MEETING OF THE COMMISSION

Thursday 25 June 2015

Session 4

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MEETING OF THE COMMISSION
1st Meeting 2015, Session 4

CONVENER

*Colin Beattie (Midlothian North and Musselburgh) (SNP)

DEPUTY CONVENER

*John Pentland (Motherwell and Wishaw) (Lab)

COMMITTEE MEMBERS

Alex Johnstone (North East Scotland) (Con)
*Angus MacDonald (Falkirk East) (SNP)
*Paul Martin (Glasgow Provan) (Lab)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Russell Frith (Audit Scotland)
Caroline Gardner (Auditor General for Scotland)
John Maclean (Audit Scotland)
Andrew McBean (Alexander Sloan)
Diane McGiffen (Audit Scotland)

CLERK TO THE COMMITTEE

Catherine Fergusson

LOCATION

The Robert Burns Room (CR1)

Scottish Parliament

Meeting of the Commission

Thursday 25 June 2015

[The Convener opened the meeting at 09:31]

Decision on Taking Business in Private

The Convener (Colin Beattie): Good morning everyone, and welcome to the first meeting in 2015 of the Scottish Commission for Public Audit. I remind everybody to switch off their mobile phones and electronic devices. We have received apologies from Alex Johnstone.

Our first agenda item is a decision on taking business in private. Do we agree to take in private agenda items 3, 4 and 5 and to consider in private our work programme at our next meeting?

Members *indicated agreement.*

Audit Scotland Annual Report and Accounts and Auditor's Report on the Accounts

09:31

The Convener: Agenda item 2 is consideration of Audit Scotland's annual report and accounts for 2014-15. I welcome to the meeting Caroline Gardner, the Auditor General for Scotland; John Maclean, chair, Audit Scotland; Russell Frith, assistant auditor general; and Diane McGiffen, chief operating officer, Audit Scotland. I believe that either Caroline Gardner or John Maclean will make an opening statement.

John Maclean (Audit Scotland): Yes, convener. Thank you for the opportunity to make a brief opening statement. I hope that you have enjoyed and found interesting reading in the annual report and accounts, which describe Audit Scotland's work and the financial outcomes of the past year.

As you know, our job is to help ensure that public money is spent properly and effectively on the wide range of public services that are provided in Scotland. It is an important task. We audit 184 public bodies—from the smallest council or health board to the Scottish Government itself—involving total annual expenditure of more than £40 billion. We also publish a wide range of reports that seek to provide assurance that that money is well spent and highlight areas for improvement.

The annual report demonstrates the strong foundations of the Scottish public audit model. Nonetheless, we always need to be agile in responding to changing needs and conditions, for example in areas such as new devolved powers, the integration of health and social work, restructured police and fire services and more intensive audits for the European agricultural funds. Currently, and for the foreseeable future, all of that is set against a backdrop of ever-scarcer financial resources and rising demands, which underline the need for better longer-term financial planning across the public sector. Included in that is the continuous requirement for Audit Scotland itself to strive for the highest standards.

I took over as board chair last October, succeeding Ronnie Cleland, who made an immense contribution over five years and led the organisation through periods of substantial change. We were pleased to welcome to the board two new independent non-executive members—Ian Leitch and Heather Logan—who have brought fresh insights to our work and who have each chaired one of the two board committees. As you know, Ian will succeed me as chair in October.

Finally, I pay tribute to the staff of Audit Scotland for their commitment and the quality of their work, as is amply evident from the annual report. It has been my pleasure to work with them over the past six years.

The Convener: We move to questions. I have a question on one thing that really stands out in the annual report. In the past few years, we have talked about performance measurement and efficiencies and so forth, but I do not see anything on that in the annual report or in anything else that has been produced. How do you measure your performance?

John Maclean: Before we deal with that, convener, Caroline Gardner was going to make a few introductory remarks as well. Do you want her to do that now?

The Convener: By all means.

Caroline Gardner (Auditor General for Scotland): I am happy to move straight to questions, convener. I am sure that you will cover the ground that we want to cover through your questions, and it is your time to use.

You asked about performance measures and efficiency. We have included some high-level performance measures in our annual report, as we normally do. I hope that, together with the pattern of efficiency savings that we have achieved in the past four years, that gives you the high-level picture that we have maintained, and in many cases improved, our performance while reducing the cost of audit by 20 per cent.

As you would expect, underpinning that, we have a much more detailed system of performance management in the organisation that focuses on performance measures that are monitored quarterly by the management team and the board to ensure that we are on track to maintain the volume of activity that we are committed to, the quality of it and the improvement projects that we have under way.

Diane McGiffen is well placed to tell you more about how that works in practice, if you would like a bit more detail.

The Convener: That would be useful, because the commission has raised the issue on a number of occasions, so it has obviously been a concern for members.

Diane McGiffen (Audit Scotland): The annual report reports on the final year of the four-year plan to reduce the cost of audit by 20 per cent. We are pleased to report that we achieved that. It was achieved largely by reducing the number of staff whom we employ. We have done quite a bit of restructuring in the past five years. We also retendered for the work that we contract out to private audit firms to deliver, and we have passed on the savings to audited bodies in the form of reduced charges for audit. Over the four-year period, there has been a real fall in the cost of audit and in the number of staff that we have.

The Convener: The performance measurements that you are talking about are purely financial, but there are obviously broader measures. How do you capture those?

Diane McGiffen: We capture them in a number of ways. We have efficiency performance measures within the business, which are reported to the board quarterly. Those measures look at the average costs that we are running for delivering projects, the time taken to deliver projects and the ways in which we use colleagues and the available resources that we have. The measures also look at the activity and the outputs that are delivered during the period. There is on-going reporting to our board on those things. Our financial performance is examined every quarter by the audit committee of the board, and the board then considers in detail the business performance and wider issues. That covers a spectrum of things, including the ways in which we are restructuring, our vacancy and turnover levels and ensuring that we are resourced to do the work that we need to do and that we are doing it as efficiently as possible.

We produce a report alongside the annual report that covers the wider impact that the work has. That report shows examples of the ways in which the work of our audit teams has helped to improve public services. We have internal performance and efficiency measures and we also try to capture a rich picture of the impact that our audit work has through our engagement with audited bodies.

The Convener: It would be of interest to the commission to see some of those performance measurements that you extract, given the interest that has been expressed in the issue in the past.

Diane McGiffen: I would be very happy to share those with the commission, and to discuss them in any forum with you.

The Convener: Page 10 of the annual report states:

> "Auditors completed 98 per cent of the audits of health, central government, further education and local authority bodies on time."

Clearly, that is the majority of the work, but the audits of four of the 184 bodies were not completed to the timetable. Why was that? Was there any common reason across the four bodies or were individual issues involved?

Caroline Gardner: Russell Frith will pick that up, because he oversees the quality and the time limits of the audit reporting.

Russell Frith (Audit Scotland): In this instance, the issues were individual. In large part, it was because the accounts were presented late for audit in the first place or they required significant further work, which took the agreement of the adjustments required beyond the target deadline for completing the audit.

The Convener: The information that was provided to you was not adequate in the four cases.

Russell Frith: That is correct.

The Convener: Which cases were they?

Russell Frith: The audit of the Scottish Police Authority's first year was one; Orkney NHS Board was another. In the case of the health board, if I remember rightly, the accounts were finally signed off only a few days after last year's target date of the end of June.

The Convener: What was the problem with the accounts?

Russell Frith: The issue was the capital accounting—revaluations had not been put through correctly, and the board needed to carry out extensive administrative work to get all the figures correct.

The Convener: That seems pretty basic. Does the board not have an accountant?

Caroline Gardner: Convener, you and Mr Martin might recall that, last year, I brought section 22 reports on both the SPA and Orkney NHS Board to the Public Audit Committee. Those reports reflected problems including their difficulties in preparing their accounts to the agreed timetable, as well as other financial management and internal controls issues.

The Convener: What were the other two bodies?

Caroline Gardner: One is Coatbridge College, where a section 22 report is waiting to be laid. I am not sure that I know what the fourth one is, but we can come back to you with that information.

The Convener: Thank you. There was no common reason across the bodies; rather, it was individual issues with those individual bodies.

Caroline Gardner: That is right. It is probably worth letting the commission know that, over a long period, the Accounts Commission for Scotland as well as my predecessor and I as Auditor General have focused on improving the timeliness of financial and audit reporting. In the past, there was quite a strong pattern of accounts and audits being completed late. The more that that is the case, the less useful the information is to the body and, importantly, to the Parliament and others with an interest.

The number of late reports is generally very small, and it almost always reflects problems in the particular body rather than a wider pattern of problems with the accounting or the auditing of them.

Paul Martin (Glasgow Provan) (Lab): Page 13 of the annual report says that the work on the police reform has found

"urgent work was required on the financial strategy for achieving the £1.1 billion of savings expected from restructuring."

Given that Police Scotland is one structure, which replaced the previous eight structures, what are the expected audit fee savings?

Caroline Gardner: We have just referred to the Scottish Police Authority in response to the convener's question. It is fair to say that we have not seen the reduction in the SPA audit fees that we expected to see at the time that reform was under way, because the authority is making slow progress on financial management and in bringing together its financial systems. When I reported to the Public Audit Committee last autumn through a section 22 report, I think that the SPA was still at the stage of operating eight separate financial systems. My report drew attention to problems with the SPA's internal controls and governance. That all means that the audit fee is larger than it otherwise would be.

We had expected—Russell Frith will keep me right on this—that the single force's audit fee would probably be around half of the total audit fee for the predecessor authorities. We still have that aspiration, but it depends on the authority being able to make the efficiency savings in bringing together its systems and getting in place good systems of governance and control, which we have not yet seen.

Paul Martin: What timescale do you think would be attached? When would you want to be in that position?

Caroline Gardner: It is very hard to say at this stage. I had a briefing from the auditor of the authority quite recently about the progress of this year's audit. There are still some issues that may result in a report to the Public Audit Committee later this year. The audit fee will need to be larger to reflect that.

I am very happy to keep the commission up to date through our budget submission later this year. I am very clear that it would not be proper to reduce the audit fee until that is justified by improvements in the governance and financial management within the authority.

09:45

Paul Martin: Okay. I move on to page 26 of the annual report, which states:

"The Scottish Public Services Ombudsman upheld one complaint against us."

Could we have further information on that complaint?

Caroline Gardner: Absolutely. We are obviously disappointed to have found ourselves in that position. Diane McGiffen can tell you more about the complaint.

Diane McGiffen: The Scottish Public Services Ombudsman upheld a complaint from a member of the public about the way in which Audit Scotland had handled the complainant's request for us to investigate another public body. The SPSO had originally not upheld the complaint, but had revisited it.

We have taken on board the SPSO's findings. He has reported them in public and we have recorded them in our annual report. We have apologised to the person concerned. We did not do well enough in that case and we have used it as an opportunity to improve our handling of correspondence and concerns.

Paul Martin: Can you be specific about the actual complaint? What exactly were the lessons learned?

Diane McGiffen: The lessons are about the allocation of resources to complex complaints. In this case, we did not do well enough in keeping the complainant informed about the progress of the complaint and our handling of it. That was because, from the perspective of colleagues handling the complaint, there was not much information to add, but that is not good enough in the context of keeping communication flowing. We have learned lessons about how we keep different internal teams informed about the process of handling complaints.

The case has helped us to follow a lot of process-handling issues from beginning to end and to see where we could do better. Our handling of correspondence and complaints, which we flag in the report, is an area that we have sought to improve overall over the past year. The finding by the SPSO was a disappointment and one that we have apologised for and sought to learn from. We did not do well enough.

Angus MacDonald (Falkirk East) (SNP): In the final paragraph on page 27, the report states:

"Most internal audits in 2014/15 achieved 'substantial assurance', the highest standard available, from our internal auditors tiaa. A follow-up report showed that we were making excellent progress in applying previous recommendations."

Which internal audits did not achieve substantial assurance and what levels of assurance were given by the internal auditors?

Diane McGiffen: Only one report did not achieve substantial assurance. It was a review of our readiness to seek accreditation for an information security standard. The audit was planned as part of a staged process as we implemented and worked towards the standard. The audit was an opportunity for a stocktake of how we were doing. The audit provided limited assurance about our readiness to seek accreditation.

There was a lot of discussion about the findings and how we would use them. A key issue for us is that a big aspect of the accreditation that we are seeking is specific to the properties in which we are located. As we are relocating in autumn this year, there is a need for us to rework all our documentation to reflect that. We are using the report as planned to inform the improvements that we need to make and we will be seeking to go for accreditation by the end of March 2016. The audit was looking at our readiness for something, and we planned it to help us focus our attention on the areas that we need to improve.

The Convener: Just for the interest of members, what does "tiaa" stand for?

Diane McGiffen: I really do not know. It changed in the course of the year. Do you know, Caroline?

Caroline Gardner: No.

Diane McGiffen: It means something to the team—I do not know whether it is an acronym.

The Convener: It is not a misprint, is it?

Diane McGiffen: No. It is lower case in the report.

The Convener: Yes, I find it odd that it is lower case, which would imply that it is not an acronym.

Caroline Gardner: We use it as it is the name under which the internal auditors trade but none of us knows what the initials stand for.

The Convener: Interesting.

John Pentland (Motherwell and Wishaw) (Lab): On page 32 of your report, you report an underspend of more than £1 million. That represents approximately 4 per cent of Audit Scotland's total resource requirement and 14 per cent of the direct funding approved by the Scottish Parliament in the year. When we consider that most of the underspend may have come from Government funding and indeed from local authorities, could you perhaps give me a breakdown on what proportion of the underspend came from the Scottish Government and what proportion came from local government?

Caroline Gardner: It might be helpful if I first break down the big areas where the underspend occurred—they come under three broad headings—and then I will ask Russell Frith to pick up the question of how that underspend falls across the different sectors that we audit.

First, a large chunk of the overall figure—about £200,000—came from the pension adjustments that we are required to make under international accounting standard 19. Therefore, £200,000 of the underspend is simply an adjustment to the way in which pensions are accounted for.

Another element of the underspend, if we break it down by expenditure category, is fee income being higher than we budgeted for. We have talked to the commission before about how our fee budgeting works. An indicative fee is set for each body, based on the assumption that it has good governance and good internal controls in place but with freedom for the auditor and the audited body to agree a fee up to 10 per cent above or below that figure. We found last year that fee income was agreed in total, across the piece, at about £485,000 extra, so that is a big contributor to the underspend in net terms.

The other element that made a significant contribution involves the legal, professional and consultancy fees, which came in with an underspend of just over £200,000.

Those are the big areas. We can allocate the underspend across sectors, and I will ask Russell Frith to pick that up, but I thought that it might be useful to give you that breakdown by expenditure category first. Russell, can you shine a bit more light on that for us?

Russell Frith: I will just add a point about the significant area within the overall £1 million of £200,000 on the pension adjustments that are made at the end of the year. They are entirely notional amounts. They came through the annually managed expenditure adjustment that we sought at the spring budget revision and therefore go straight back to the consolidated fund in underspend from that.

We do a detailed allocation of all our costs across the various sectors—local government, the national health service, central Government, further education and activities funded directly from the consolidated fund. As you can appreciate, those costs include a lot of apportionments of some of the central costs that do not directly relate to activity and so have to be apportioned, whereas direct costs such as staff and payments to firms can be very easily allocated to sectors. We do that at the budget stage and then we do it again at the outturn stage.

For local government, our overall income was £11.5 million and our expenditure was £11.45 million, so the difference is only £58,000. For the national health service, we had income of £3.8 million and expenditure on an outturn basis of £3.5 million, so there is an underspend. In that sector, we have recovered more income than we incurred expenditure, so a consideration for the board in August will be whether to make an application for the autumn budget revision to provide for that money to be refunded to the NHS. In previous years, we have done that on some occasions when the amounts have been significant but not on others when they have been fairly low. In central Government chargeable activity, we had income of £2.3 million and expenditure of £2.8 million, so on that one we incurred more expenditure than we received in income. The balance is in the consolidated fund funded expenditure.

John Pentland: That brings me on to my second question. You said that in August—or at some point later in the year—you will think about a mechanism and a timetable for returning the underspends in the authorities to which you refer. Given that those authorities have been under extreme financial pressures, why did that not happen in the past?

Caroline Gardner: The brief answer is that, on occasion, it has happened in the past. The Public Finance and Accountability (Scotland) Act 2000, which is the legislation that governs our finances, provides that we must break even, taking one class of audits with another and taking one year with another. We look to smooth our expenditure across each sector and, as far as possible, across bodies each year to ensure that there is predictability about the audit fees that people pay and that it is an efficient system.

Russell Frith talked about a very small underspend on local government of about £58,000. If you divide that between the 67 bodies that the Accounts Commission audits in the local government sector, that is less than £1,000 each. There is a question about whether it is worth while for us to incur the expense of processing refunds and for them to incur the expense of banking those, when it is likely that the next year the costs may come out in a slightly different direction. We are increasing the transparency of the way in which we budget and report that, but it is built into the legislation that we have the flexibility to smooth our expenditure over a period.

When there is a significant underspend, past practice has been for the board to agree that we apply to the SCPA for the budget cover to refund that money to the bodies involved, but it is a matter that depends on the extent of the underspend—or, indeed, the overspend—in particular bodies and the extent to which that is likely to come out in audit work in future years.

John Pentland: You had an underspend of more than £1 million but, in the same year, you sought a further resource of £1.7 million to cover additional pension costs. Can you tell us why that was the case?

Caroline Gardner: Certainly. As both Russell Frith and I said a moment ago, some of the pension adjustments that are required are purely accounting adjustments that we have no control over and which have no direct impact on the income or expenditure that we manage in the year. Over Audit Scotland's life, those adjustments have varied significantly from significant credits in our favour, which we have returned to the Scottish consolidated fund, to significant movements against our finances—a charge to us—in which case we have come back to the SCPA to ask for cover, generally from underspends, to manage them. Russell Frith can give you a bit more detail on what the movements look like in 2014-15. It is something that moves markedly from one year to another and over which we have no control.

The way in which we need to ask for budget cover is a reflection of the fact that we are largely a member of the local government superannuation scheme but require to manage our finances under the central Government Scottish public financial management model, which leads to some tensions that we discuss with the SCPA each year.

10:00

Russell Frith: As has been mentioned, in the spring budget revision we applied for £1.8 million additional cover under AME rather than the departmental expenditure limit. That was to cover what we were expecting, based on the actuarial advice that we had received, to be the additional non-cash charge that we have to make in our income and expenditure account for pension costs over and above the contributions that we routinely make to the fund during the year. That is because the accounting basis for accounting for pensions and the actuarial basis are different.

When we got the final year-end figures from the actuary, rather than £1.8 million of adjustment it was £1.6 million. That is why there is a £200,000 underspend in relation to that entirely non-cash element, which then feeds back through into the consolidated fund, in that we would not apply to carry that forward for any reason.

John Pentland: But the general public would see only that that request came only four months before you recorded your underspend.

Caroline Gardner: I completely understand that this is a complex area, Mr Pentland. We have tried in the past to separate it out, in our own reporting and for the commission. In a sense, the pension accounting adjustments are like the weather—we have to respond to what the actuary requires of us. They have no impact on the resources available to us, although they feed through to the outturn figures, in the way that Russell Frith has described, and the costs that we manage more generally.

Of the £1 million underspend that you referred to, about £800,000 comes from the things that we control. The pension adjustments happen outside that, due to things such as changes in the discount rate that is applied and changes in the valuation of the assets for the local government pension fund. There is very little that we can do to manage any of that. As you know, we are also not in a position to carry forward reserves to manage it, as most local authority bodies do. With the commission's agreement, we try to ring fence that and separate it from the other things that we manage here.

With regard to the remaining £800,000, which we have reported here—the £1 million less the £200,000 pension adjustment—we completely agree that we can continue to apply more discipline to bring that figure much closer to a match between our expenditure and our income. We have outlined two areas in that. One is the higher fee income; this summer, we are looking at how we put the income budget into our overall budget to minimise the chance of there being more money recovered than we need across the year. The other is the legal and professional fees; we are budgeting more tightly every year to bring that underspend down.

I remind the commission that, under our financial regime, we simply are not allowed to overspend, so you will always see a small underspend. The challenge for us is to make that as small as possible, while ensuring that we are not coming back to the commission for extra resources every time a small change in our cost envelope occurs. However, you are absolutely right to ask the question, Mr Pentland, and we will continue to apply pressure to it and to make that transparent to the commission in our budgeting round.

John Pentland: If it is a complex area for the people who work in it, I am sure that you will appreciate how the layperson would see it.

On page 33 of the annual report, you say that savings of £209,000 and £140,000 respectively

> "were recorded as a result of reduced use of external consultants and professional services providers and ICT and web development expenditure".

However, expenditure on those services increased from the 2013-14 level by £156,000 and £58,000 respectively. Can you provide some explanation of those savings against budget, taking account of the increased expenditure on those services year on year?

Caroline Gardner: I think that Russell Frith is the man to give us a bit of detail on both those areas. By way of introduction, though, I would say that what you are seeing in those areas is the effect of us trying to budget more tightly. The budget is coming down, and you are seeing an underspend against it, but the pattern of expenditure year on year varies depending on what is required in those budget headings. Can you give us some information about the underlying figures, Russell?

Russell Frith: I can try. That overall explanation is absolutely right. The consultancy and external support budget has been coming down year on year as we have sought to get it closer to what we spend, and indeed as we have revisited why we are or are not spending it. In that respect, the answer is that we did not achieve the spend on consultancy that we thought we would achieve, but it was higher than in the previous year.

An element of that is down to the national fraud initiative expenditure of just over £200,000. The national fraud initiative is an exercise that takes place every second year in which we pay what used to be the Audit Commission to process all the data. That is a lumpy piece of expenditure—it is just over £200,000 every second year—and it is the principal reason for the variance year on year.

Caroline Gardner: On information technology, which is the other area that you asked about, the expenditure last year, in 2014-15, was £58,000 higher than in 2013-14. That was made up of increased software licence charges from Microsoft, which is our provider, and additional licences for the software that we use to allow our staff to securely log into our systems wherever they find themselves.

As part of our overall efficiency push, we are looking for staff to work much more flexibly from our clients' offices and from the various Audit Scotland offices that we have, and they have to be able to do that securely. The software that we use for that generates savings in other ways, but it has a cost in itself, and that was a significant part of the increased spend on IT in 2014-15 compared with 2013-14.

Angus MacDonald: Page 37 of the annual report shows that the salaries for three senior staff members rose by one salary band between 2013-14 and 2014-15. The band increase can reflect a salary rise of anything between £1 and £9,999. Notwithstanding the fact that the Auditor General's salary is a matter for the Scottish Parliamentary Corporate Body, can you confirm that the pay awards for senior staff were commensurate with the rises elsewhere in Audit Scotland and the wider public sector?

Caroline Gardner: Absolutely, Mr MacDonald. As you would expect, we apply the Scottish Government's pay policy to our staff across the piece. For our main-grade staff, we applied a two-year deal, in line with the policy. That was a modest deal, but we were able to flex the payment in a way that our staff valued by making a 2 per cent increase in the first year and having a freeze in the second year. For our senior management team, whose pay is governed by the remuneration committee, the senior pay policy from the Scottish Government was applied, and the treatment was consistent with the policies across the piece.

Diane McGiffen will keep me straight, but I think that the pay awards that were available for senior management team members were smaller in percentage terms than those for main-grade staff, which is consistent with the pay policies that apply.

Angus MacDonald: Is that the case, Ms McGiffen?

Diane McGiffen: Yes.

Angus MacDonald: Okay. Thank you.

Going back to the pension fund, which was mentioned earlier, I note from page 38 that

"A payment of £273k was made to Lothian Pension Fund to secure early access to pension benefits"

for a former senior staff member. We know that the individual left Audit Scotland and subsequently joined the board of Revenue Scotland. I think that it is fair to say that that aspect of the report has raised a few eyebrows. Can you confirm that a robust business case was prepared before the payment was made?

Caroline Gardner: Absolutely. I will ask John Maclean, as chair of the board, to comment in a moment, but I can give you an absolute assurance that all the voluntary severances that have been agreed by Audit Scotland this year and in previous years are in line with our voluntary severance policy. That policy complies in all respects with the reports that we have published on the way that other bodies manage voluntary severance, and it has been an important part of our ability to reduce our costs by more than 20 per cent over the past four years.

We have reduced the management team from seven members to five since 2012, which has generated significant recurring savings for us. The departure that is referred to in the annual report and to which Angus MacDonald referred has generated recurring savings of £121,000 for us, with a payback period of 27 months. It is clear to us that that is value for money. It has also provided us with business benefits in having a smaller and tighter management team that can get some of the benefits of one-organisation working. That is one of the key ways that we are able to keep on delivering our audit work to the standards that are required while reducing the cost.

For each early severance that comes forward, there is a robust business case that has to comply with our overall policy. That is considered by the management team. The cases that we consider represent value for money are then considered by the remuneration committee of the board to provide assurance about the balance between the immediate costs that we will incur and the benefits that we will gain in future years. We report annually to the board to demonstrate that the savings have been achieved in practice.

I ask John Maclean to give members a bit more assurance about the roles of the board and the remuneration committee in that.

John Maclean: I can confirm all of that and that the full case for the matter was presented to the remuneration committee, which considered it in detail, scrutinised every aspect of it and eventually approved the business case, as the board did subsequently. Therefore, we had no concerns about the matter, especially bearing in mind the restructuring that followed it, which allowed overall savings to be made.

Angus MacDonald: Just to clarify, how much have you saved in reducing the management team from seven members to five?

Caroline Gardner: We can give members the total figure. The figure that I have available is the figure from the change that happened in 2014-15; I think that the previous one happened in 2013-14 and was reported to the committee last year. In each case, we are looking for a saving that is at least 25 per cent more than the cost of the post. Therefore, we have not just taken out the cost of the post; we are saving 25 per cent more. We can confirm the full saving to the committee separately, if that would be helpful.

Angus MacDonald: Yes, it would. Thank you.

Caroline Gardner: Mr MacDonald mentioned the appointment of the staff member to the board of Revenue Scotland. It is important for us to be clear that we have no role in the appointment decisions that are made by other bodies.

Angus MacDonald: Absolutely. There was no suggestion that that was the case.

John Pentland: I refer to page 39 of the report. I seek clarity; perhaps it is just the way that I am reading what is said. The first paragraph on that page, on "Service contracts", probably needs a wee bit of clarity. It says:

> "Senior managers hold appointments which are open-ended until they retire."

I assume that that is not a contract. Is that right?

Caroline Gardner: Absolutely. It is normal employment practice that our people are on an open-ended employment contract that is terminated when they leave, resign or retire. If we want to terminate their employment before that, we will incur a cost in the way that we have just discussed.

John Pentland: That is where I want clarity. How can that be terminated if there is not a contract and the appointment is open ended?

Caroline Gardner: There is a normal employment contract, so we would have to do that through a voluntary severance agreement under the terms of the policy that the board has approved, which applies to all those contracts. The disclosure is required to be clear with the commission that that is the basis on which all our staff are employed, so we have a continuing liability unless we reach agreement about voluntary severance or voluntary redundancy under the terms of our policy for those departures.

John Pentland: I am still a wee bit unclear. My understanding is that a person can be on a contract for one to five years or whatever, but what does an open-ended contract mean?

Caroline Gardner: That is the way in which we are required to describe the standard employment contract that all our staff are employed under and which all the staff of the Parliament or a local authority are employed under. The alternative is a service contract, which is a one-year contract, a five-year contract or a contract that has a fixed term and comes to an end at an agreed point. Our contracts are open-ended employment contracts in the way that I think that you would expect for most public bodies.

John Pentland: Yes, but you are saying that a cost is involved if you decide to terminate an open-ended contract. Why?

Caroline Gardner: I think that the word "contract" might not be helping. I wonder whether Diane McGiffen can explain more clearly what I am evidently not explaining.

10:15

Diane McGiffen: I shall try, but I am not sure that I will succeed.

The heading is required by the accounting standards. It requires us to disclose whether senior managers are on fixed-term contracts or other contracts. The word "contract" is required by the accounting standards. Our description is designed to explain that our managers are all on appointments that are open ended until they retire. They are not fixed-term contracts. I think that the title is perhaps getting in the way—it is a requirement under the accounting standards. We have the usual employment contracts.

We have some staff on fixed-term contracts, the expiry of which have no cost. Generally, the vast majority of our staff are on permanent employment contracts. The only way to end those is through dismissal, voluntary exit, redundancy and so on, some of which would incur costs. Is that any clearer?

John Pentland: No. I think that you should consider changing the wording, so that people who are outside the bubble can fully understand it. Your report says:

"Early termination, other than through misconduct, would result in the individual receiving compensation."

That is where it becomes a wee bit more complex. If the appointment is open ended, why should any compensation be paid to somebody who finishes it?

Caroline Gardner: If the individual decides to retire or resign and move on, obviously no compensation would be payable, as you would expect. If, however, we were to conclude that we did not need a particular group of staff any more and we agreed voluntary redundancy with them, they would be entitled to compensation under our voluntary redundancy scheme for their loss of office. That is the difference that is intended to be described in that part of the report. As I said, the wording of the heading is based on the guidance with which we are required to comply that covers our annual reporting, and I am sorry if that is not helpful to you. That part of the report is trying to explain that the terms on which our senior managers are employed are the absolutely standard employment contracts that senior managers across the public sector have. There is no difference at all.

Diane McGiffen: We made the same disclosure last year. However, we will take on board your comments about how we can bring some clarity to that part of the report. There has been no change to the situation from last year to this year.

John Pentland: We went into the report in more detail this year. That is why we are asking the questions.

Paul Martin: Excuse my ignorance here, but I ask this for clarity and to put it on the record. I have seen some reports presented to the Public Audit Committee in connection with severance payments, which have been a result of the general scrutinising of such arrangements. How is the Auditor General audited in that respect? It would be helpful to get comments on that in the *Official Report*.

Caroline Gardner: Of course. The Scottish Commission for Public Audit appoints our external auditors, who look at significant transactions in our accounts in the same way that the auditors that I appoint do for public bodies. They have reported on their conclusions as part of the annual report, and I think that you are taking evidence from them shortly after this session, so if you have any questions on that I am sure that they would be happy to give you feedback on their work in the area.

The Convener: As a footnote to John Pentland's and Paul Martin's questions, I should say that there is a lot of sensitivity about pension payments, particularly to senior staff, across the public and private sectors. I do not think that it is surprising that the commission is focusing on that aspect.

Caroline Gardner: We understand that, convener, and we are committed to ensuring that we apply the same standards of governance to ourselves as we expect of the bodies that we audit. I am happy to give the commission any explanation of that that you would find useful.

The Convener: Note 5 on page 56 of the annual report sets out the fees and charges paid by the audited bodies for the audit services. On 30 October 2014, the commission asked Audit Scotland to provide details of the fee strategy review that is referred to in the 2015-16 budget submission. In evidence to the commission, Russell Frith commented that Audit Scotland was

"looking at all aspects of fee setting and charging—at every aspect of what is in the fee strategy document."

Mr Frith confirmed that the work

"will finally be concluded over the early months of next year so that we are in a position to set out clear arrangements for our next audit procurement round, which kicks off next autumn, and to present our budget next year."—[*Official Report*, *Scottish Commission for Public Audit*, 30 October 2014; c 5.]

Can I have an update on the review?

Caroline Gardner: Certainly, convener. We have taken a number of papers on the topic to the board since we were with the commission last autumn, partly because the board has a number of new members so we wanted to set out the way in which our funding and the fees element of that work in practice, and partly to set out some questions for the board to review for the strategy going forward. We have made good progress on that and the board has made some key decisions about the options that we should be bringing to the commission as part of our budget submission later this summer. We will be happy to update you on that in detail at that point.

The Convener: Okay. Unless members have any other questions, I will nip through one or two points with you. Paragraph 2 on page 33 talks about

"an increased deficit in other finance income (£134k) caused by increased interest costs on pension liabilities."

I think that I know what that is, but perhaps you could walk us through it.

Caroline Gardner: I ask Russell Frith to do that because he understands it better than I do.

Russell Frith: As part of the pension accounting, we have to show through our accounts the movement in the net pension asset or liability relating to the local government scheme. One of the movements is the increase in value of the fund that is caused by the increase in the value of the fund's assets. The other is to record an expense for the interest cost on the liability. Those are required to be disclosed in that part of the accounts. The deficit is accounting for the movement in the net pension liability of Audit Scotland.

The Convener: A bit further down on the same page, in the paragraph headed "Comparison with budget", it says:

"Fee income, net of sums paid to appointed external audit firms, was £488k greater than budget as a result of an increase in agreed fees compared to budget".

You are saying there that lower levels of expenses were paid to external audit firms but there was an increase in fees. Perhaps you could walk me through that one.

Caroline Gardner: Of course, convener. The £488,000 is the same element that I described in my answer to Mr Pentland's question as a significant part of the net underspend that we saw and have reported for 2014-15. It comes from the difference between the budget that we set for audit fees across the piece, which the commission approved last autumn, and the individual fees that were agreed between auditors and audited bodies for each of the 200 or so audits that were carried out.

As you know, we set an indicative fee in the fee strategy and that feeds into our budget. Auditors and audited bodies then have the freedom to agree a fee that is plus or minus 10 per cent around the indicative fee. For a range of reasons, during 2014-15, the net effect was £488,000 higher than we had budgeted for.

Part of that was due to particular issues such as the Scottish Police Authority, which we talked about earlier. Part of it is due to bodies that have smaller problems with parts of their governance or internal controls and require more audit work. Part of it is simply because the auditor and the audited body agreed that a bit more work would be helpful. Some audit fees come in below the indicative amount, but the net effect was £488,000 above the budget.

The Convener: You can understand that it looks a bit odd. If you are paying less for the audits, why are you charging other people more?

Caroline Gardner: I appreciate that this is complex, and it takes us time to understand all the things that affect each other. It is due to the agreement of higher than indicative fees between the auditor and the audited bodies.

The Convener: I am looking at the legal and professional fees on page 55. There has been a huge increase there. What was that? It does rather stand out.

Russell Frith: That is the impact of the point that I referred to earlier about the cost of the national fraud initiative occurring every second year. The costs were incurred during 2014-15, but not in 2013-14, and that is the line that they fall under. The cost of the national fraud initiative is just over £200,000 each time it takes place, which is every second year.

The Convener: Okay. I am looking at the heading "Intangible assets" on page 58. Can you remind me what they are?

Caroline Gardner: They are software licences.

The Convener: I think that I asked that question before.

Caroline Gardner: You did, and I remember the answer that we gave you, which is convenient.

The Convener: It seems that members have no further questions.

Russell Frith: If I may, convener, I have been handed an answer to your earlier question about what "tiaa" stands for. Apparently it stands for the internal audit association.

Angus MacDonald: We could have guessed that.

The Convener: You couldn't make it up, could you?

Thank you very much for your attendance. We will pause for a moment while the witnesses change over.

10:26

Meeting suspended.

10:27

On resuming—

The Convener: We continue on the same agenda item. I welcome the representatives of

Alexander Sloane, which is the external auditor of Audit Scotland. With us are Andrew McBean, senior partner, and David Jeffcoat, associate.

I invite members to ask questions.

Angus MacDonald: Good morning, gentlemen. The commission notes that your firm has issued a true and fair audit opinion following its work on Audit Scotland's annual report and accounts. Can you confirm that you have received all the necessary information and explanations that you require to form your opinion on the financial statements?

Andrew McBean (Alexander Sloan): Good morning. Yes—I am happy to confirm that we received all the information and explanations that we required to undertake an audit for the year ending March 2015. I will give a brief overview of the work that we carried out.

Our firm was appointed to carry out the external audit of the accounts of Audit Scotland. We are required to provide an audit opinion on whether the accounts give a true and fair view; to state 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 Scottish ministers.

We carried out an interim audit in February this year, and our final audit work was carried out in May and early June. Our audit was carried out in accordance with international standards on auditing. As I mentioned, we received all the information and explanations that we required to carry out the work, and the audit was completed without any problems or issues. We signed our audit report on 9 June 2015.

Our audit report is unmodified—that is, we are satisfied that the accounts give a true and fair view and that no significant matters require to be brought to the attention of the commission today, or of other readers of the accounts.

We are also required to prepare a report to management. The purpose of that report is to summarise the key issues arising from our audit, including following up on the main audit risks that were identified at the planning stage, and to report any weaknesses in the accounting systems and internal controls that came to our attention during the audit. I am pleased to report that, during our audit work this year, we did not find any weaknesses in the accounting or internal controls.

Finally, I record my thanks to the staff at Audit Scotland and the support staff at the SCPA for their assistance during our audit process this year.

Angus MacDonald: Thank you.

Paul Martin: In your report to those who are charged with governance, as required by the international standards on auditing, and in your report to the audit committee of Audit Scotland, did you raise any matters that the commission should be aware of?

10:30

Andrew McBean: No. There were no significant issues that we had to raise. We followed through our audit process, looking at the audit risk and examining all the areas of significance, and no issues or problems needed to be brought to the commission's attention.

Paul Martin: Thank you.

John Pentland: Good morning. At paragraph 4.2 of your report, you refer to your

"effective working relationship with the Internal Auditors"

of Audit Scotland. Will you confirm whether you relied on the work of internal audit in order to avoid duplication of effort and to maximise efficiency for both internal and external auditors and, if so, the extent of that reliance?

Andrew McBean: Our audit approach did not place great reliance on the work of the internal auditors. The areas that they cover in their internal audit are not always relevant to the audit of the financial statement. We examine their work, but we do not place great reliance on it. It is useful to know that they have looked at particular areas, and that gives us assurances.

Saying that we do not place great reliance on internal audit should be taken to imply that we do not want to restrict our tests. We carry out detailed testing to be certain that there are no issues or problems. That might create some additional audit work for us, but it does not create any additional audit fees for Audit Scotland.

The Convener: Thank you. You were present earlier when members asked for information in connection with the pension payment to a member of staff, and the Audit Scotland witnesses indicated that your firm had audited that. Are you satisfied with the business case that supported that decision?

Andrew McBean: Yes. We examined the paperwork that had been prepared. We do not have an opinion on the business case, but we examine all the information in the reports to ensure that it is appropriate. We looked at each of the cases under the voluntary early release scheme and we are satisfied that all the calculations have been properly prepared and that the information is properly disclosed in the accounts. We have carried out our detailed work on that area and there were no issues or concerns.

The Convener: Thank you. Is there any other matter that you want to bring to the commission's attention?

Andrew McBean: No. It was a satisfactory audit process this year. Our management letter confirms that there were no issues or problems. There is nothing to add at this point.

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

Before we conclude the public part of the meeting, I note that we are about to lose Catherine Fergusson, who is going off to greater things. I put on the record our thanks to her for her help and support over the past few years.

10:33

Meeting continued in private until 10:52.

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