

MEETING OF THE COMMISSION

Thursday 25 October 2012

Session 4

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SCOTTISH COMMISSION FOR PUBLIC AUDIT
5th Meeting 2012, Session 4

CONVENER

Colin Beattie (Midlothian North and Musselburgh) (SNP)

DEPUTY CONVENER

John Pentland (Motherwell and Wishaw) (Lab)

COMMISSION MEMBERS

Iain Gray (East Lothian) (Lab)

Alex Johnstone (North East Scotland) (Con)

Angus MacDonald (Falkirk East) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Ronnie Cleland (Audit Scotland)

Russell Frith (Audit Scotland)

Caroline Gardner (Auditor General for Scotland)

Diane McGiffen (Audit Scotland)

SECRETARY TO THE COMMISSION

Fergus Cochrane

LOCATION

Committee Room 2

Scottish Commission for Public Audit

Meeting of the Commission

Thursday 25 October 2012

[The Convener *opened the meeting at 09:30*]

Decision on Taking Business in Private

The Convener (Colin Beattie): Good morning and welcome to the fifth meeting in 2012 of the Scottish Commission for Public Audit. I remind everyone to switch off their mobile phones and any other devices that they might have. We have received no apologies. We are missing Iain Gray at the moment, but perhaps he is on his way.

The first item of business is to ask the commission to take in private items 4 and 5 and future consideration of its draft report on Audit Scotland's budget proposal for 2013-14. Are members agreed?

Members *indicated agreement.*

Audit Scotland Budget Proposal 2013-14

09:30

The Convener: The next item is consideration of Audit Scotland's budget proposal for 2013-14. I welcome the Auditor General for Scotland, Caroline Gardner, who is making her first appearance before the commission; Ronnie Cleland, the chair of Audit Scotland's board; Diane McGiffen, the chief operating officer; and Russell Frith, assistant auditor general.

I invite Audit Scotland to make an opening statement.

Ronnie Cleland (Audit Scotland): Perhaps I can make a few introductory comments, convener. As you will know, this has been a year of significant transition for the organisation, with Caroline Gardner's appointment as Auditor General for Scotland. I hope that I can reassure the committee by saying that, so far, the appointment has gone very well.

On the matter in hand, the Audit Scotland board met the Auditor General several times over the summer to consider the budget proposals. I want to reassure the SCPA that the governance of the process of formulating the proposals before the commission has, to my mind, been very sound. We are also confident that the proposals represent considerable and sound progress towards reducing the cost of audit, but I make it clear that that has not happened at the expense of the quality or volume of work and that there has been no diminution in that respect. We have ensured that we have sufficient resources to maintain the coverage and quality of our audit work.

You might be interested to know that the board met yesterday to take stock of the main issues facing Audit Scotland in the future now that Caroline Gardner has been in post for three months. We confirmed at the meeting our belief that our future strategy is well founded and that the new Auditor General's input has helped us to develop our approach with greater emphasis on quality and the impact of our work. We are very comfortable with our position and our proposals.

I will now hand over to Caroline Gardner to talk through the key messages of the budget proposals.

Caroline Gardner (Auditor General for Scotland): The submission before the commission sets out Audit Scotland's budget proposal for 2013-14, which is the third year of our four-year plan to reduce the costs of audit by at least 20 per cent, as well as updated financial

projections for the two following financial years to give members a picture of our direction of travel.

The total resource requirement that we are requesting for 2013-14 of £6.592 million represents an overall cash decrease of 5.5 per cent, or 7.8 per cent in real terms, on our 2012-13 budget. We are confident that the proposals will allow us to reduce average audit fees by 4.35 per cent for the 2012-13 audits, to freeze planned fees for 2013-14 audits at 2012-13 levels, and to ensure that we continue to carry out our audit responsibilities to the necessary quality standards.

We are also continuing to look for new ways of working and responding to changes in the public sector environment. For example, we have piloted new audits of community planning partnerships to examine their performance in the current context.

I hope that that has been helpful in setting the scene, convener. My colleagues and I are happy to answer the commission's questions.

The Convener: I will begin with a broader question about the very welcome and ambitious savings that you are looking to achieve, which have been the subject of previous discussion around the table. Are you satisfied that, in this period of reduced resources and increased pressure on your finances and given the ambitious targets that you are pitching for, you will be able to maintain the standards of audit over the coming year?

Caroline Gardner: We have worked very hard to balance the expectation on all public bodies to respond to the challenging financial climate with the recognition that, in this climate of financial stringency, our work has probably never been more important. As Auditor General, I am absolutely clear that we have to get right the quality of our audit work across the wide range of our audit responsibilities. I am confident that, by continuing to look at the ways in which we work, we can achieve the targeted reduction of 20 per cent by 2014-15 and that this proposal is a safe step in our journey towards that goal.

The Convener: A feature of the changes taking place in Audit Scotland is a far greater reliance on third-party audit companies to carry out its work in the public sector. How do you assure yourself that the quality of audit is being maintained at this time of price pressures?

Caroline Gardner: I will ask Russell Frith to give the committee a bit more detail on how we are going about that but, in broad terms, the volume of work that the firms carry out on my behalf and on behalf of the Accounts Commission has not changed significantly through the last range of audit appointments. However, as Auditor General, I am very keen to build the extent to which we work with those firms as partners in

delivering the public audit model. There is scope not only to ensure the quality of their work but to increase its impact by joining it up with Audit Scotland staff.

Russell Frith will say a bit more about the quality processes for which he is responsible in Audit Scotland.

Russell Frith (Audit Scotland): We adopt fairly extensive quality processes not only for the work carried out by firms but for the work of our own teams. The firms are all required to follow relevant professional standards, and we require them to give us detailed returns to explain to us exactly how they are meeting them. Those standards include internal reviews as the work is going on and reviews of a selection of audits by staff independent of the audit teams after the audits have been completed. Moreover, the returns that we get from the firms' internal quality control processes allow us to see what points are coming up and how the firms are responding to them.

All the firms we use are subject to regulation by professional bodies and inspections by either the audit inspection unit of the Financial Reporting Council or by one of the institutes. We have access to the results of those inspections and also review a lot of the outputs from the audits to ensure that they are meeting expected standards. I can fairly safely say that so far we are confident that, despite the reductions that we were given 18 months ago, audit quality is being maintained.

The Convener: One fear is that with the reduction in audit fees the audit companies might be tempted to use less experienced or indeed less qualified staff. Are you satisfied that there has been no sign of that?

Russell Frith: There is no sign of that at the moment. In addition to our cold review work, we get all the firms in each sector around the table two or three times a year to discuss the risks prevalent in those sectors before the audits start. We then get them together again during the audits to discuss the issues that are coming up across the sector, to ensure that everyone is aware of them and that we are getting consistent responses to those risks and issues.

The Convener: At this point, I throw the questioning open to my colleagues.

Angus MacDonald (Falkirk East) (SNP): Auditor General, you mentioned in your introduction that your budget proposal for 2013-14 represents an overall cash decrease of 5.5 per cent on the 2012-13 budget. Did you at any time project those decreases to be greater or lower?

Caroline Gardner: As part of the budget process, we asked all of the business groups in Audit Scotland to review their performance in the

financial year that has just closed and then to look at a range of options for different levels of work and different ways of working. We were then able to home in not only on where we could make real efficiency savings and cost reductions but on where there would be risks in taking cost reductions further.

Through that process of sensitivity testing we arrived at a budget that we feel properly balances the need to respond to the financial pressures facing all public bodies with the need to keep up the quality of our work so that it provides Parliament with the assurance that it needs about the £34 billion or so that is spent every year in Scotland.

Diane McGiffen can talk a little more about how the process worked in terms of testing out the options that were available.

Diane McGiffen (Audit Scotland): Since we started the process of seeking to reduce the cost of audit, year on year we have had a dynamic process of looking at the progress that has been made in cost reduction, where that has come from, what that means for our workforce planning and resourcing, and what options are available if we have made faster progress than we perhaps anticipated.

We look at what we know about the skills mix that we have and where there might be a need to enhance and develop skills. We also look at the expectations that are on us to deliver our core programmes of work and anticipate the demands that are coming, for example through the development of community planning partnership auditing, which the Auditor General mentioned in her opening statement. It is a dynamic process that we revisit throughout the year and in great detail at budget time, and we are confident about the budget that is before you.

Angus MacDonald: I recognise that it is a dynamic process that you go through, but the question was whether the decrease was always 5.5 per cent or whether it had been greater or lower as you approached that final figure.

Diane McGiffen: We set a broad objective at the start of the period for a four-year reduction and we set outline estimates of where we planned to be. There has been adjustment within that, on which Russell Frith can give some details.

Russell Frith: At this time last year, we were projecting a smaller reduction in audit fees for the 2012-13 audit year. However, over the past 12 months, we have been able to accelerate the rate of progress towards our 20 per cent target, which has enabled us to offer a greater reduction than we would have planned at this time last year. That greater reduction is due to acceleration towards

our target rather than the target being any different.

John Pentland (Motherwell and Wishaw) (Lab): On page 2 of the Audit Scotland budget proposal, you state that you

“are on target to deliver a further 8.5% per cent reduction”

in the cost of audit in 2012-13. Your budget proposal for 2012-13 forecast a 7.75 per cent reduction. Can you explain that better-than-expected return?

Caroline Gardner: We have tried hard to set out clearly the reductions across financial years and audit years and the differences between real terms and cash terms. I will ask Russell Frith to draw out the distinctions.

Russell Frith: The difference is in relation to the difference between the audit years and the financial years in terms of what represents a reduction in our costs and how we are able to pass that on in relation to fees.

Caroline Gardner: Does that answer your question, Mr Pentland, or would you like a bit more detail?

John Pentland: That is fine.

Angus MacDonald: On page 16 of the budget proposal, the operating cost statement shows a small increase of £16,000 in travel and subsistence costs. Can you explain why there has been that increase, given that the staff complement has decreased over the past while?

Caroline Gardner: Perhaps Diane McGiffen can answer that.

Diane McGiffen: We reviewed all our budgets for travel and subsistence and looked at the mix of new audit appointments. What you see in the budget proposal is the first full-year effect of the different allocation of travel costs, which we think is now more accurate, following the appointments that were made last year. A range of things are going on in the travel and subsistence budget, including the different location of auditors, the general increase in the costs of transport and fuel, and so on. We manage and monitor that budget closely, and our new approach is an attempt at more accurate forecasting.

09:45

Angus MacDonald: For example, most public bodies have a set mileage allowance. Are you saying that you take into account the cost of fuel by resetting the mileage allowance on a regular basis?

Diane McGiffen: We have a set mileage allowance, too. We use the standard mileage allowance that HM Revenue and Customs

determines, so we work very closely with that. What has changed is that, when we rotate audit appointments, auditors' travel requirements for moving to the different audited bodies also change. We pull all the costs together so that there is no disadvantage to any audit client from us rotating auditors to ensure the independence of audit. However, that means that costs will shift, because some auditors will now have a portfolio that, for example, includes more travel than was the case the previous year. That is part of the system of audit that we have.

I do not know whether Russell Frith has more to add to that.

Russell Frith: No, that is absolutely fine.

Caroline Gardner: Another factor to add in is that we encourage our staff to use public transport wherever possible—partly because of the carbon impact, obviously—and we are seeing rising public transport costs coming into play.

Angus MacDonald: Okay.

Alex Johnstone (North East Scotland) (Con): Have we got to my question already?

Page 3 of the budget proposal submission states that Audit Scotland's capital expenditure will reduce by 42 per cent year on year. Is that mainly as a result of the fact that the 2012-13 budget included funding for an office refit and the impact of the Aberdeen office closure?

Caroline Gardner: That is absolutely right. The 2012-13 budget contained a significant element, of about £250,000, to cover the relocation of our west of Scotland office, and that will be fully spent in 2012-13. The 2013-14 budget is therefore lower and reflects almost entirely information and communication technology investment costs.

Alex Johnstone: On page 14, you anticipate a capital outlay of £900,000 in 2015 for the fitting out of the new Edinburgh office. We will not consider that budget for another couple of years, but I note that the overall 2015-16 budget is projected to be lower than the 2012-13 budget. Where do you expect to make the savings that will allow that to add up?

Caroline Gardner: Let me touch first on the indicative capital requirement for 2013-14 and 2014-15. You are right that that reflects the next stage of our property strategy. We want to continue with the process of rationalising our office accommodation as lease end dates allow. We do not yet have a firm figure for that. All that we want to do at this stage is lay down a marker that there is likely to be a significant capital cost associated with the move, which we hope will also lead to reductions in running costs and improvements in working.

On the broader cost movements within that indicative cost forecast, I will ask Russell Frith to talk you through the main movements.

Russell Frith: Mr Johnstone, did you say that the overall amount was going down?

Alex Johnstone: You have projected that your budget in 2015-16 is likely to be lower than it is for 2012-13.

Russell Frith: That reflects the continuing cost reductions that we envisage in 2013-14. After that, you can see that the total net cost is pretty static, other than on the capital side. That reflects the fact that we think that there will be modest pay increases for staff in future years in line with the Government's recent announcements.

Alex Johnstone: We asked last year whether Audit Scotland had set aside any contingency funding should any unforeseen matter, such as a section 23 review, arise and require detailed audit scrutiny or review. The Auditor General, in his "hypothetical" response, stated that such an issue would become more challenging

"as the organisation reduces in size and takes out costs."—*[Official Report, Scottish Commission for Public Audit, 27 October 2011; c 49.]*

I ask the same question again and ask whether the answer has changed since last year.

Caroline Gardner: The budget that you have in front of you is based on our existing audit responsibilities: the audit of about 211 public bodies each year; an assumption of 10 to 12 performance audits on national services and national issues; and the programme of best value audits that is carried out on behalf of the Accounts Commission.

Within those resources, we aim to achieve a balance so that we can do the planned work that we expect to do each year—looking ahead to the big issues that we know are coming—but keep a small amount of flexibility to respond to big issues that might emerge at any time.

If the responsive work that is required exceeds the flexibility that we build into the budget, our first response would be to reschedule. One example of that is the performance audit on modern apprenticeships, which was in this year's programme. We still think it is an important issue but it has been slipped into 2013-14 to make space for a piece of work that we are carrying out on managing waiting times in the national health service.

We have a bit of flexibility in the way that we schedule work to meet such unexpected demands but, as the former Auditor General said, as we head towards our target of a 20 per cent reduction

in the cost of audit, the flexibility that we have to meet such demands obviously becomes tighter.

I stress that the budget proposal that you have in front of you focuses on our existing responsibilities. If in future we are required to pick up new responsibilities—as a result of the Scotland Act 2012, for example—we will have to build them into the baseline that we have established based on our current responsibilities.

John Pentland: The commission was advised last October that significant savings had been made from Audit Scotland's information technology investment programme, but the operating cost statement shows that there will be an increase of £34,000 in your IT budget this year. Why has the budget line increased?

Caroline Gardner: Diane McGiffen will give you the details of the movements, but the broad picture is that by investing in good, modern IT we can generate savings elsewhere in the business by enabling people to work more smartly, by reducing travel time and so on. The investment in IT is reducing our costs, but not necessarily our IT costs.

Diane McGiffen: The budget includes proposals to continue investing to deliver further efficiencies through IT. They include the greater use of the next generation of Citrix access boxes to replace desktops and laptops and to enable our staff to work securely and safely very remotely. We have them in place across a lot of the business and we want to refresh and extend the use of that software, which delivers huge efficiencies for us through reduced reliance on hardware for laptops or desktops. It also generates efficiencies in running costs, as it is much more economic to run in terms of energy use. Most important, it gives our staff secure access to all the information on our servers when they access it remotely, wherever they are. That is important in light of the need for our staff to work across Scotland and the need to be able to join up the different elements of work that we do.

We are going into the second phase of investment in our technology that delivers better knowledge management across the business. We have an electronic working papers system, which all the auditors use. That is supported by the documents and records management system. Anyone in the organisation will be able to access information that all their colleagues contribute to Audit Scotland from anywhere. A bit of further investment is required in that.

We have already had great benefits from the intelligence sharing with which those systems provide us. As with any system, there is a need to continue to invest in them. Our electronic working papers will need some investment next year to

keep them up to date and ensure that they continue to meet our requirements. We also continue to invest in other associated projects that deliver more efficient working.

There are a few areas of investment that we think will really help us continue to be efficient. We have crafted the budget to ensure that, as well as reducing the cost of audit, we continue to invest so that the reductions that we make are sustainable. Some of the investment in IT helps to make the reductions sustainable because it delivers better ways of working.

John Pentland: We could probably go out and refresh IT equipment every day of the year, given the fact that new technology is ever improving. I acknowledge that you can identify that making that investment provides a financial benefit, but do you have an outcome on service delivery that can identify and prove that the investment is worth the money that you are putting into it?

Diane McGiffen: We do, particularly for our electronic working papers programme. We have examined closely the efficiency that it has delivered. That has helped us to consider the workforce planning in some areas. With, for example, the software that supports knowledge management, it is more a qualitative judgment about the greater quality of our reporting and, for example, the ability of our teams more quickly to collate information that supports better audit judgments.

We keep under review the benefits that we get. You can see them in the fact that we continue to do the work that we are required to do to a particular quality standard and on time with fewer people. Some of the benefits relate to our ability to share what we know more quickly and support better audit judgments in so doing, but it is difficult for us to evidence that to you on a balance sheet.

John Pentland: Last year, there was quite a bit of discussion about telephony system replacements. A figure of £60,000 was given. This year, it is £80,000. I assume that that is not for mobile replacements.

Diane McGiffen: We deferred the programme of mobile replacements last year because of the capacity that would have been required to run it. As we relocate some of our offices and replace some of our equipment, we need to consider a telephone system that has better access through Citrix. Therefore, the figure is for an enhancement of our core telephone system and the replacement of some mobile phones. However, we did not complete the replacement project that we forecast in last year's budget.

The Convener: The Auditor General touched on possible changes arising from the Scotland Act 2012. Earlier this year, the Finance Committee

took oral evidence from HMRC on additional financial powers that the Parliament will receive. As I understand it, the National Audit Office will cover in its annual report on HMRC a note on the expenditure relating to the Scottish rate of income tax. Is Audit Scotland involved in that in any way? Will it conduct any audits or assist the National Audit Office in any way?

Caroline Gardner: That is very much a developing issue for us, convener. I am keen that we get fully up to speed with the whole range of the implications of the Scotland Act 2012.

You touched on the Scottish rate of income tax. We also need to ensure that we are fully prepared to audit the arrangements for the collection of the replacements for stamp duty and the landfill tax in Scotland. Indeed, we also need to take account of the new borrowing powers that accrue to the Scottish Government under the act.

We have had some initial discussions with the National Audit Office about the work that it expects to have to do to audit HMRC's new responsibility in the area of the Scottish rate of income tax. However, in many ways, the responsibilities will become clearer as the memorandum of understanding between the Scottish Government and the Treasury is signed a bit later this year.

Russell Frith, who is leading on this area in the organisation, can tell you more about our thinking on those audit responsibilities.

10:00

Russell Frith: As you might be aware, the NAO audits HMRC, and we do not have direct access to HMRC records. Therefore, as Caroline Gardner says, we are starting discussions with the NAO to try to ensure that the overall amount of assurance that is provided to Parliament and the Government is suitable to reflect the significance of the Scottish rate of income tax to the Scottish budget, which might be somewhat greater than the significance of the £4.5 billion or so to the overall audit of HMRC that the NAO would normally conduct.

Those discussions are at an early stage, but one of our priorities over the next year is to ensure that the appropriate assurance arrangements are in place.

The Convener: Is there any anticipation of there being any budgetary impact or a need for an increase in budget or staffing? I realise that we are at an early stage, but budgets are tight. Might you have to ask for an increase in your budget?

Caroline Gardner: At this stage, we do not know what the implications for our budget will be, and we have tried to make that clear in our submission for 2013-14. We are already doing some work through our audit of the Scottish

Government to seek assurance about the level of preparedness in the Scottish Government for all the new powers that will come through the Scotland Act 2012. That is coming through in the Scottish Government annual audit report, and will increasingly be reported by me to the Parliament.

As the new powers come closer to implementation and we get a clearer sense of what the audit requirements are—for example, for revenue Scotland—we will be able to give you a much clearer idea of whether there will be a need for additional resource. We hope to pick up on that much more specifically in next year's budget submission, when we reach that stage. For now, however, we are doing what is required within our existing resources.

Iain Gray (East Lothian) (Lab): My colleagues have explored whether, given the cost reductions and efficiencies, we can still have confidence in the quality of service that Audit Scotland provides. You have said clearly that we can have that confidence. However, that is a concern for the 211 bodies that depend on Audit Scotland for their external audit—and, indeed, pay for that. In developing those cost reductions, what consultation did you do with those bodies in order to ensure that the measures that you were taking left them with confidence in Audit Scotland as their auditor?

Caroline Gardner: Our budget process and fee-setting process have a bottom-up element as well as a top-down element. Quite properly, you are focusing on the top-down element, which involves consideration of our overall audit responsibilities and the ways in which we can work more smartly to carry them out at a lower cost. However, at the same time, each year there is a discussion between each of the 211 bodies and their auditor about the challenges that they are facing, the quality of their internal systems and the sorts of audit risks that that throws up.

At that stage, the auditor is making a decision about the audit work and the audit fees that are required in relation to each individual body, within the limits and constraints that we set for the type and size of body. That is the point at which we consider the fine-tuning of how much audit work is required, given the circumstances of the body and the financial pressures that it is facing. As you would expect, that is quite a complex discussion, not least because the financial pressures themselves throw up audit risks, as does structural reform in areas such as the further education sector and the police, where the process of change means that more audit work might be required in order to give a proper assurance that public money is being safeguarded.

Iain Gray: If I was on the other side of this fence, as a member of one of the bodies that

might be likely to face a performance audit, I would want the Audit Scotland staff who were involved in the audit to be involved consistently from beginning to end, so that the information did not have to be provided over and over again. Sometimes, when bodies are reducing headcount, such consistency becomes difficult to deliver. Are you confident that, in reducing your staff complement, you can still ensure that consistency of staffing for particular projects?

Caroline Gardner: That is one of the advantages of the approach that Audit Scotland has taken to cost reduction, although I cannot take credit for it as it started before I took up my job as Auditor General. Taking a four-year approach to reducing costs allows us to plan to minimise the impact of the reductions on the day-to-day carrying out of the work and to make the investments that we have made in longer term efficiencies, rather than making opportunistic cuts that might have the impact that you describe.

On occasions, staff will leave in the middle of a project, but we have ways of managing round that as well, and I am confident that the risk of that has not been increased by the approach that we have taken to cost reductions.

Diane McGiffen: I will add to that with an example. As you know, we have been running a voluntary early release scheme for staff, and eight colleagues will leave Audit Scotland at the end of the year. The planning for the resourcing of the audits in which they are involved started much earlier, so there is a degree of overlap with the change in responsibilities. We have been clear in making new rounds of appointments and starting the audit year in that, if colleagues are leaving, we ensure that the clients know who their key point of contact will be and that there will be continuity. We have been able to use the long lead-in period for those departures to get experienced staff who are leaving to share their skills and experience with people who will be taking on different roles in teams. The long lead-in time to the known departures has allowed us to manage that for our clients.

We are conscious of the importance to our clients of the consistency to which you referred. Changes to personnel can disrupt the process. We know that our audited bodies value the named contact and the continuing presence of a person who knows them so that they do not have to keep repeating the same messages, and we have taken that on board in planning the arrangements. In any business, there will be unplanned departures when someone moves to a different role, and a different set of things happens there. However, in planning the managed reduction in staff, we have carefully taken those issues into account.

John Pentland: Are you finding your role with regard to Government and local government more challenging, given that a lot of experienced personnel have left for various reasons? Diane McGiffen said that you have a process in place to cover your staff reductions, but in some cases local government does not have that privilege. Are you having to spend more time with such organisations to reach your conclusions?

Caroline Gardner: It is a great question. By coincidence, earlier this week, we got together the senior people from all our audit teams—from Audit Scotland and the firms—to look ahead to the new audit year that is about to start, to share experiences and to think about the risks that they should be taking into account in doing their audit planning. One thing that is coming up consistently is that we need to look out for those signs of strain, primarily in the finance departments—there are one or two examples where a loss of skills and experience is making things tougher—but also throughout organisations. That factor is being taken into account in the bottom-up planning that goes on for each of the 211 bodies and in our top-down planning for what we do in the performance audit programme.

We are kicking off a joint piece of work for me and the Accounts Commission that will look at the way in which public bodies are managing workforce reductions. The aim is to ensure that they are doing it in a way that takes account of the impact on service levels and the people who rely on services, and that reductions are sustainable and bodies do not make cuts now that lead to increased costs further down the line because of unforeseen consequences.

We are alive to the issue, which might well make our jobs more interesting over the next two or three years.

The Convener: I have a couple of points that arose from going through the budget. First, the reader has to stay fairly alert as to what is being dealt with in the percentages and whether they are real-time figures. Looking at page 3 of the budget proposal, I note that capital expenditure is reduced by 42 per cent from 2012-13 levels. What will that reduction impact on?

Caroline Gardner: The biggest change there is the effect of relocating our west of Scotland office this year. There is a provision in the 2012-13 budget of £250,000 for the fit-out of that office, which drops out next year. That accounts for the bulk of the difference; there are some other, more minor shifts, but that is the most significant element.

The Convener: Moving on to the second paragraph on page 4, how are audit firms chosen

by Audit Scotland? What criteria do you use? Do you have a list of approved firms?

Caroline Gardner: It is a very well-developed process, which Russell Frith manages on behalf of me and the Accounts Commission.

Russell Frith: Every five years, we run a specific procurement exercise for the appointment of the auditors to public bodies. That is a very open and transparent exercise, which is conducted in accordance with European Union procurement rules. Our major criteria are experience, quality, capacity and, in the last round, price. We evaluate all the bids that we receive, in accordance with those criteria, heavily weighted towards experience and quality. From that, Audit Scotland recommends to the Auditor General and the Accounts Commission which firms should be appointed. Those appointments hold for five years unless the firm resigns or we have significant concerns about quality. Within that five-year period, if there are minor changes between audited bodies as a result of reorganisations, the replacement auditor will come from within that group of firms.

The Convener: John Pentland queried the telephony system replacements, at a cost of £80,000. Part of the response indicated that rolled up in that was upgrades for your in-house telephony system, as opposed to mobile telephones and so on. On page 8 of the budget proposal, there is a sum of £25,000 for communication room equipment replacement; I assume that that relates to the line that you were talking about.

Caroline Gardner: I think that it relates to our main servers. We use our servers for all forms of communication now. One of the developments that we are looking to implement is for telephony to be able to use our internet connectivity to bring the organisation together more effectively. I invite Diane McGiffen to expand on that.

Diane McGiffen: I can see that that is an unfortunate choice of label for that heading. It really refers to what we would have called a server room before, and the hub that we have at the heart of the information technology network. We need to do some upgrading there, particularly now that we have moved from three to two locations in Edinburgh; we need to ensure that we have sufficient back-up and business continuity ability, because we had previously located that elsewhere. A number of small upgrades are required for that.

The Convener: On the same page, the last paragraph talks about pay growth. I thought that there was a pay freeze. Does pay growth mean incremental pay rises for staff—in other words, as

they move up every year they get an increment—as opposed to a cost of living increase?

Caroline Gardner: There are two elements within our pay assumptions for 2013-14, both of which are fully compliant with the Scottish Government's pay policy. The first is the movement of staff through our pay bands. Some time ago, we moved away from having pay scales, partly because they were very long scales that built a significant amount of pay drift into our pay bill. We now have target rates, with the ability for staff to earn a small amount above that for effective performance. There is a 1 per cent assumption built in there for movement within those short ranges and 1 per cent for pay inflation, in line with the Scottish Government's pay policy. We have made an assumption of no pay growth for staff earning £80,000 a year or more; again, that is strictly in line with the Government's pay policy across the public sector.

The Convener: On page 9, under the heading "External legal and professional support", the proposal states that you have targeted a reduction of £105,000 for external consultancy support. I presume that that relates not to the audit firms that you deal with, but to another purpose entirely. Will you give a bit more information on that?

10:15

Caroline Gardner: Certainly. That matter is related to the question that Mr MacDonald asked about the way in which we respond to demands as they arise during the year and the need for us to have available particular skills and expertise for the pieces of work that we are planning in our work programme. To avoid an unnecessarily high pay bill, we keep a provision to allow us to buy in expertise as required in specialist areas and a small amount to allow us to respond to unexpected demands that are not in our planned work programme. After looking ahead to the ways of working that we are developing and our planned work programme, we think that we are safe to make the reduction of £105,000 that is set out in the submission, as an efficiency saving arising from our ways of working. That is part of the picture of getting smarter at matching our resources to the planned work programme and our ability to flex that programme as required.

The Convener: At the bottom of page 11, the proposal mentions non-pay costs. I would like to know a bit more about that. You assume that

"non-pay costs excluding fees and expenses paid to appointed audit firms"

will increase by 2.5 per cent. Will you explain those costs a bit more?

Caroline Gardner: It might be worth touching first on the assumptions on appointed audit firms,

because it is important to be clear that we are not suggesting that there will be no movement in those fees. I ask Russell Frith to pick up on that, after which Diane McGiffen will deal with the assumption on the other non-pay costs.

Russell Frith: The five-year contract that we have with the firms includes provision for their remuneration to rise by the same percentage as our base staff cost increase—the inflation increase. This year, the firms will get a 1 per cent increase in their remuneration, because that is what our staff got the previous April.

Diane McGiffen: The assumptions that we use for our non-pay costs projections, which are set out on page 11, are based on our best use of the current official expectations of the impact of price increases in those years. Members will see that not all the budgets that we propose are increasing by 2.5 per cent, because, within each budget heading for the proposed years, there will be ongoing efficiency savings. We used the best current guidance on the assumptions that we should make. The budgets take into account that there will inevitably be some inflation.

The Convener: To return to Russell Frith's comments, should the increase of 1 per cent for the audit companies actually be 1 per cent, given that the 1 per cent increase for staff is only for certain staff and higher paid staff do not get it? The cost to Audit Scotland should therefore be less than 1 per cent on average across the pay amounts. Are you saying that you give the firms a 1 per cent increase, based on the increase that has been given to staff who earn less than £80,000? Is that how it works?

Russell Frith: Yes. The link is to the inflation increase that is given to the senior auditor grade, which is our main qualified grade and which is the biggest single grade of staff. Those staff are paid less than £80,000, so the increase is 1 per cent.

The Convener: What is the logic behind that?

Russell Frith: When we went out to tender, which was two years ago now, the differentiation in pay increases in Government policies at Westminster and in Scotland was not the same as it is now. We had to come up with a mechanism that gave firms certainty over the five-year period about how their increase would be calculated. The mechanism that we chose was the inflation increase that was given to senior auditor grade staff.

The Convener: I presume that that was on the basis that it would be a senior auditor who would carry out the work.

Russell Frith: It would be staff of the equivalent grade, which is the most common grade. We had to come up with a mechanism that was clear and

relatively straightforward for the firms to take into account when they were bidding, given that part of their bid was based on price. They needed a degree of certainty as to the mechanism that would be employed during the course of the contract.

The Convener: The "Legal & Professional Fees" line of the operating cost statement on page 16 is quite up and down over the various years. This year, you propose a reduction from what was almost a record high in 2012-13. Will you explain why that line has a rather bumpy look?

Diane McGiffen: The first two columns show our actual expenditure, but the budgets in both years would have been higher. If we showed the budgets for all four years, rather than the actuals for two years and the budgets for two years, the picture would be less bumpy, although there would still be some movement.

That reflects the point that the Auditor General made. In our budget provision, this budget heading is where we make provision for some of the resourcing that we might need for unplanned work. In years in which we have not had to commit expenditure to additional resourcing to take on unplanned pieces of work, we have been left with an outturn that has been lower than the budget. The columns for the first two years show our actual expenditure, while those for the second two show our budget projections. Our actual spending could go up or down, depending on the additional resources that we require to bring in consultants or legal advisers for events that happen in the course of the year that are not in our planned programmes of work. The figures show the capacity that we have and—for previous years—the actual level of activity.

The Convener: Okay. Do members have any other questions?

John Pentland: I have one more small question. It is about the three initial community planning partnership audits that you intend to undertake, which you mention on page 4. Is that a new area of work for Audit Scotland? Are you hoping to expand it?

Caroline Gardner: Yes. It is something that the Accounts Commission has initiated this year in response to the importance of the role of community planning partnerships in the public service reform agenda. It is about improving the quality of services and focusing on prevention and reducing costs in the longer term. The approach will build on the Account Commission's experience of carrying out best-value audits in councils and broaden that out to look at the performance of CPPs in improving the circumstances of their local communities. We expect the three initial audits, which are looking at specific CPPs, to report early

in 2013. At that stage, the Accounts Commission and I will look at how well those audits have gone, what value they have added and whether the right approach in future would be to take forward that work or to shift our other programmes of work to reflect the same public service reform requirements.

John Pentland: Will a cost be associated with those audits? I ask that because many CPPs are funded to help regenerate communities, to boost the local economy and to provide help with jobs, and it would be quite shameful if a big percentage of their funding ended up paying Audit Scotland for auditing the money that they spend.

Caroline Gardner: Absolutely. The three initial audits are being funded from within our existing resources, primarily using the money that has been spent on completing the programme of best-value audits in councils and in police and fire authorities. Once we reach the stage of evaluating the audits' effectiveness and thinking about the long-term direction of that work, we will look at what the resource requirements are and how such audits can be paid for. We would certainly not expect there to be any significant call on CPPs' resources for that. Again, it is an area that we flagged up as one that we might wish to talk further to you about in the context of future resource requirements but, at this stage, there is no expectation that, in the current climate, it would require additional resource.

John Pentland: Okay.

The Convener: Members have no further questions. Do the witnesses from Audit Scotland have anything to add to their evidence?

Caroline Gardner: I do not think so.

The Convener: In that case, the commission will report to the Parliament on Audit Scotland's budget proposal so that the Finance Committee can consider it as part of its wider scrutiny of the draft budget. We will consider a draft report at our meeting on 1 November.

Audit Scotland Autumn Budget Revision 2012-13

10:24

The Convener: The next item on the agenda is Audit Scotland's autumn budget revision 2012-13. Again we have Ronnie Cleland, Caroline Gardner, Russell Frith and Diane McGiffen. Does Audit Scotland want to make an opening statement?

Caroline Gardner: I will keep it very brief, convener. This year, our end-year flexibility proposal is solely to fund fee rebates to audited bodies and not for any other projects. As the commission can see from the proposal, our underlying underspend was just over £700,000, mainly as a result of our progress in being ahead of where we expected to be in relation to our four-year cost reduction target. We think that our proposal is an appropriate way to return those resources to the audited bodies and to the Scottish Parliament block.

The Convener: Thank you. I throw it open to questions.

John Pentland: Audit Scotland has requested £515,000 for end-year flexibility. It will be returned to audited bodies by way of a reduction in audit fees to be levied in future years. The effect of that will be an average 4.9 per cent reduction in audit fees for one year. Why is the amount requested lower than in previous years?

Caroline Gardner: I ask Russell Frith to take you through the detailed figures.

Russell Frith: We have used the same underlying mechanism to work out the amount to be refunded to audited bodies. We start with the level of overall underspend that Audit Scotland had at the end of last year. As it was lower than at the same time the previous year, less money is potentially available to return to audited bodies. The request is entirely a function of the underspend that occurred in our accounts for the previous year.

John Pentland: If you are going into an overspend or creating an end-year flexibility contingency, that will have come about because organisations have been overcharged in the first instance. They can ill afford that at this time, but they will still have to wait until later to get payback. Is there a more secure charging mechanism so that it is not necessary to create those big contingencies?

Russell Frith: We have been trying—generally successfully—for the past few years to tighten up our budgeting so that the level of underspend at the end of the year comes down. However, in the

past two years, in comparison with our plans, we have accelerated our ability to reduce our costs. If we were in a totally steady-state environment, I would say that your raise a fair point. However, the amount is available because we have been more successful than we anticipated in relation to the speed at which we have reduced our overall costs. In effect, the audited bodies are benefiting from something that we did not originally think they would be able to benefit from, because we thought that it would take us longer to reduce our costs.

John Pentland: Okay.

Alex Johnstone: When we spoke to you last year, we asked if you had been making it clear to the audited bodies that the discount was non-recurring and unlikely to be applied year on year. Did you do that? How did they respond?

Russell Frith: Yes, we made it clear that we thought that the discount would be non-recurring because, at that stage, we did not anticipate the degree of success that we would have in reducing our costs. As ever, those bodies are happy to receive a refund, however it is described.

Alex Johnstone: I presume that you will be keeping them informed that is not likely to recur unless similar progress is made.

Russell Frith: Indeed we will.

Alex Johnstone: Thank you.

Angus MacDonald: If the discount recurs, will that be made explicit in the advice that Audit Scotland sends out to audited bodies?

Russell Frith: Yes, and it is covered in the letters that we send out informing the bodies of next year's fee levels.

The Convener: It is probably difficult for you to answer this, but do you anticipate that in future the amount of end-year flexibility might be at the same level as this year's level? Is that your plan?

Caroline Gardner: We would expect it to be lower in future. As Russell Frith said, last year's underspend reflects faster-than-expected progress towards our 2014-15 target. As we approach that target, I expect that our ability to deliver much below budget will be reduced. It is worth stressing that we do not have any other mechanism for carrying forward reserves from one year to the next. One of the worst things that I could do would be to deliver an outturn that is higher than budget and a qualified set of accounts for Audit Scotland. We are very careful to make sure that we have enough confidence in our approach to the budget that there is no risk of overspending.

The underspends should reduce, but you will probably always see underspends because we simply cannot afford to overspend against our

budget because of our own reputation for probity and financial management.

10:30

The Convener: Are there any other questions?

John Pentland: Is the audit fee that Audit Scotland charges when it goes into an organisation the same as the fee that it charges when it sends in a private company? Do you make a percentage profit from sending in a private company?

Caroline Gardner: Russell Frith will talk you through the way that works in practice.

Russell Frith: We aim to break even across the piece. We do our utmost to make sure that there is no difference in the amount that an audited body is charged because of who the auditor is. An audited body should not see any difference in the amount that it pays whether an audit is carried out by one of the private firms or by one of our in-house teams.

John Pentland: Does Audit Scotland make any money from sending in a private firm?

Russell Frith: No.

The Convener: As there are no more questions from members, would Audit Scotland like to add anything to its evidence?

Caroline Gardner: We are comfortable that the proposal before the commission sets out our requirements for the year ahead and balances the pressures on all public bodies with the need to keep quality up. If the commission has any further questions after the meeting, we will be happy to answer them; otherwise, we thank you for your time this morning.

The Convener: Thank you for attending and for your evidence. We now move into private session to discuss the evidence that we have heard.

10:32

Meeting continued in private until 10:42.

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