

MEETING OF THE COMMISSION

Tuesday 19 June 2012

Session 4

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SCOTTISH COMMISSION FOR PUBLIC AUDIT
4th 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:

Mr Robert Black (Auditor General for Scotland)

Ronnie Cleland (Audit Scotland)

Steven Cunningham (Alexander Sloan)

Russell Frith (Audit Scotland)

Andrew McBean (Alexander Sloan)

Diane McGiffen (Audit Scotland)

SECRETARY TO THE COMMISSION

Fergus Cochrane

LOCATION

Committee Room 4

Scottish Commission for Public Audit

Meeting of the Commission

Tuesday 19 June 2012

[The Convener *opened the meeting at 11:00*]

Decision on Taking Business in Private

The Convener (Colin Beattie): Good morning, everybody. Welcome to the fourth meeting in 2012 of the Scottish Commission for Public Audit. I remind everybody to ensure that their mobile phones and other electronic devices are switched off. There are no apologies.

Agenda item 1 is to agree to take item 4, which is consideration of a paper on Audit Scotland's corporate governance, in private. Are members content to do so?

Members *indicated agreement.*

Audit Scotland Annual Report and Accounts and Auditor's Report

11:00

The Convener: Item 2 is consideration of Audit Scotland's annual report and accounts for the year to 31 March 2012 and the auditor's report on the accounts.

The commission is responsible for securing the audit of those accounts and has contracted the chartered accountants Alexander Sloan to take on that role. We will hear first from Audit Scotland and then from Alexander Sloan.

I welcome Mr Robert Black, the Auditor General for Scotland, who is the accountable officer for Audit Scotland. This is your last appearance before the commission so, on behalf of the members, I wish you a very happy retirement although, from what we have heard, you might not spend your time swinging a golf stick. Nevertheless, we wish you very well on your retirement.

Mr Robert Black (Auditor General for Scotland): Convener, I am glad that you recognise my face because, the last time we met, you made some very generous comments about my time in office. In many ways, it is cleaner and more appropriate that I leave at the end of the parliamentary year, so that I have the opportunity to present and be held to account for Audit Scotland's annual report for the last year. Thank you for your comments.

The Convener: We also have, from Audit Scotland, Mr Ronnie Cleland, chair of Audit Scotland's board; Russell Frith, the assistant auditor general; and Diane McGiffen, chief operating officer.

I invite Mr Black to make some opening comments.

Mr Black: If it is acceptable to you, Mr Cleland will offer one or two comments.

The Convener: That is fine.

Ronnie Cleland (Audit Scotland): Thank you for your invitation to meet the commission this morning. The last couple of times I have been in this room, I have sat in the public gallery, so I am familiar with the format and welcome the opportunity to be at the table.

I will say a few words about the governance of Audit Scotland as a precursor to Bob Black taking you through the report and accounts. As you know, the board comprises me; John Baillie, who is the chair of the Accounts Commission; Bob

Black, as the Auditor General; and two independent non-executive directors, Mrs Katharine Bryan and Mr John Maclean. The board works within a framework that sets out the principles of partnership working between the Auditor General, the Accounts Commission and Audit Scotland. The framework helps the three parties to work together effectively to deliver their mission of public audit. The board met 10 times during the year.

There are two main board committees. One is the audit committee, which is chaired by John Maclean, with a membership of John Baillie and Katharine Bryan. It met four times during the year. The other is the remuneration committee, which is chaired by Katharine Bryan, with John Baillie, Bob Black and John Maclean as its members. It met three times during the year.

I will give a small snapshot of the audit committee's areas of work—there is more information in the report and accounts. Its role is, among other things, to manage and maintain risk, to receive and interrogate financial information and to appoint internal auditors.

The remuneration committee's areas of work include reviewing and approving remuneration policy and practice for the organisation, ensuring that an effective performance management and appraisal system is in place and considering the effective use of the human resource within the organisation. We have developed the role of the remuneration committee over the past couple of years or so, particularly since Mrs Bryan took on the chairmanship, and I am grateful to her for that.

As a board, we ensure the timely development and implementation of our corporate plan. We ensure that Audit Scotland's policies and procedures comply with legislation, reflect best practice and are administered openly, transparently and fairly. We consider and approve the work of the audit and remuneration committees.

As the chair, I take responsibility for the board's performance, which I monitor on an on-going basis. We have talked a wee bit about that before in other fora. Performance is monitored against the objectives that the commission set for me in my letter of appointment.

That is a snapshot of how the board operates, where it sits and what its responsibilities are. I will hand over to Bob Black to lead members through the annual report and accounts.

Mr Black: I will be brief, because members have the papers. I will mention quickly the business achievements and the work highlights. On business achievements, we are making good progress on implementing our four-year plan to reduce audit fees and our costs by at least 20 per

cent in real terms by 2014-15. That includes reducing audit fees by a further 5.5 per cent in 2011-12.

Efficiency savings continue to be delivered—£3.3 million of efficiency improvements were achieved—and quality continues to be maintained. We went through a procurement exercise, which Russell Frith led, to appoint the firms that work in partnership with us. We introduced a price element into that, which will save £1.2 million a year. We have built that into the numbers that are before the commission.

Over a year, the Public Audit Committee sees all the performance audit work that we have undertaken. We published 27 performance audit reports and best-value audits during the year—that is our highest-profile work. Beneath that, every audited body in Scotland gets a final audit report, of which 211 were produced. The appointed auditors produced well over 700 reports for audited bodies.

We got a very good response to the survey that Russell Frith's team organised of central Government and local government bodies—97 per cent of central Government bodies and 100 per cent of local government bodies think that our audits provide a high-quality service.

Through the national fraud initiative, we have identified cumulative overpayments and savings that amount to £78 million.

On the whole, we have had a good year. As ever, my colleagues and I will do our best to answer questions. I will rely particularly on Russell Frith and Diane McGiffen to answer the commission's detailed questions, because of their continuing roles in the foreseeable future as, in Diane's case, chief operating officer and, in Russell's, assistant auditor general.

The Convener: Before I throw open the meeting to members' questions, I would like clarification of a couple of points. On page 3 of the annual report and accounts, one highlight of 2011-12—Mr Black touched on it—is:

"Reduced 2010/11 audit fees by 5.5%".

That was also a highlight in the 2010-11 annual report. Is that an error or has the same reduction in fees—5.5 per cent—been achieved in both years?

Russell Frith (Audit Scotland): We reduced fees by that sort of figure in both years. The reduction for the 2010-11 audits was the first stage of our cost reduction process, which included reducing fees in relation to the introduction of the international financial reporting standards in central Government and the health service. Although the amounts vary between sectors, we managed another reduction of a similar average

amount in 2011-12, when we started to make even more progress on our cost savings.

The Convener: I remember that a reduction of 20 per cent was mentioned someplace, but I do not remember whether that is what Audit Scotland has achieved or whether that is your aspiration.

Russell Frith: Twenty per cent in real terms is our aspiration over a four-year period starting with the 2010-11 reductions and going through to 2013-14. We believe that we are very much on track—in fact, we are slightly ahead of track—to achieve that.

The Convener: Excellent. You said in your annual report for 2010-11 that Audit Scotland made efficiency savings of £1.6 million, and the 2011-12 annual report states that £3.3 million of efficiency savings were achieved. Can you confirm that those are cumulative figures? In other words, is the total £4.9 million for the two-year period?

Diane McGiffen (Audit Scotland): The savings that we quoted for 2011-12 were all achieved in 2011-12 and the savings for the previous year were achieved in that year. I do not think that anything carries forward on a cumulative basis, but I can certainly provide you with more detail on that, if you would like.

The Convener: Is there a great deal more to be achieved in efficiency savings?

Diane McGiffen: We have been working very hard on efficiency savings, as has the rest of the public sector. I think that we all believe that our efficiency savings will not reach the same level in subsequent years that they did this year, because we have made faster progress than we intended in some of the main areas of cost reductions, in particular in changing the mix of skills in the organisation. We are making good progress and are on track to achieve the 20 per cent reduction that we discussed, but we would expect—all other things being equal—the efficiency savings that we will be able to achieve in future years to be of a lower level.

Russell Frith: Within the 2011-12 savings figures, there is only £465,000 of the £1.2 million that we expect to save each year from the reappointment of firms, so another element will come in next year in relation to that.

John Pentland (Motherwell and Wishaw) (Lab): Good morning. Page 10 of the annual report states that Audit Scotland achieved 12.5 per cent efficiency savings on its budget, which is equal to £3.3 million in 2011-12. Page 5 states that your overall savings target is 20 per cent efficiency savings by 2014-15. Is your target still 20 per cent and is your timescale still by 31 March 2015?

Mr Black: Twenty per cent remains the target. The other numbers chart our progress towards that target by the end of the spending review period. As both Diane McGiffen and Russell Frith indicated, we are ahead of schedule in moving towards that target.

John Pentland: Will the drive for efficiency have an adverse impact on the service that you continue to deliver?

Mr Black: That is a critical question, if I may say so. My colleagues and I in Audit Scotland have been very concerned to ensure that there is no adverse impact. I am sure that Russell Frith can give you more details of the methods by which we are safeguarding the quality of the audit. However, essentially, what we have been doing is refreshing and refining the audit model, with a greater emphasis on good risk assessment, and developing new electronic working packages, which make the process more efficient. In reducing the size of the workforce to reshape the teams, we have also had the opportunity to get the right skills in place that are needed for modern audit work. Alongside that, Russell's team, which stands somewhat to one side of the audit activity, oversees the quality assurance work that we undertake. He can give you an indication of the positive assurances that have been given to me in that regard.

11:15

Russell Frith: Quality was one of the key criteria with which we evaluated the tenders that we let for the appointment of the firms, and our strong commitment on that remains. This year, in order to boost our internal quality monitoring arrangements, we invited for the first time the Institute of Chartered Accountants of Scotland, which is the regulator and quality monitor of the private firms that are registered with it, to come and look at our in-house teams' work. In January, it reviewed our overall arrangements and six of our audits. We brought it in to give an external perspective to quality to ensure that we are at least maintaining—and preferably improving—the quality of the audits.

John Pentland: Are you doing more in-house or are you outsourcing more to meet your efficiency target?

Russell Frith: We let the contracts in 2011 for the next five years, so we are keeping the amount of work that is undertaken by firms roughly the same, at around 38 per cent. The rest is undertaken by the in-house teams.

John Pentland: My next question is about VAT. An increased accrual for outstanding VAT of £218,000 is noted on page 13 of the annual report, and note 18 on page 45 mentions a potential

further VAT liability of up to £300,000. Can you provide some background on the VAT situation and the reasons for the £218,000 accrual, the contingent liability and the current situation vis-à-vis the contingent liability having to be fully provided for?

Russell Frith: Audit Scotland's VAT position has been a somewhat grey area ever since it was formed. It took from 2000 to 2006 to get a final agreement with Her Majesty's Revenue and Customs on the status of the audit element of our work, which is the vast majority of our work. At that point, the position on the other income that we get for secondments to other public bodies and occasional pieces of audit work for other audit agencies, for example, was still left a little unclear. We registered for VAT with effect from 2009 for that additional element—secondments and the additional audit work. Based on professional advice that we have received over the past two years, we have recognised that we probably should have registered back to 2006, when we reached agreement on the audit work side with HMRC. We made the additional charge to the accounts this year to recognise the move back to 2006.

We are still in discussion with our advisers and HMRC to get absolute clarity on what the date of registration should be. The position is somewhat complicated by the fact that Audit Scotland has a completely unique arrangement in relation to its VAT. All the audit agencies in the United Kingdom have different arrangements, which does not help to provide clarity on what the situation should be. The worst-case scenario would be an agreement that goes right back to 2002. That would be where the additional £300,000 would come in. My view is that we have a very good case for stopping at 2006, which was when we reached agreement with HMRC for the bulk of our activities, and that is the line that we are pursuing with it.

John Pentland: Thank you.

Angus MacDonald (Falkirk East) (SNP): Good morning, panel. I draw your attention to page 14 of the report. The fees paid by further education colleges go against the general trend in increasing from £560,000 in 2011 to £598,000 in 2012. Can you explain that increase, given the falling trend in other sectors and the reduced audit fees that are being charged by Audit Scotland generally?

Russell Frith: Certainly. As we showed in the fee strategy that supported the budget for this year, which we presented to the commission in September 2010, the further education sector was the one sector in which we did not anticipate early reductions in audit fees. The main reason for that is that, at that point, all the FE colleges were audited by firms, not by the in-house teams. We were still in the fourth and fifth years of the

previous audit appointments, so there was no scope to reduce the audit fees for that sector until we let the new appointments. Even then, as we expected, the firms offered significantly lower discounts—the discounts were virtually nil—in relation to the FE sector, because all the auditors involved thought that the fees in that sector were extremely tight. That was the case to a much greater extent than it was in the other sectors.

Angus MacDonald: Given that FE colleges paid £598,000 for audit work in 2011-12, why were appointed audit firms paid £623,000 for audit work on the FE colleges in 2011-12?

Russell Frith: I am sorry. Where does the figure of £623,000 come from? Does it come from the notes to the accounts?

Angus MacDonald: Yes. It is stated that £623,000 was paid to appointed audit firms in 2011-12.

Russell Frith: The two ways of getting to the numbers are because of slight timing differences.

Iain Gray (East Lothian) (Lab): I want to ask a couple of questions about remuneration, which refer to the "Remuneration Report" section of the annual report and the table on page 18.

Audit Scotland is affected by the public sector pay freeze that is in place, but the table on page 18 appears to show that one member of staff moved up by two pay bands and two members of staff moved up by one pay band. Those members of staff have seen a significant increase in their salary—in one case, it was an increase of around £5,000. How is that consistent with the public sector pay freeze? What was the reason for that shift in salary banding?

Diane McGiffen: I think that we touched on the issue at a previous meeting of the SCPA. It relates to changes in the roles and structure of the management team at Audit Scotland. Members of the management team assumed different roles, initially during Caroline Gardner's secondment and then following her departure.

Iain Gray: So there was a change in responsibility.

Diane McGiffen: Yes, and the role of deputy auditor general was removed from the management team structure completely, so the total cost of the senior management of Audit Scotland has reduced over the period. One post was taken out and the responsibilities were distributed differently, as I think was touched on in a previous meeting of the SCPA.

Mr Black: The overall saving is about £150,000 net. There is a small cost because of the reallocation of responsibilities.

Iain Gray: The other change over the year that we are looking at, which is a much smaller one, is that a couple of the senior management team who receive payments of benefit in kind have seen an increase in those payments. The note that refers to that states that the benefits in kind are for vehicles. Can you expand on why those payments have gone up and why those members of staff need or are entitled to those benefits in kind? What scheme allows that?

Diane McGiffen: Where there is a business need in some roles for a vehicle, we offer that to staff on a business case basis. There have been legacy terms for some members of staff, including some members of the management team, whereby they have retained for a period their membership of the car lease scheme until the lease expires or there is a change in their duties. The position that you see in the report has changed since the end of the year, and one fewer member of the management team is in receipt of a benefit in kind in relation to a car lease, as their responsibilities have changed. One member of the management team who has membership of the car scheme that we run is responsible for the oversight of all the audits that are delivered by our audit services teams, which are based throughout Scotland, and the job need for a car in that instance has been well documented in terms of our internal processes.

There is a mix of legacy arrangements, there is some transition going on, and there is a member of the management team who will retain a car for the foreseeable future because of a business need, which has the support of a documented policy and business case.

Iain Gray: We know that a good number of staff—both senior and less senior—have to travel to undertake their work. Are you saying that staff have a choice? If there is a demonstrated business need, can they either enter the car leasing scheme or pay for travel otherwise?

Diane McGiffen: We have designated some roles in the business as requiring a car lease because that is the most efficient and reliable way for folk to get on with their portfolios of work. There is a choice in that, if those designated postholders want to leave the car scheme so that we can reduce our car fleet, they have the option of making a case to leave the scheme if they can demonstrate that it would not cost us more for them not to be provided with a car but to make alternative arrangements and receive an allowance in lieu of the car. There is no option for anyone to join the car scheme unless their role has been designated as requiring business travel.

Iain Gray: So the benefit in kind is a business need scheme, not salary by proxy.

Diane McGiffen: It is a business need scheme. There is a mix of legacy arrangements and the different scenarios at work in the table on page 19. We have been working to reduce the size of our car fleet over time and continue to do that. We are currently revisiting the membership rules and requirements of the car scheme. It would be difficult for us to carry out the work that we undertake in different locations without access to a car scheme for some members of staff, but we have worked to reduce it over time and the fleet is significantly smaller than it has been.

Iain Gray: Mr Cleland, in your introductory remarks you mentioned the remuneration committee and praised its work. The board of Audit Scotland has a majority of independent non-executive members, but that is not the case for the remuneration committee, which is more balanced—I think that there are two independent members and two executive members—although it is chaired by Katharine Bryan, one of the independent members. Do the membership of that committee and the way in which it works display best practice as you understand it from a wide experience of governance?

11:30

Ronnie Cleland: I am comfortable with the way in which the remuneration committee is structured. As far as I am concerned, its membership is consistent with my other experience. John Baillie is a board member in the right of being chair of the Accounts Commission, plus we have Katharine Bryan, John Maclean and Bob Black.

As I said earlier, we are developing the role of the remuneration committee beyond its focusing principally on remuneration towards a broader governance responsibility. The work that we—and you, in your role—have done to develop the structure of the board has enabled us to do that. We are moving into the performance management area, ensuring that appraisal systems are appropriate for the organisation and that they are carried out appropriately, and we will develop things from there.

I do not feel that the membership of the remuneration committee in any way compromises its performance, but there is still work to be done. Perhaps we will talk about that another time.

Mr Black: May I add a comment on the composition of the committee? The chair is Katharine Bryan, who is a non-executive, as is John Baillie, who is there ex officio as chair of the Accounts Commission. John Maclean is also a non-executive, so there is a majority of non-executives on the committee. My remuneration is not covered by anything within the Audit Scotland policy but is determined by the Scottish

Parliament. I believe that the governance is strong because three of the four members are non-executives and the fourth member, namely me, has an interest in the efficient running of the organisation, but not a direct interest in the remuneration committee.

Iain Gray: I was probably indulging in degrees of independence, maybe a little unfairly. However, I am interested in what Mr Cleland said. Are you suggesting that the remuneration committee is becoming more of a human resources committee that looks at broader HR issues and not just remuneration?

Ronnie Cleland: It is funny that you should ask that, because we had that very discussion at our meeting last week. We talked about whether the committee's name is appropriate, given its expanded remit. However, one sometimes has to be cautious about the messages that a change in title can send out, and we are perhaps not quite there yet. We are doing a lot of good work but, as I said earlier, we have a bit further to go in refining and developing the agenda, given the new role and the independence bias that the board has as a whole. At some point we might have to revisit the name a wee bit, but we should be cautious and ensure that the message that we send the organisation is in line with what we intend rather than with what people might think we are trying to do, because if it were the latter, that would be wrong.

Iain Gray: Thank you.

Alex Johnstone (North East Scotland) (Con): I note that the total underspend for Audit Scotland in 2011-12 was £996,000. Do you anticipate any bids for end-year flexibility in the current year?

Russell Frith: We have not formally come to a view on that yet. The commission will be aware that a significant proportion of our income comes from fees and charges to other public bodies. In previous years, we have suggested to the commission that we should return the element of any underspend that arises from fees and charges to those bodies. In a normal business, one would do that simply by adjusting the levels of reserves, but because of the parliamentary accountability rules, we cannot carry forward reserves, so we cannot do it through that mechanism. EYF is therefore the only approach that we have.

We will certainly not be putting forward a case for close on £300,000 of that amount, because it arises from actuarial adjustments—non-cash adjustments—to our accounts at the last minute, so it would not be reasonable to do that.

Alex Johnstone: I notice that the table on page 37 shows that rent and rates have increased by £19,000 and other accommodation costs have increased by £23,000. Although those increases

are modest, they go against the general trend of falling administration costs and appear to be inconsistent with the comment on page 13 that

“Further cost reductions were recorded for building rent and depreciation £85k”.

Can you explain the inconsistency and say why the year-on-year increase in rent and rates and other accommodation costs has happened?

Diane McGiffen: We are in the process of reorganising our property portfolio, so we have signalled our intention to quit one of our properties. There are no longer any members of staff occupying the building, but we are still incurring some costs. Also, this year, we had an additional rate revaluation and so on.

The overall move in the cost of rent and rates is downward, but we have not yet finally quit the lease for one of the properties that we have in Edinburgh. The lease will end in June. We will also benefit from leaving property in Aberdeen. Our overall property portfolio is reducing, and some of the costs in the table that you refer to are associated with the process of finally exiting the properties that we have. I can give you more detail on that, if you would like.

Alex Johnstone: You mentioned leaving one property in June. Is that the end of this month?

Diane McGiffen: Yes.

Alex Johnstone: And when will you leave the property in Aberdeen?

Diane McGiffen: Towards the end of the year.

Alex Johnstone: Recruitment costs were £70,000 in 2010-11 and rose to £101,000 in 2011-12. Given the on-going recruitment freeze, why has there been a year-on-year increase in that cost?

Diane McGiffen: We have maintained our graduate trainee recruitment scheme, even during the recruitment freeze, so we incur costs annually in recruiting to that scheme. In the past year, we have recruited eight trainees on to that scheme.

The rest of the costs are primarily to do with running assessment and selection centres for internal recruitment. Because we have had a recruitment freeze and have been using our voluntary early-release scheme to change our skill mix, we have been running a series of internal recruitment campaigns, using selection centres to do that.

There are a small number of posts in relation to which we do not have the skills internally and which are regarded as business critical—for example, in our information technology team. On occasion, with the approval of the management

team, we have had to go out to the market to get those critical skills into the organisation.

This year, graduate recruitment costs were just over £16,500.

Alex Johnstone: Is that an increased cost in the year that we are discussing, or is it simply an on-going cost?

Diane McGiffen: It is an on-going cost. It will vary each year because it includes selection-centre costs and is affected by the number of applicants whom we shortlist, which depends on the number of applications that we receive.

This year, the cost of the advertising and selection of graduate trainees was just over £16,500.

The Convener: Page 3 of the report says that the cumulative impact of the national fraud initiative since 2000 is £78 million. In last year's report, that figure was £63 million. Can you explain the notable increase? Also, what role did Audit Scotland play in generating those savings?

Russell Frith: The increase is simply the elapsing of time as the bodies that receive the matches investigate them. They record the outcomes, so they continue to increase. We carry out the national fraud initiative exercise every second year. One of the reasons that we do it every two years rather than every year is that it takes significant time for bodies to work their way through the information that they receive. That explains why the figure continues to increase; indeed, it is now more than £78 million.

Audit Scotland co-ordinates and arranges the exercise. We arrange for all the public bodies to take part and for those bodies to provide specified data sets to the Audit Commission and its contractor, which carries out the physical matching of the data. We then monitor how the bodies deal with the matches that they get and encourage them to investigate the most promising ones. We provide software tools so that, from a list of, in some cases, many thousands of matches, they can identify those that are most likely to yield results. We provide assistance and advice to them if they need it. The bulk of the investigation work is carried out by the audited body's in-house teams, either internal audit teams or benefit fraud teams, depending on the issue.

The Convener: From the management commentary on page 14 of the report it seems that the operating costs have increased reasonably substantially. You have touched on elements of that already, but what would you say is the single biggest element in that increase?

Russell Frith: In the analysis that is there, the biggest single element of that increase is the additional VAT provision.

The Convener: Has that been put under operating costs?

Russell Frith: Yes, that analysis is split between staff costs, fees to auditors and property costs. Everything else is within that.

The Convener: Moving on to page 28, I am curious about the "Intangible assets". I am no accountant, so I take it from whence it comes, but to me, intangible assets tend to be things like good will and so on.

Russell Frith: Indeed. In Audit Scotland's case, intangible assets are computer software.

The Convener: That is an intangible asset?

Russell Frith: That is an intangible asset under international financial reporting standards.

The Convener: On the same page, the net funded pension, which is a liability, has gone up substantially. Is that because of people moving on or downsizing?

Russell Frith: No. That is almost entirely the result of slightly different actuarial assumptions having been made this year, in particular the decrease in the real discount rate that is used to evaluate the liabilities. When interest rates are relatively low, as they are now, a small change in the discount rate results in a significant change in the total liabilities. For example, a 0.5 per cent decrease in the real discount rate puts the liabilities up by 11 per cent. It has a significant impact. That is the main reason why our net pension liability has been swinging around over the past five or six years. It has been an asset in some years and it has been a big liability in other years. In the past two years, it has been back down to a liability of between £7 million and £9 million.

The Convener: We have already had a bit of discussion on VAT. Presumably the decision by Audit Scotland to opt to register for VAT was on the basis that it would lead to annual savings.

Russell Frith: No. The registration, in relation to our other activities, was because the amount, particularly of secondments, had exceeded the VAT threshold for registration. It was not a choice.

11:45

The Convener: So, in fact, it will be a net charge to you.

Russell Frith: For prior years, yes. Going forward, it will not be, because we will build VAT into the amounts that we will charge other bodies for secondments, for example.

The Convener: I presume that your output VAT will be your billing and so forth.

Russell Frith: It will be, in relation to things such as secondment income. However, in future we will make sure that we price secondments to include VAT. The bodies to which we second people may well be able to recover the input VAT. Local authorities, for example, would be able to recover that VAT.

The Convener: Can you recover input VAT on things such as your rental?

Russell Frith: We have suffered the cost of input VAT ever since we started. The arrangement that we reached with Her Majesty's Revenue and Customs in 2006 enabled us to recover input VAT only in relation to local authority audits. We have a very specific agreement that we can recover input VAT in relation to bills from firms that carry out local authority audits, but no other input VAT.

The Convener: So your registration for VAT purposes is actually for a piece of the business, not the whole business.

Russell Frith: Yes. We are now charging VAT when we second someone to another body. If we were able to identify any specific costs attached to a secondment that incurred input VAT, we would be able to recover it. However, given that the principal cost of seconding a member of staff is their pay, which does not attract VAT, in reality we do not recover any of that input VAT.

The Convener: That is interesting.

As members have no other questions, I thank the Audit Scotland representatives for their attendance.

11:47

Meeting suspended.

11:48

On resuming—

The Convener: I welcome Andrew McBean, Steven Cunningham and David Jeffcoat from Alexander Sloan Chartered Accountants, which is the external auditor to Audit Scotland.

I will start by asking Mr McBean to confirm that Alexander Sloan has received all the necessary information and explanations to inform its opinion on the accounts, and to provide an overview of any observations that arose from its work.

Andrew McBean (Alexander Sloan): Good morning, convener. I am happy to confirm that we received all the necessary information and explanations to allow us to undertake our audit for the year ending 31 March 2012, and I would like to give a quick overview of our work.

As you are aware, Alexander Sloan was appointed to carry out the external audit of Audit Scotland. We are required to provide an audit opinion on whether the accounts give a true and fair view, whether they have been prepared in accordance with international financial reporting standards, as interpreted and adapted by the financial reporting manual, and to confirm that they have been properly prepared in accordance with the Public Finance and Accountability (Scotland) Act 2000 and directions by the Scottish ministers.

We carried out an interim audit in February 2012 and our final audit work was carried out in May and early June 2012. Our audit was carried out in accordance with international standards on auditing. We received all the information and explanations that were required to carry out our work and the audit was completed without any significant issues. We signed our audit report on 12 June 2012.

Our audit report is unqualified, which means that there are no significant matters that should be brought to the attention of the readers of the accounts or this commission—it is a clean audit report.

We are also required to prepare a report to management. The purpose of that letter or report is to summarise key issues arising from the audit and to report any weaknesses in the accounting and internal controls that have come to light during the audit. I am pleased to report that in the course of our audit work this year, we did not find any weaknesses in the accounting and internal controls.

I want to thank, on behalf of the firm, the staff at Audit Scotland and the support staff at the SCPA for their assistance during the audit this year.

John Pentland: Mr McBean, I am delighted—as I am sure everyone is—that it is a clean audit report. Obviously, that is subject to your relationship with the internal auditors. Can you explain your relationship with Audit Scotland's internal auditors and whether there is any way to make the internal and external audit process more efficient?

Andrew McBean: This year—as we have done in previous years—we met with the internal auditors, but we have formalised procedures with them. That was partly at the request of Audit Scotland itself—it was looking at its own governance issues. We prepared a formal report for the board of Audit Scotland to confirm our working arrangements—Steven Cunningham can expand on that.

Steven Cunningham (Alexander Sloan): We formalised arrangements and agreed that there would be at least two meetings a year. In addition, the internal auditors agreed that each year we will

be given drafts of the internal audit plan and internal audit reports. Even in the current year, we reviewed all the internal audit reports that were done and we considered the impact of that for any of our external audit work.

Andrew McBean: We look at what the internal auditors have done with a view as to whether any reliance can be placed on that work. Internal auditors cover a number of areas—not all of those necessarily impact directly on the financial statements. However, we look to see where there are areas that we can place some reliance on—albeit limited reliance. We do not like to place too much reliance on the internal audit, because from our point of view this is a fairly high-profile audit. We carry out our own procedures to verify figures in the financial accounts.

Alex Johnstone: The figures on page 37 of the annual report make it clear that the cost of the internal audit has dropped from £30,000 in 2010-11 to £17,000 in 2011-12. I am usually in the business of praising cuts in costs. However, I will be cynical on this occasion and ask whether—in your opinion—that drop indicates that there is some danger that the scope and coverage of the internal audit work for the organisation has been reduced?

Andrew McBean: I cannot give an opinion on the exact reasons for the drop in the internal audit cost. Both external and internal audits have been subject to competitive tender processes, but I cannot give any specific opinion at this point in time because I have not reviewed the documentation. The only comment I can make is that with internal and external audits the focus is very much on risk mapping—looking at the risk areas and identifying where the focus should be. Perhaps that is a reason for the drop in the cost, but I cannot specifically explain it.

Alex Johnstone: Do you not share my worry that the fact that the figure has dropped by nearly a half indicates that the level of internal audit has been reduced?

Andrew McBean: We have been in post for only two years, but we have worked with the current and previous internal auditors—we had meetings with the previous auditors at the end of their term. I have experience of internal audit. We have seen all the reports; the work has been extensive and has been carried out professionally. That has been well received by us, by Audit Scotland's board and by the board's audit committee. I see no evidence to suggest any issues.

The Convener: We have touched on VAT. I assume that Alexander Sloan is giving advice on the VAT issue.

Andrew McBean: No—we are not giving advice on the VAT issue; another firm has done that. That issue was under way before we got involved—it has been running for a while. As has been said, the subject is complicated. We have reviewed all the relevant correspondence and our VAT people have considered the issue, but we have not been involved in the process.

The Convener: I presume that you were involved in the decision about the appropriate level of provision.

Andrew McBean: Yes. Audit Scotland worked out the provision; we checked the figures in detail with Audit Scotland and looked back to what should be shown as a liability in the accounts. We also had good discussions with Audit Scotland about how a contingent liability figure should be shown in the accounts.

I will describe the main point about the amount being shown as a contingent liability. The contingent liability should be shown as a provision only when the payment is probable. Having had discussions with Audit Scotland and having reviewed the documentation and correspondence, we believe that, at this point, it is not probable that the contingent liability will be a liability. We discussed likely and probable liabilities, and we and Audit Scotland reached a satisfactory situation that gave the reader adequate disclosure in the accounts.

The Convener: Do you have any relationship with the third-party company that is advising on VAT? Are you talking to it or does it have direct communications only with Audit Scotland?

Andrew McBean: We have just reviewed the direct communications. The issue relates to a specialist area, but we have reviewed all the correspondence that has gone to Audit Scotland and we are satisfied with the provision that has been made.

The Convener: As members have no other questions, I thank the witnesses for their attendance.

Annual Report

11:58

The Convener: Item 3 is consideration of our draft annual report for the parliamentary year from 11 May 2011 to 10 May 2012. Members will recall that we agreed to align the SCPA's working practices to those of the parliamentary committees, which includes producing an annual report. I will give members a moment to read through the report before we reach a decision.

The draft annual report consists of three pages. If members have any comments on any page of the report, I ask them to speak up. As members have no comments, does the commission agree that it is happy to sign off the report?

Members indicated agreement.

The Convener: Do we agree that the report should be published this week?

Members indicated agreement.

The Convener: As agreed earlier, we will move into private session. I ask members of the public to leave.

12:00

Meeting continued in private until 12:07.

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