715	1,273	17.1%	15.2%
Capital	150	150	0	0.0%	-1.9%
<b>Total resource requirement</b>	<b>7,592</b>	<b>8,865</b>	<b>1,273</b>	<b>16.8%</b>	<b>14.9%</b>

## Resource analysis

26. The 2020/21 proposal increases people costs by £1,124k; other administrative costs increase by £552k and income increases by £403k. Full details are on pages 11 to 15.

## Principal budget assumptions - 2020/21 to 2022/23

27. The principal assumptions underlying the budget proposal for 2020/21 and our cost projections for the two following years are set out below.

### 2019/20 Budget

28. The Autumn Budget Revision increased our base budget by £28k leading to a revised Total Resource Requirement of £7,592k. This covers the cost of the increase to employer pension contributions for staff in the Principal Civil Service Pension Scheme.
29. Our 2020/21 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.

### Pay and pensions

30. Our current pay agreement ends on 31 March 2020. Audit Scotland negotiates pay awards annually and actual awards will be determined as part of this process. For the 2020/21 budget we have assumed that the new agreement could add 3% per annum to our pay bill (2% for increases in pay scales and up to 1% for pay progression).
31. For planning purposes only, we have assumed that in 2021/22 and 2022/23 pay levels will continue to increase at the same level.
32. The budget proposal reduces the vacancy factor from 2% to 1% to address resourcing pressures. This adjustment increases the budget for salaries and on costs by £155k.
33. 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.

### Appointed auditors (firms)

34. Payments to appointed auditors (firms) for 2019/20 audits increase in line with the remuneration increases applied to our own staff at April 2019. For 2020/21 and 2021/22 audits we have assumed that auditor remuneration will increase by 2% per annum.

### Management contingency

35. Given the current level of uncertainties we have set out in paragraph 6, we have maintained the management contingency at £300k, which is 1.1% of the total expenditure budget.
36. 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 adjustments with the SCPA.

### Quality

37. The Audit Quality Framework 2017/18, [Audit Quality Framework](#), provides assurance that work is of high 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

2020/21 budget proposal and projections for 2021/22 and 2022/23 maintain investment of £250k to support audit quality inspection and reporting. The 2018/19 audit quality report can be found at [Quality of public audit in Scotland 201819](#).

### **Property**

38. Our budget proposals for 2020/21 and our projections for 2021/22 and 2022/23 assume continued occupation of our three offices in Edinburgh, Glasgow and Inverness on existing long term leases. Property costs in 2020/21 will increase by £34k due to a planned Edinburgh office rent review and inflationary increases applied to business rates and utilities.

### **Training and organisational development**

39. We continue to develop our business to improve the way we work and to ensure we deliver efficiencies while maintaining the quality of our work. Budget is allocated to our rolling Learning and Development (L&D) plan, which is updated each year in collaboration with colleagues to align with our corporate plan and changing external audit landscape.
40. We remain committed to our professional trainee, modern apprentice and student placement programmes to deliver our workforce planning and long term talent strategies.

### **GDP deflators**

41. We have assumed a GDP deflator of 1.9% for 2020/21. For 2021/22 and 2022/23 the deflators are 2.0% and 2.1%. This is consistent with the September 2019 rates published by HM Treasury. These are used to remove the effect of price changes (inflation) when comparing expenditure over time.

### **Net Revenue Expenditure**

42. An analysis of 2020/21 net expenditure by category is attached in Appendix 1, it also provides information on actual net expenditure levels in 2017/18 and 2018/19 and the approved budget for 2019/20.
43. Net expenditure increases in cash terms by £1,273k from the 2019/20 budget, a real terms increase of 15.2%.
44. Excluding the specific budget increases required for New Financial Powers and the National Fraud Initiative, the cash increase is £628k, a real terms increase of 6.5%.
45. The table overleaf provides an analysis of the movement from the net approved expenditure in the 2019/20 budget to the proposed 2020/21 net expenditure resource requirement.

Table 2 - Movement of net approved expenditure to proposed resource requirement

	£k	£k
<b>2019/20 Net Approved Expenditure</b>		<b>7,442</b>
<b>Analysis of budget change</b>		
New Financial Powers	+425	
April 2020 pay growth	+490	
Vacancy factor adjustment	+155	
Pension contributions increase	+54	
<b>Increase in People Costs</b>		<b>+1,124</b>
National Fraud Initiative	+220	
Accommodation	+34	
Other administration <sup>1</sup>	+137	
Approved Auditors	+161	
<b>Other administrative costs increase</b>		<b>+552</b>
<b>Fee income increase</b>		<b>-403</b>
<b>2020/21 Net Expenditure Resource Requirement</b>		<b>8,715</b>

<sup>1</sup> Budget increases include travel and subsistence, information technology and depreciation.

## People Costs

46. People costs represent 66% of our expenditure budget proposals and our 2020/21 budget requirement is £1,124k higher in cash terms than the approved 2019/20 budget. In real terms this is an increase of £804k (4.8%).
47. The main drivers of the increase are annual pay growth, staffing for new financial powers and employer pension contributions.
48. The proposed budget increases the established staffing requirement by 10.2 w.t.e. from the 2019/20 budget, providing a total staffing of 292.7 w.t.e. in 2020/21. The main reason for the increase is new financial powers resourcing requirements (6.6 w.t.e.).
49. The balance of the increase (3.6 w.t.e.) relates to changes to our resourcing requirements because of departures or adjustments in working hours, enabling us to revise our establishment levels at no additional cost. For example, following a review of our resourcing needs we have been able to increase the number of modern apprenticeships to the current level of 4 w.t.e.

### Other administrative costs

50. Other administrative costs are £552k higher in the proposed 2020/21 budget compared to the approved 2019/20 budget.
51. The main changes relate to an increase of £220k for the biennial National Fraud Initiative (NFI) exercise and a £161k increase for fees and expenses payments to external firms for which additional fee income will be received.
52. The balancing movement of £171k reflects a number of increases and decreases across several budget headings.
53. The main areas of increase are:
  - uplifts in rent, rates and cleaning contract (£34k)
  - depreciation due to a higher than planned element of capital purchases being of a shorter write off period (£19k)
  - bringing travel and subsistence budget in line with audit requirements (£25k)
  - communications budget (£27k)
  - uptake of employee health checks (£26k).
54. In October 2019 the Office of National Statistics advised that Audit Scotland had been reclassified for the purposes of the national accounts, public sector finances and related national statistics. This brings us into the same categorisation as the other UK audit agencies and we have been advised that this should have no financial implications.

### Income

55. Audit Scotland is funded by fees and the Scottish Consolidated Fund (SCF), 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.
56. Our funding and fee arrangements are set out in our Funding and Fee Strategy at Appendix 3.
57. The increase to the proposed fees budget for 2020/21 is 2.2%, an increase in real terms of 0.3%.
58. In addition to the specific funding increases required for new financial powers and the National Fraud Initiative, the increase in SCF funding is mainly due to public sector re-structure and the impact this has on the cost apportionment allocations across all sectors.

59. Income from fees to audited bodies by financial year is provided in Table 3 below:

Table 3 – Income from fees to audited bodies

	Actual 2017/18 £000	Actual 2018/19 £000	Budget 2019/20 £000	Proposed Budget 2020/21 £000
Local authorities	11,565	11,576	11,636	11,912
NHS bodies	2,999	2,980	2,866	2,948
Further education colleges	515	532	540	527
Scottish Government depts. and sponsored bodies	2,811	2,944	2,938	2,996
<b>Total income from charges to audited bodies</b>	<b>17,890</b>	<b>18,032</b>	<b>17,980</b>	<b>18,383</b>
% cash increase in fees from approved 2019/20 budget				2.2%

60. For 2019/20 audits the proposed average fee increase is 2.0%, a real terms increase of 0.1% on 2018/19 fees.

61. Appendix 2 provides an analysis of the 2020/21 budget by sector and funding source.

## Capital

62. The proposed capital budget for 2020/21 is £150k to support our rolling information technology programme. Details of the 2020/21 capital requirements are provided below:

	<b>£000</b>
IT Hardware	40
Printers	70
Software	40
<b>TOTAL</b>	<b>150</b>



# Budget Projections 2020/21 to 2022/23

63. In addition to our budget proposal for 2020/21, we have prepared projections for the following two years.

## Principal assumptions

64. The principal assumptions for our 2020/21 budget proposal and projections for 2021/22 and 2022/23 are set out on pages 11 and 12 of this submission.

## Projections

65. The table below summarises Audit Scotland's budget projections for the period 2020/21 to 2022/23.

Table 4 – Budget Projections for 2020/21 to 2022/23

	Original Budget	Proposed Budget	Projection	
	2019/20 £000	2020/21 £000	2021/22 £000	2022/23 £000
Expenditure				
People costs	16,847	17,971	18,777	19,415
Other administrative costs	8,575	9,127	8,991	9,245
Gross administrative costs	25,422	27,098	27,768	28,660
Total Income	(17,980)	(18,383)	(18,795)	(19,216)
<b>Net Expenditure Requirement</b>	<b>7,442</b>	<b>8,715</b>	<b>8,973</b>	<b>9,444</b>
Capital	150	150	150	150
<b>Total Resource Requirement</b>	<b>7,592</b>	<b>8,865</b>	<b>9,123</b>	<b>9,594</b>
Annual GDP deflators		-1.9%	-2.0%	-2.1%
Net cost at 2019/20 prices		8,700	8,777	9,041
Staff Projections (w.t.e.)	282.5	292.7	296.6	295.6

Note 1 – assumes continuation of same level of discount received in respect of the external firm's contracts. New contracts will commence from 2021/22 audit year.

66. People costs are rising in cash terms in all years of the projection. Explanations of the movements in 2020/21 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.

67. Other administrative costs decrease in 2021/22 and then increase in 2022/23 as a result of the National Fraud Initiative costs, which takes place every two years.

### SCPA approved funding

68. Revenue support from the Scottish Consolidated Fund provides funding for:
- non-chargeable Central Government audits (see Table 5 below for list of the audits which by statute we cannot charge for)
  - performance audits
  - the Auditor General
  - the Accounts Commission
  - a proportion of Audit Scotland senior management
  - management contingency
  - National Fraud Initiative
  - Auditing related to the new financial powers, fiscal framework and social security
  - Assuring the quality of public audit in Scotland.

Table 5 – Current non-chargeable Central Government bodies

Scottish Government	Accountant in Bankruptcy
Scottish Consolidated Fund	Crown Office and Procurator Fiscal Service
Scottish Courts and Tribunals Service	Disclosure Scotland
Scottish Fiscal Commission	Education Scotland
Scottish Housing Regulator	Food Standards Scotland
Scottish Parliamentary Corporate Body	Scottish Forestry
Scottish Prison Service	Forestry and Land Scotland
Scottish Teachers' Superannuation Scheme	NHS Superannuation Scheme (Scotland)
Scottish Public Pensions Agency	Non-Domestic Rates Account
Social Security Scotland	Office of the Scottish Charity Regulator
Student Awards Agency for Scotland	QLTR
Transport Scotland	National Records of Scotland
Revenue Scotland	

## Appendix 1 - Net Expenditure Statement expenditure trends

	Actual		Approved	Proposed
	2017-18	2018-19	2019-20 Budget	2020-21 Budget
	£k	£k	£k	£k
<b>People Costs</b>				
Salaries and temporary staff	11,860	12,179	12,821	13,514
Employers on costs	3,421	3,611	3,727	4,162
Pension adjustments	1,859	2,349	125	126
	17,140	18,139	16,673	17,802
Accounts Commission members	153	163	174	169
<b>Total people costs</b>	<b>17,293</b>	<b>18,302</b>	<b>16,847</b>	<b>17,971</b>
<b>Fees and expenses paid to external firms</b>	<b>4,355</b>	<b>4,475</b>	<b>4,189</b>	<b>4,350</b>
<b>Other operating expenditure</b>				
Rent & Rates	519	479	511	535
Other accommodation Costs	420	437	393	403
Travel & Subsistence	855	871	852	877
Legal & Professional Fees	474	740	879	1,134
Stationery & printing	121	117	131	129
Training & organisational development	429	464	481	470
Staff recruitment	128	135	130	130
Communications (telephone, postage)	26	82	38	65
Insurance	80	72	79	79
Information technology	414	470	444	462
Internal Audit	28	27	30	30
External Audit - financial statements	27	29	30	30
Other	35	45	65	91
Depreciation	372	369	323	342
<b>Total other operating expenditure</b>	<b>3,927</b>	<b>4,337</b>	<b>4,386</b>	<b>4,777</b>
<b>TOTAL OPERATING EXPENDITURE</b>	<b>25,575</b>	<b>27,114</b>	<b>25,422</b>	<b>27,098</b>
Corporation Tax payable	1	1	0	0
<b>Income</b>				
Fees and charges payable	17,890	18,032	17,980	18,383
Bank Interest	7	4	0	0
Miscellaneous income	58	53	0	0
Other finance income - pensions related	-893	-798	0	0
<b>TOTAL</b>	<b>17,062</b>	<b>17,291</b>	<b>17,980</b>	<b>18,383</b>
<b>NET EXPENDITURE AFTER TAX</b>	<b>8,514</b>	<b>9,824</b>	<b>7,442</b>	<b>8,715</b>

## Appendix 2 - 2020/21 Budget sector cost analysis

Expenditure budget	Fees				Total Fees £k	SCPA Parliament £k
	Local Authorities £k	NHS Bodies £k	Further Education £k	Central Government £k		
Auditor General for Scotland	0	0	0	0	0	247
Accounts Commission	0	0	0	0	0	179
Governance	109	23	1	34	167	478
Audit Quality incl. NFI	331	108	21	103	563	304
External Audit firms	2,211	885	446	533	4,075	274
Audit Services	4,648	1,476	36	1,661	7,821	2,880
Performance and Best Value audit	2,151	0	0	0	2,151	1,908
Corporate Services and overheads	2,462	456	23	665	3,606	2,445
<b>Total budgeted expenditure</b>	<b>11,912</b>	<b>2,948</b>	<b>527</b>	<b>2,996</b>	<b>18,383</b>	<b>8,715</b>
Fee income	11,912	2,948	527	2,996	18,383	0
Support from Parliament	0	0	0	0	0	8,715
<b>Total Income</b>	<b>11,912</b>	<b>2,948</b>	<b>527</b>	<b>2,996</b>	<b>18,383</b>	<b>8,715</b>

## Appendix 3 – Funding and Fee Strategy

### Funding and Fee setting arrangements

#### Objectives of the funding and fee setting arrangements

69. The overall aim of the funding and 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.
70. 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.
71. Audit Scotland considers that audit fees should be set with the objective of recovering the full cost of audit work in each sector.
72. 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

73. 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

74. 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.

75. The fee setting arrangements therefore cover all local government audit work, including integration 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**

76. Fee setting is one part of the annual budget process. During July to September draft cost budgets are prepared for the following financial year. The implications of these on the levels of charges and Parliamentary funding are considered, including new audit burdens, cost pressures, efficiency targets and outturn from the previous financial year.
77. 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.
78. Because charges are set for audit years that run from approximately November to October, the fee setting process for each financial year covers two audit years. Therefore in September 2019, Audit Scotland confirm the levels of charges for 2019/20 audits which were provisionally set as part of the 2019/20 financial year budget in December 2018.

### **Calculating audit fees**

79. Audited bodies will receive the following breakdown of the total audit fee from 2019/20 audits and prior year fees:
- Auditor remuneration
  - Pooled costs
  - Performance audit and best value (where relevant)
  - Audit Scotland costs.

### **Auditor remuneration**

80. 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.
81. Auditors and audited bodies can agree remuneration up to 10% 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.

82. 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

83. 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)**

84. 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.
85. 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.
86. 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 believe that it is appropriate when considering the way in which councils were funded for best value.

#### **Audit support costs**

87. 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 2019/20 audits

### Fee levels

88. Each sector will see a fee increase of 2.0% for 2019/20 audits which in real terms represents a movement of 0.1% on 2018/19 charges.
89. The 2.0% movement is based on achieving a break even position for the 2020/21 financial year in all sectors.

### Future years

90. For 2020/21 and 2021/22 audits we aim to keep increases across all sectors at levels no higher than the increase applied to 2019/20 audits.

### Hourly rates

91. 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).
92. For the 2019/20 financial year the hourly rates used to cost audit work are:

	2018/19	2019/20
Trainees	£44	£43
Business support specialist	£20	£20
Audit/support officer	£39	£40
Auditor	£43	£44
Senior auditor	£63	£63
Manager	£76	£76
Senior manager	£93	£97
Directors and Assistant Directors	£155	£158

93. The rates for the 2020/21 financial year will be calculated once the budget has been finalised.