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The Scottish Commission for Public Audit is not formally a parliamentary committee. The Commission was established under Section 12 of the Public Finance and Accountability (Scotland) Act 2000 and is made up of 5 MSPs.

The main areas of responsibility of the Commission are to:

a. examine Audit Scotland’s proposals for the use of resources and expenditure and report on them to the Parliament;

b. appoint a qualified person to audit the accounts of Audit Scotland;

c. lay before the Parliament and publish a copy of Audit Scotland’s accounts and the auditor’s report on them;

d. appoint three of the five members of Audit Scotland on such terms and conditions as the SCPA determines;

e. appoint one of these three members to preside at meetings of Audit Scotland.
Commission Membership

Chair
Colin Beattie
Scottish National Party

Deputy Chair
John Lamont
Scottish Conservative and Unionist Party

Alison Johnstone
Scottish Green Party

Rona Mackay
Scottish National Party

Jenny Marra
Scottish Labour
Introduction

1. Section 11(9) of the Public Finance and Accountability (Scotland) Act 2000 requires that Audit Scotland prepares proposals for its use of resources and expenditure and sends these proposals to the Scottish Commission for Public Audit (“the Commission”). The Commission then examines the proposals and reports to Parliament on them.

2. As Audit Scotland’s budget forms part of the total Scottish budget, the Commission particularly directs this report to the Finance and Constitution Committee in order to assist that Committee in its wider scrutiny of the Draft Budget for 2017-18.

3. Audit Scotland submitted its budget proposal for 2017-18 and associated fee strategy on 7 December 2016 in recognition of the timescale for scrutiny of the 2017-18 Scottish budget. The Commission took oral evidence on the budget proposal and fee strategy at its meeting on 21 December 2016. Specifically, the Commission took evidence from Ian Leitch, Chair of the Board of Audit Scotland; Caroline Gardner, Auditor General for Scotland; Russell Frith, Assistant Auditor General and Diane McGiffen, Chief Operating Officer for Audit Scotland.
Budget Proposal and Fees Strategy

Overview

4. Audit Scotland’s budget proposal for 2017-18 is £6,531K which represents an overall cash reduction of £51K (-0.8%) on the approved 2016-17 budget. The Audit Scotland budget proposal was accompanied by a fee strategy which recommends that the funding of NHS performance audit work should come entirely from the Scottish Consolidated Fund (SCF). At present, 60% of this work is funded from the SCF and 40% by NHS boards. The fee strategy is considered later in this report. Excluding this proposed additional cost to the SCF and the cost of the biennial National Fraud Initiative (NFI) which was funded in 2016-17, Audit Scotland state that—

the revenue support sought in 2017-18 on a comparable basis has been reduced by 5.4%. In real terms (2016-17 prices) this represents a 7.0% reduction

5. The gross administrative costs proposals for 2017-18 are £1,060K which represents a 4.3% reduction, in cash terms, on the 2016-17 budget. Within this total, staffing costs are proposed to be £122K higher, or 0.8%, than the 2016-17 budget. Audit Scotland primarily attribute this increase as being due to an assumed pay increase for staff of 2%.

6. The increase in staffing costs is offset by other administrative costs being £1,182K, or 12.4%, lower than the 2016-17 budget. This reduction is a consequence of a procurement exercise to appoint external firms to carry out audit for the next five years. This has resulted in the fees and expenses being paid to external audit firms being £1,060K lower than the 2016-17 budget. The Auditor General summarised the budget proposal in the following terms—

“The proposal will deliver an average real-terms reduction in audit fees of 8.6 per cent for the 2016-17 audit year, which has just started; a 2.6 per cent real terms reduction in the revenue resource requirement sought from the Scottish consolidated fund; simplified funding arrangements for the NHS performance audit;... a reduction in our gross administrative costs of just over £1 million or 6 per cent of our expenditure budget for the year; and greater transparency in our funding arrangements

7. Audit Scotland’s budget proposal highlights new areas of audit work, arising from legislative change, which will impact on the work of Audit Scotland in 2017-18. This includes audit of 30 Integrated Joint Boards (IJB) created under Public Bodies (Joint Working) (Scotland) Act 2014; audit work in relation to Revenue Scotland as new tax powers come into force; and, work in relation to the financial aspects of the Scotland Act 2016. In addition, Audit Scotland emphasised that the budget proposal had been prepared in the context of a number of uncertainties.
These uncertainties include the scale of work required as a consequence of the Scotland Act 2016 and the impact of the recent European referendum result. The Auditor General commented on these uncertainties in the following terms—

“The budget proposal was prepared in the context of some uncertainty, in particular, the amount of work that will be required as a result of the full implementation of the Scotland Act 2016 and, of course, any further devolution of powers as a result of the impact of the referendum on the European Union. The proposal in front of you is based on our known workload. As our audit responsibilities change in the light of those developments, we will obviously discuss further the resource requirements with the commission.”

8. The Commission welcomes the work that Audit Scotland has undertaken to achieve efficiency savings and recognises the commitment of Audit Scotland to obtaining value for money whilst safeguarding the quality of audit. The Commission notes the uncertainties highlighted by Audit Scotland which provide a wider context to the budget proposal and looks forward to discussing these issues with Audit Scotland in due course.

Resource Expenditure: new areas of work

9. The Commission sought clarification with regard to the areas of new work and the uncertainties highlighted by Audit Scotland in their budget proposal with the witnesses from Audit Scotland. In response to questioning with regard to the audit arrangements for IJBs the Auditor General stated—

“All the funds spent by the joint boards will come from local authorities or the NHS. At the moment, we think that spend is about £8 billion a year, which is a significant amount of public money. It is an area where the strengths of the public audit model are apparent. The Accounts Commission appoints the auditors to the bodies and can report on problems that occur in the individual bodies. However, because of the significant amount of NHS funding that comes through them, I will also have oversight and can report back to the Public Audit and Post-legislative Scrutiny Committee.”

10. With regard to constitutional change, the budget proposal notes that the 2016-17 budget included £100K under workforce to provide support for the assessment of any additional work arising from the new financial powers. The budget proposal states that this resource will continue to be required in the 2017-18 budget and in projections for the following two years to take account of constitutional change arising from the Scotland Act 2016 and the European referendum result. The Commission queried how the additional resource in this area would be utilised. The Auditor General commented on this issue that—
“The £100,000 pays for an assistant director who we have tasked with leading our thinking in the area. The money accounts for the full cost of the post and for his and his team’s development. It is to ensure that we are thinking through the audit implications, managing them well, building up our expertise and coming to you with a credible plan for the resources that we need for the longer term as that thinking develops. Since June, we have asked the assistant director to take on responsibility for the implications of the EU referendum. We do not know what that will mean for Scottish public finances – that is, what funding will be devolved to Scotland and what audit arrangements will be needed. We will do that in a joined-up way.”

11. The Commission understands the need for forward planning to deal with constitutional change. However, the Commission wishes to receive further information on the £100K being utilised in this area. Specifically, the Commission seeks clarification as to whether the assistant director is required to undertake his previous responsibilities or whether these have been reallocated.

Quality of Audit work

12. As noted above, Audit Scotland’s other administrative costs budget is forecast to decrease by 12.4% which is largely a result of a procurement exercise to appoint external firms to carry out audit work which has resulted in the fees and expenses being paid to these external firms being budgeted to be £1,060K lower than the fees and expenses budget for such work in the 2016-17 budget. The Commission raised concerns that whilst such significant savings are welcome this could result in a risk of poorer quality audit work being undertaken. The Audit Scotland budget proposal notes that a review of Audit Scotland’s quality arrangements is currently underway and that the budget proposal for 2017-18, and projected for two further years, of £100K to support an enhanced quality regime.

13. The Chair of the Audit Scotland board responded to the concerns raised by the Commission by observing that—

“The board probed that question, because it is a matter of concern. … we are satisfied that, by enhancing our quality regime and putting in additional resource, we can check to ensure that the competitive fees that we got in the procurement round will not result in a poorer audit service. We are bolstering that so we can do more checks on that work.”

14. The Assistant Auditor General elaborated further on this issue as follows—

“Our quality expectations were made clear to the firms before the tender round. We are investing in enhanced audit quality arrangements to ensure that we can continue to give assurance to the Auditor General, the Accounts Commission and indeed the Scottish Commission for Public Audit
about maintaining and improving the quality of audit. It is absolutely right that we see the discounts that were offered as potentially posing a risk to audit quality. We are aware of that and we plan to ensure that does not happen.”

15. The Commission sought reassurance that the quality regime would also be applied to the in-house audit work carried out by Audit Scotland. The Auditor General responded—

“That is one of the things that I am keen for us to do. At the moment, we have different information about the in-house teams and the firms, and there should be a level playing field. We are also looking at how we assure the quality of the performance audit work, which is what the Public Audit and Post-legislative Scrutiny Committee sees most directly. All of that will be on a common basis.”

16. Lastly, the Chair of the Commission also raised concerns in this area, particularly with regard to the work of internal and external auditors in relation to Coatbridge College, Edinburgh College and NHS Tayside. The Auditor General responded to the concerns raised by stating—

“We have quality arrangements in place and I am satisfied that the auditors that we appoint are all meeting the requirements that we place on them. That is clearly not quite the same thing as the impression that you take from them when they appear before you as witnesses. There may be more that we can do to support them to perform as well as they can in that setting.”

17. The Commission notes the reassurances provided by Audit Scotland but continues to have significant concerns about the impact of a reduction in fees upon the quality of audit work which has been heightened by experience of recent audit work in relation to the three examples cited above. Accordingly, the Commission seeks further detail in relation to what measures Audit Scotland is putting in place to ensure quality including how the £100K budget for this purpose will be allocated. The Commission gives notice that this is an issue which it intends to take further evidence on.

**Efficiency Savings**

18. The budget proposal highlights three areas of efficiency savings and cost reductions which result in a reduction of 6.5% in gross expenditure as compared to the 2016-17 budget. This reduction accrues from three areas. Firstly, a reduction in staffing costs of £542K. Staffing costs account for 64% of Audit Scotland’s proposed expenditure in 2017-18. A combination of a Voluntary Early Release Arrangements programme implemented in 2016-17, a restructuring of administrative services (considered below) and a reassessment of workforce...
requirements within financial and performance audit teams is anticipated to reduce costs by £542K. Secondly, an audit procurement exercise (discussed above) is expected to realise a reduction in fees paid to external firms of £864K. Lastly, a further outcome from the audit procurement exercise is that the volume of audit work allocated in-house has increased. This work will be accommodated without additional resource which is expected to result in an efficiency saving of £196K. This results in total efficiency savings of £1,602K.

19. The Commission questioned how in-house audit teams could undertake work previously carried out by external firms without any additional resource being required. The Auditor General commented—

“An additional £196,000 worth of work that we had expected to go to the firms went to the in-house teams, without any increase in those teams’ resources to take it on. We are confident that they can cover through smarter working, the use of technology, which we talked about, and the investments that we are making in one organisation working. In effect, we are generating an extra £196,000 worth of efficiencies as a result of the fine tuning of the audit appointments at the end of the process compared with what we expected at the start of it”\(^{10}\).

Business restructuring

20. The 2017-18 Audit Scotland budget includes proposals to restructure administrative support arrangements in order to deliver longer term savings. A budget of £100K has been allocated to fund the transition to a new structure. The Commission sought further information on the rationale for this process and reassurance that genuine efficiency savings will be realised and not result in administrative tasks being passed to other members of Audit Scotland staff. The Auditor General summarised the context for the restructuring exercise as follows—

“The background is the move that we made in 2015 from two offices in Edinburgh to a single office. We previously had two offices, each of which was on five floors and had lots of different rooms, but we now have one office that is all on a single footprint, with much more efficient ways of working and better use of technology. Together with the ways in which we are changing our staffing and how people work more widely in Audit Scotland, that means that we need quite different administrative support from what we needed previously.

Against the backdrop of a policy of no compulsory redundancies, we have designed the structure that we think that we need to support our business, which has involved going through a process of supporting our existing staff to apply for roles in the new structure. We are looking for the provision in the 2017-18 budget that you mentioned to enable us to redeploy the staff who were not matched into jobs in the new structure”\(^{11}\).
21. With regard to ensuring that genuine efficiencies would be generated from the restructuring exercise, Diane McGiffen, Chief Operating Officer, stated—

“We continually look to maximise efficiency, and it would not be efficient for us to displace work so that it went to our audit teams – those teams would be the first people to tell us that. We are seeking the opportunity to have projects and support that add greater value to audit teams in delivering their work. However, what that looks like has changed significantly since the teams were established and it is time for us to resolve that.”

Information Technology

22. The 2017-18 budget proposal seeks an increase in expenditure on information technology from £367K in 2016-17 to £436K in 2017-18. Audit Scotland’s entire proposed capital budget of £200K for 2017-18 is allocated for expenditure on information technology. The Commission queried the increase in expenditure in this area. Audit Scotland responded in the following terms—

“The resilience and reliability of our IT are critical to the business. The more our colleagues who carry out auditing in public bodies travel around and work across Scotland, the greater is the resilience that we need in the IT service to keep them able to work and to access secure networks and so on. Much of the additional cost that is shown in appendix 1 relates to ongoing improvements to resilience and security.

This year, we achieved a lot in achieving our ISO accreditation, to ensure that we hold data in a very secure way, and we were pleased to get that. We are continuing to invest in equipment that enables our teams to work from anywhere and at any time. The investment is the on-going investment in IT resilience and security.”

Income and Fee Strategy

23. The Audit Scotland budget proposal is accompanied by a fee strategy which supports the budget proposal. Audit Scotland is responsible for setting audit fees which accounts for around 75% of the organisation’s total income. Audit Scotland conducted a review of funding and fee setting arrangements in 2016. As part of the review process, Audit Scotland consulted with audited bodies and other stakeholders. The fees strategy document summarised the outcomes of this consultation as being that respondents—

“Agreed that audit fees should be set with the objective of recovering the full cost of audit in each sector;

Supported the principle that an audited body should pay the same fee irrespective of who is appointed to deliver the audit;

Agreed that some costs therefore be pooled across each sector.”
24. The principal change proposed in the fee strategy is that whilst the consultation found that the arrangements for most of Audit Scotland’s work were appropriate and well understood, respondents to the consultation considered that “there was scope to reconsider the funding of NHS performance audit work”\(^\text{15}\). At present, NHS performance work is funded 60% from the SCF and 40% by NHS boards. This funding structure differs from all the other sectors within the remit of the Auditor General where all performance audit costs are funded from the SCF. The Auditor General observed that the background to the funding arrangements for NHS performance audit work dated back to the establishment of Audit Scotland. The Auditor General commented—

> “At that time, all the performance audit for local government and the NHS was funded through audit fees within the Accounts Commission regime. When Audit Scotland was formed, it became clear that the local government regime would continue at arm’s length but that the performance audit in the NHS would have a benefit to the Parliament as well as to the NHS boards. Therefore, the decision was taken at the point that it made sense to share the costs between them, and 60:40 was an estimate of where the benefits might lie.

Our experience of carrying out the fee review over the past year or so has been that it is now an outlier – it is the only area where the costs are split between the Scottish consolidated fund and audit fees – that is inconsistent with the way in which all the other audit performance work that is carried out for the Parliament is done. It is difficult to explain to people and means that the fees in different sectors move at different rates for reasons that have very little to do with the work that is done for individual bodies.

It seems to us that, if the commission is happy to support it, what is proposed would be quite a straightforward way of simplifying the funding and fee arrangements, making them more transparent and making it clear that performance audit is one of the key parts of the support that we provide to the Parliament in overseeing the use of public money.

The short answer to your question is that it happened a long way back in the mists of time”\(^\text{16}\).

25. The Chair of the Commission recognised that the impact to Audit Scotland of the proposed change to the treatment of NHS performance audit work would be cost neutral. However, the Chair questioned whether such a change would result in an increase in the NHS budget, and thereby to the SCF, and therefore would not be something that the Commission would be competent to agree to if it resulted in an increase to the SCF. The cost to the SCF would be in the region of £495K. The Auditor General responded that—

> “I think that it would actually mark a very small – miniscule in the scheme of things – saving to NHS budgets. I do not imagine that the Scottish
Government would want to reallocate the funding away from the NHS. It is one of the things that contribute to the reduction in the audit fees that you will see in the audit proposal for that sector\textsuperscript{17}.

26. In later written correspondence on this issue, Audit Scotland stated—

\begin{quote}
“We discussed the principle of requesting parliamentary funding for NHS performance audit work with Scottish Government Health Directorate staff when consulting on the fee strategy, and no concerns were raised.

If the SCPA approves this transfer, the effect would be a reduction of £495,000 in NHS audit fees. We consider it would be a matter for the Scottish Government to determine if any adjustment needed to be made to the allocation to health boards in the context of a total health budget of more than £13bn for 2017-18\textsuperscript{18}.
\end{quote}

27. The fee strategy seeks to achieve the objective of recovering the full cost of audit within each sector. The Commission queried whether, in addition to full cost recovery within sectors, plans were in place to ensure individual bodies are only billed for the actual audit service they receive. The Auditor General commented on this issue in the following terms—

\begin{quote}
“We are not looking to recover the cost at the level of the individual body each year. We have focused on doing that at sector level, matched with greater transparency for individual audited bodies about what they are paying for. Bodies can see the breakdown in the fee strategy, where there will be four lines showing the direct cost of audit, the pooled costs, performance audit and the overhead costs for which they are making a contribution. Bodies get much more transparency. The sector will balance overall and individual fees will move across the life of the audit appointment, depending on our experience of doing that audit\textsuperscript{19}.
\end{quote}

28. The Commission approves the fee strategy including the change to the funding of NHS performance audit work.

29. The Commission encourages Audit Scotland to give further consideration as to how there could be a closer alignment between the fees charged to individual audited bodies and the cost of the actual audit service they receive.
Conclusion

30. The Commission recommends that Audit Scotland’s budget proposal for 2017-18, including the request for a total resource requirement of £6,513K, is approved.

¹ Audit Scotland Budget Proposal 2017-18, p.6
Scottish Commission for Public Audit
Audit Scotland's Budget Proposal for 2017-18, 1st Report, 2017 (Session 5)

3 Ibid

7 Ibid

9 Ibid

14 Audit Scotland Fees Strategy, p.8.
15 Ibid, p.8

18 E-mail correspondence from Audit Scotland to the Secretary to the Commission, 21/12/16.
Annexe A

Extracts from the minutes of the Scottish Commission for Public Audit and associated written and supplementary evidence

2nd Meeting, 2016 (Session 5) Wednesday 21 December 2016

2. **Audit Scotland’s Budget Proposal for 2017-18 and Fees Strategy**: The Commission took evidence from—

   Ian Leitch, Chair of the Board, Audit Scotland; Caroline Gardner, Auditor General for Scotland; Russell Frith, Assistant Auditor General, and Diane McGiffen, Chief Operating Officer, Audit Scotland.

   The Commission agreed to write to the Finance Committee with its views on Audit Scotland’s budget proposal.

**Written evidence**

[Audit Scotland budget proposal 2017-18](#)

[Audit Scotland Fees Strategy](#)