

MEETING OF THE COMMISSION

Thursday 30 October 2014

Session 3

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MEETING OF THE COMMISSION

2nd Meeting 2014, Session 3

CONVENER

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

DEPUTY CONVENER

*John Pentland (Motherwell and Wishaw) (Lab)

COMMITTEE MEMBERS

*Hugh Henry (Renfrewshire South) (Lab)

*Alex Johnstone (North East Scotland) (Con)

*Angus MacDonald (Falkirk East) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Russell Frith (Audit Scotland)

Caroline Gardner (Auditor General for Scotland)

John Maclean (Audit Scotland)

Diane McGiffen (Audit Scotland)

CLERK TO THE COMMITTEE

Catherine Fergusson

LOCATION

The Adam Smith Room (CR5)

Scottish Parliament

Meeting of the Commission

Thursday 30 October 2014

[The Convener opened the meeting at 10:02]

Decision on Taking Business in Private

The Convener (Colin Beattie): Good morning, everybody, and welcome to the second meeting in 2014 of the Scottish Commission for Public Audit. I remind everybody to switch off their mobile phones and other electronic devices.

Agenda item 1 is to decide whether to take items 3 and 4 in private. Are members content to do that?

Members *indicated agreement.*

Audit Scotland Budget Proposal for 2015-16

10:02

The Convener: Item 2 is Audit Scotland's budget proposal for 2015-16. I welcome Caroline Gardner, the Auditor General for Scotland; John Maclean, the chair of Audit Scotland; Russell Frith, the assistant auditor general, and Diane McGiffen, the chief operating officer. I invite Caroline and/or John to make an opening statement.

John Maclean (Audit Scotland): I will start, thanks, convener. This is my first appearance at the commission and I take this opportunity to put on record my thanks to Ronnie Cleland for his service as chair of Audit Scotland and to say that he leaves an organisation that seems to me to be in healthy shape and fit for purpose. There have been a number of other recent changes to the membership of the board, and part of my role will be to seek to ensure that the new board works effectively and harmoniously.

I give you my assurance that the board will continue to monitor and review Audit Scotland's plans carefully and will be engaged with the creation and approval of the next corporate plan. We shall continue to scrutinise costs and manage finite resources while delivering a full programme of work for the Auditor General and the Accounts Commission.

That work will include carrying out the annual audits of more than 200 public bodies of varying size and complexity; producing about 20 best-value and performance audit reports covering key areas of health, local government and central Government; regularly reporting our findings to the Public Audit Committee of the Scottish Parliament; providing briefings on areas of our work that are of interest to other parliamentary committees; and working closely with other scrutiny bodies to help to ensure consistent scrutiny across Scotland's public bodies by carrying out 32 shared risk assessments and related follow-up work. That will all be done against a background of seeking to reduce further the cost of audit while maintaining output levels and, most important, the quality of that output.

If there are no questions for the moment on any of that, I shall ask Caroline Gardner to say more about our budget proposals.

Caroline Gardner (Auditor General for Scotland): The paper that is before the commission sets out Audit Scotland's budget proposals for the 2015-16 financial year.

As John Maclean touched on, the Audit Scotland board has overseen a four-year plan to

reduce our costs by more than 20 per cent, which we have now completed.

From 2015-16 onwards, Audit Scotland will take responsibility for new audit work, even before the implications of any further devolved powers are known. Setting aside that volume increase and despite the cost pressures that we face, the revenue budget proposal that is before the commission reduces the cost of audit to the Scottish Parliament by a further 1.6 per cent in real terms. Most of the cost of that new work will be recovered from other sources, but a small part is attributable to the Scottish Parliament. We have worked to minimise the additional costs of meeting those new audit responsibilities.

Our budget proposals therefore request a revenue resource requirement of £6,438,000, which represents a cash increase of £37,000—or 0.6 per cent—from 2014-15. The increased revenue support that is sought from the consolidated fund is directly attributable to the creation of Revenue Scotland and food standards Scotland.

As we signalled previously, an increase of £1,530,000 in capital funding is sought to invest in office relocation. That investment will deliver revenue savings of at least £2 million over the 10-year period of a lease.

Overall, our budget proposals request a total resource requirement of £7,968,000. Those proposals assume continued investment in our organisation to ensure the quality of our work. Developing the skills of our workforce at all levels, including the capability of our managers, is essential to maintain and improve Audit Scotland's quality and productivity into the future.

We are happy to answer any questions that the commission may have.

The Convener: Thank you very much. I will start with a general question on fee strategy, if I may. On page 4 of "Fee Strategy 2014", Audit Scotland notes that the average cash increase from 2013-14 to 2014-15 will be 1 per cent across all sectors. Given that that is an average, are there any reasons why some increases will be more than 1 per cent and some may be less than 1 per cent?

Caroline Gardner: I will ask Russell Frith to explain that, if I may.

Russell Frith (Audit Scotland): Thank you. This year, the fee increase will be level across all sectors. In some years, we have varied it between the sectors. In this case, because the increase is a general price-based one, it is equal across all sectors.

The Convener: So it is not actually an average; in reality, it is a flat 1 per cent.

Russell Frith: It is an average and a flat 1 per cent this time.

Caroline Gardner: It is probably worth being clear that it is the average across the sector, but individual bodies in each sector may see a different change to their audit fee. You will know that we set an indicative fee that reflects our best estimate of what would be needed for a body of a particular scale and type, but audited bodies may negotiate a reduction in the audit fee if they have particularly strong internal controls and governance. The auditor may feel that a higher fee is required if there are problems in a body. Therefore, the figure is an average in that sense. However, you are absolutely right: it is a level increase for each sector.

The Convener: So you are starting on the basis of a flat increase of 1 per cent, but individual bodies may negotiate differently and some might conceivably be charged a little bit more, depending on the scope of the services.

Caroline Gardner: Absolutely. Some fees may be higher and some may be lower, depending on the audit that is required in the particular body. However, that is the indicative fee level that is set for each sector.

The Convener: Okay. So in fact you are aiming for an average of 1 per cent.

Caroline Gardner: The fee level that has been set is going up by 1 per cent, but the audit fee may vary by more than that because of changes in the level of audit that is required in each body.

Angus MacDonald (Falkirk East) (SNP): Good morning, everyone.

On page 5 of "Fee Strategy 2014", Audit Scotland notes that it is

"currently conducting a review of its fee setting arrangements to ensure that they remain appropriate for future years. Any proposed changes to these arrangements will be included in future Fee Strategies."

Can you provide some background to that review, such as the progress to date, the main issues that are being considered, and when the review is likely to conclude?

Caroline Gardner: I will ask Russell Frith to come in in a moment, but the broad background is that I felt when I came into post in 2012 that it was a good time to review the overall approach to securing the audit, which had been in place since Audit Scotland was established back in 2000. Within that, the approach to setting the audit fee and recovering our costs from audited bodies is a key strand. Russell is leading the review on behalf of me and the Accounts Commission and is reporting it to the board.

Russell Frith: As Caroline Gardner said, we have not done a thorough review of our funding and fees strategy for many years, and it is time that we did so. The things that we are looking at include the balance of funding between what is provided by Parliament and what is provided by fees; we are looking at the highest level to make sure that that balance is appropriate for the type of work that we are doing. We are also looking at the balance of fees between the various sectors, such as local government, health and central Government, to make sure that it is still in line with the levels of work that we are doing in those sectors. We are also looking at the balance of fees between different sizes of bodies. Over the last decade or more, as auditing standards and technology have changed, it is probably the case that the degree to which fees go up with the size of the body has changed in the profession, too. We are looking to ensure that we are still getting that balance right as well.

We are therefore looking at all aspects of fee setting and charging—at every aspect of what is in the fee strategy document. We hope to reach provisional conclusions on that very early in the new year.

Angus MacDonald: Thank you. You say “provisional conclusions”, but when will the review finally be concluded?

Russell Frith: It 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.

Angus MacDonald: That is great. Thanks.

On page 7 of the document, Audit Scotland refers to

“around 37% of annual audit work being carried out by firms under five year fixed term appointments”.

Per the budget proposal for 2015-16, firms will be paid £5.016 million, which is around 20 per cent of Audit Scotland’s overall gross administration costs. How do you ensure that audits that are carried out by your own staff and those that are carried out by firms achieve the same value for money?

Russell Frith: First, as you know, we appoint the firms for five-year periods and that involves price competition, so we get a degree of competition in at that point. Obviously, we will repeat that at the end of the five-year period. We also compare the costs of our in-house teams with those of the firms to try to ensure that they keep within the range of values offered by the firms, so that we have good competition between the two.

Angus MacDonald: Thank you.

The Convener: I will come in on the back of that with a small question. Again, on page 7, the first paragraph, which is headed “Mixed Market”, states that firms are appointed for a

“five year fixed term ... with an option”

for Audit Scotland

“to extend for up to two years”.

Seven years is quite a long time for an appointment. Given that in the private sector there is a tendency to review such appointments every three years unless there are exceptional circumstances, is seven years too long? Is it that there is only a limited pool of companies available to do the work and therefore the reality is that you will probably appoint the same half-dozen companies all the time?

Caroline Gardner: We think that five years is about the right period. Under United Kingdom auditing standards—Russell Frith will keep me straight on this—I think that the requirement is that the partner is rotated every seven years, with at least a two-year cooling-off period. As you will know, the Financial Reporting Council increasingly requires audits to be tendered more frequently than that but does not require rotation, so we go further than the auditing standards require.

10:15

In broad terms, we use the two-year extension power to give us more flexibility if there are particular changes within the world that we are working in. It is not something that we would routinely use, not least because it makes sense to step back once every five years and consider the overall balance of audit appointments that are being made to ensure that they give us the right result in terms of independence and value for money.

You are right to say that there is a relatively small pool of firms from which we can draw, because quality is important. We must have the ability to invest to get the right quality of audit work and to meet the auditing standards. We think that the five-year mainstream limit that we set is right, with just a bit of flexibility in particular circumstances.

The Convener: So, at the end of the five-year period, the audit company would automatically change. The company would not have the option to rebid for that particular piece of business, and the work would go to another audit company.

Caroline Gardner: The firms do not bid for individual audits; they bid to be on the slate of providers from which the Accounts Commission and I make appointments. Within that, normally, we move the audit appointment to another firm or to one of the in-house teams. However, there

might be circumstances in which we do not do that. In the in-house teams in particular, there are sometimes good reasons for us changing the appointed auditor—the individual who is responsible—but keeping it in house.

Russell Frith can add to that, to give you a bit more colour about how the process works.

Russell Frith: That description is absolutely right. To give you a bit of reassurance, I can say that, although we have included the potential two-year extension in each one of our five-year appointments since Audit Scotland was created, we have never exercised it. It was primarily put in there because we need to build in any flexibility at the beginning, rather than later, and to account for things such as reorganisations of particular parts of the public sector, in cases in which we would not necessarily want to change the auditor at exactly the same time as the reorganisation was taking place.

Generally, we rotate the audit provider, whether it is a firm or an in-house team. Occasionally, we do not. With 68 per cent of the work being done by the in-house teams, we cannot rotate every provider every time. However, where we have not rotated the firm or the team, we will change the lead individuals, to ensure that fresh pairs of eyes come to the audit.

The Convener: As a general principle, having regard to transparency and so on, I would be concerned if someone were appointed for five years, then another five years and then another five years. That might lead to the typical situation of someone getting a bit too comfortable in the job. As you say, you really need a fresh pair of eyes or a new company coming to the audit. I would have thought that the allocations of work would move around firms within that pool of approved companies.

Caroline Gardner: That is exactly the way it works. We will almost always appoint a different firm for each five-year period. In the in-house teams, we have six assistant directors who are appointed auditors in their own name, and we will rotate them after five years whether or not the appointment remains in house. That goes further than the auditing standards expect us to, and it gives us the right balance between getting people with an understanding of the business of the bodies that we audit and ensuring that fresh pairs of eyes come to the audit at regular intervals.

The Convener: How many companies have done five years and then had their contract extended for another five years on the same job, so to speak?

Russell Frith: About a handful, over the 14 years or so that we have been operating in that way.

The Convener: Are there any currently in that position?

Russell Frith: Yes.

The Convener: How many?

Russell Frith: Two that I can think of. There might be another one.

The Convener: I would be interested in knowing a little more about that. The circumstances in which that happens must be exceptional, and it would be interesting to know the individual reasons behind those cases. I realise that you might not have that information here with you today.

Caroline Gardner: I am happy to provide the information, along with the reasons for the decision being taken in each case. That is no problem.

The Convener: I note that Hugh Henry has just arrived. Hugh, we have already allocated the questions. You can just jump in on the back of anything that you are interested in.

Alex Johnstone (North East Scotland) (Con): On page 7, under the heading “Principle assumptions underpinning the fee strategy”, the second bullet point says:

“To the extent that the budgeted cost of in-house teams is less than the estimated value of fees earned the difference will be used to reduce the fixed charge across all audits.”

The question that jumps out is why it is not your practice that, when an audit costs less than expected, the excess fee is simply returned to the audited body. Why do you take the approach that you do?

Caroline Gardner: I think that it springs from the fact that the audit fee recovers the cost of the audit of the financial statements of that body and the cost of the wider responsibilities that Audit Scotland has on behalf of me and the Accounts Commission. The mechanism that we have for recovering all the costs of audit in local government and a significant part of the costs in the other sectors that we are responsible for is an audit fee that covers the direct cost of the audit, the performance audit work, the best-value audit for local government and a range of other things, as well as the running costs of Audit Scotland. Therefore, it is not a one-to-one trade-off between the cost of the audit and the fee that is charged. Some central costs are recovered, too.

Alex Johnstone: That is a fair explanation and one that I accept, but has it ever been a point of contention for the audited bodies?

Caroline Gardner: I think that it is fair to say that discussions about audit fees are often robust, as you would expect them to be. People do not

necessarily like paying audit fees any more than they like paying insurance premiums and so on; it is something that is required. Although we are clear that we can demonstrate benefits, audit fees are not always popular. The discussions between the auditor and the audited body are properly challenging in relation to whether the amount that we are charging is appropriate and reflects the body's circumstances, and whether it reflects the discipline that we are applying to our own costs. Challenging debates often take place about audit fees, but the overall principles are reasonably well understood and are available to audited bodies through our fee strategy and through the information that we provide to them. I do not think that we have many examples of difficult discussions of the type that you allude to.

Russell Frith is closer to this work than I am, and he might be able to give you a bit more flavour of the process.

Russell Frith: What Caroline Gardner says is absolutely right. The bodies have an incentive to discuss audit fees with the auditor. We contemplated setting the fee full stop, with no negotiation, but we thought that that did not provide an appropriate set of incentives for the auditor or the audited body from the point of view of the efficiency and effectiveness of their financial management procedures and their accounts preparation, which is why we allow a degree of negotiation between the auditor and the audited body around a central estimate of the fee for that size and nature of body.

Sometimes the discussions are robust, but the long stop of central intervention in fee setting has happened perhaps four or five times over the past 14 or 15 years, and it has not happened once in the past year or two.

Caroline Gardner: If we find that we have recovered more fees than we need or have spent less than we expected in a particular sector, we make rebates to audited bodies. The commission will have seen that over the past few years, as we have reduced our costs more rapidly than expected. Some quite significant rebates have been made to individual bodies at the year end.

John Pentland (Motherwell and Wishaw) (Lab): Good morning, panel.

On page 7 of the fee strategy, Audit Scotland advises:

"Final fees should be agreed between auditors and audited bodies based on local circumstances".

On page 13, it notes that the fee for the financial audit element of audit work is

"based largely on historical experience."

Furthermore, it advises that local negotiations on the fees that are charged should be limited to between plus or minus 10 per cent.

Taking that into account, could you perhaps give us further explanation of the historical experience of setting audit fees? Is that based on how far forward a company is with information technology stuff and the extent to which it still uses pen and paper? Could you tell us how you get to that kind of margin?

Caroline Gardner: Of course. I will let Russell Frith talk you through that, if I may, as he is very close to that work.

Russell Frith: That is absolutely right. Some years ago—again, this is one of the elements of our review of funding and fees—we built up a central estimate of what we thought that it would take to do an audit of a particular size of body in a particular sector. The idea of the negotiation around that central estimate is to reflect the sort of thing that you referred to.

For example, where bodies have merged together but have perhaps retained two, three or four different systems for the first few years, we would expect the audit fee to be higher in those first few years than the average fee in the long run, once the new body got down to a single set of new systems. If internal audit is extensive in an organisation and it is carrying out the sort of work that the external auditor can rely on to reduce the amount of work that it does, I would expect the fee to go down.

There can be many different circumstances. There may be a new strand of business or a new major project that requires additional audit effort in any one year but not in every year. We do not try to specify the precise fee for each body for each year centrally because, sitting in the centre, we cannot know the detailed circumstances of each body each year. The auditor is in a much better position to discuss that with the audited body.

We set the 10 per cent boundary so that we can monitor to some extent how that is being used. If auditors or audited bodies were exerting undue pressure on one another, we would want to know about it and be able to intervene. That is why the 10 per cent limit is there. Auditors and audited bodies can agree on a fee change that is outside that 10 per cent limit, but they need our consent to do so. It is just a monitoring mechanism to ensure that there is fair play all round.

John Pentland: When you appoint an auditor for an audited body, do you take into account the robustness of the company? There is a big variation between companies that have improved their systems and, on the other side of the coin, companies that might not have been able to do that. Do you take that into account when you

appoint an auditor to a specific company or health board?

Russell Frith: We would still set the central estimate and we would expect that new auditor to form a view for itself of the position of the individual body that it was auditing. It will know in advance, before it tendered for the work, what that central estimate was. It can then form its own view of whether it wants to be involved in that sector's work. If so, it should know enough about the sector to know the significant issues across the bodies in that sector.

Caroline Gardner: Our overall aim is to ensure that each one of the auditors on the panel from which we make appointments can audit any of the bodies in a sector, whether it is a very well-run organisation—in which case, the audit fee might be lower—or whether it is an organisation that has particular problems, in which case the audit fee might be higher. It is not something that we would take into account when deciding which auditor did which audit; it is very much part of deciding how much work is needed to carry out the audit effectively.

John Pentland: Can you give us some examples of particularly well-run bodies that receive significant fees reductions—in other words, reductions of more than 10 per cent?

Russell Frith: I cannot think of any fees that have gone down by more than 10 per cent in any one year recently. Obviously, as you know, we have reduced our overall charges across the board by 23 per cent in real terms in the past four years. However, on top of that, I cannot think of any fees that have gone down by more than an additional 10 per cent in that time.

John Pentland: So the question is, why is that 10 per cent limit there?

Caroline Gardner: It is an important safeguard, as Russell Frith has said, for me and for the Accounts Commission, to make sure that we are not in a position in which the negotiation between the audited body and the auditor is leading to the audited body applying undue pressure to reduce the fee, to the point at which it does not give me and the SCPA the assurance that we need, or one in which the auditor may have an incentive to negotiate up the audit fee to increase the return that it receives from doing the work.

As Russell Frith said, if either side feels that it needs to adjust the fee by more than 10 per cent in either direction, it is free to come to us to request that, but the limit makes sure that we are aware of those movements. We can then make sure that an adjustment is being done for good reasons to do with the quality of governance, financial management and financial reporting rather than for less good reasons that would

reduce the degree of scrutiny that we can provide and the assurance that we can give to you in the Parliament.

10:30

John Pentland: I have one final question. Given that you are unaware of a 10 per cent reduction being imposed, what is the biggest percentage reduction that you know of?

Russell Frith: I would rather come back to you on that than give an inaccurate figure.

John Pentland: Okay—that is fine.

The Convener: If there are no more questions specifically on fees, we will move on to the budget.

On page 3 of your budget proposal for 2015-16, you advise that you are seeking capital funding of £1,340,000 to meet the costs of fitting out and furnishing a new office location. We have been through the issue of site consolidation with Audit Scotland in the past. According to your budget proposal, the investment will result in savings of £2 million over 10 years, and you are also looking to replace printers and so on.

Would you be able to supply a copy of the business case that justifies that move?

Caroline Gardner: Of course, convener. You are absolutely right that the issue has been on Audit Scotland's agenda for a number of years now, and it has been part of our discussions with the SCPA over that period.

In the past three years or so, we have moved from having three sites in Edinburgh to having one, thereby releasing savings and improving our working. We have also improved our working through reprovisioning our west of Scotland office. What you have described is the final stage of our overall property strategy.

The board has been closely involved in overseeing the work that has been done to prepare for the final stage, and it considered the business case at its meeting last month. I am happy to provide that business case to you in confidence, although I note that we are at a sensitive stage in our negotiations with a small number of landlords, so we would prefer to do so in a way that recognises the sensitivity of those commercial negotiations at present.

The Convener: That sensitivity is understood.

I presume that the £2 million over 10 years is a straight saving of £200,000 a year? Is that a net or a gross saving?

Caroline Gardner: It is a net saving, and it is the best estimate that was available to us when our budget submission was prepared. We have been refining the figures a bit further since then, to

the point at which the business case was approved by the board at its last meeting. We will now enter into negotiations with a landlord to crystallise those figures, but the £2 million figure is our best estimate of the net saving at the point when the submission was prepared.

The Convener: It appears to be a fairly substantial saving against the investment that is being made, albeit that the investment is being made up front and we will have to wait a wee bit for the return. Is it realistic? We have not seen the business case.

Caroline Gardner: I am very confident that it is realistic. Just to paint a picture for you, we are currently in two buildings that we inherited on George Street, which are both older office buildings with a number of floors. There is a fair amount of wasted circulation space as a result, and small offices in the buildings.

We think that, as a result of reducing the floor space that we occupy and moving into more modern office accommodation, we can generate savings of the order that we have set out in the paper and genuinely improve our productivity and the working environment that we can provide for staff. We are very confident about that.

Diane McGiffen may want to add to that.

Diane McGiffen (Audit Scotland): As the Auditor General said, we are talking about the final piece of the jigsaw in our property rationalisation. Since 2009, we have moved from six offices to four offices, which has reduced our square footage by just under 11,000 square feet—a reduction of approximately 30 per cent. That has generated reduced running costs of approximately £300,000 per year. The final move will enhance those savings and will mean that, since 2009, we will have reduced the square footage that we occupy by just under 44 per cent. That will be significant, because we are occupying very inefficient spaces at present.

In addition, the cumulative savings since 2009 have contributed significantly to our ability to reduce the cost of audit. The proposed investment is one of the key levers to enable us to release more savings, having made significant reductions in staffing and changes to grade mix.

The Convener: That saving is clearly welcome, but I would be interested in seeing the rationale behind it.

The capital request includes £60,000 for printer replacement. Given the consolidation and the move to one building, is there a case for rationalisation, moving towards digital working and so on? There is an opportunity there. To what extent are you taking advantage of it?

Diane McGiffen: We are seeking to take huge advantage of it. We currently have to provide printers across two sites and 10 floors, although not, I should add, on every floor. As part of the current printer replacement programme, we will seek to consolidate into as few as four printers, and possibly fewer than that. Those printers will have a very good specification and will not print unless someone uses their card and presses the print button for a document. We will therefore be able to reduce unnecessary printing further.

Given that our plans are built around a move, anything that we invest in just now will be taken with us to our new premises. We are seeking to reduce significantly the amount of kit that we have and improve its efficiency, while keeping control of running costs and avoiding excessive printing.

We have also invested significantly in electronic working papers and electronic storage. We use significantly less paper than we did before, and we have worked hard to stop the usage level creeping back up again.

The Convener: Are the likely savings from that source incorporated into the £2 million?

Diane McGiffen: From the printing, do you mean?

The Convener: From the printing and the changes that you have described.

Diane McGiffen: Not yet. We expect further savings to be released when we are in our new site, but those are difficult to predict at present. What we know is that the investment that we make in printing will make things more efficient than our current set-up, and we will be able to document the savings as we move forward.

The budget proposals are based on our best estimates before going to procurement to secure the printers, but we would be very happy to track the process for you. The printer savings are not part of the savings that are included in the work on property, but they will become some of the more marginal savings that we will be able to generate when we are in more efficient premises.

Alex Johnstone: Page 3 of your budget proposal contains the heading:

“When additional audit obligations and one off property costs are excluded, the budget will deliver:”

followed by a list of bullet points. The first bullet point says that the budget will deliver

“a reduction in gross administrative costs of £329k (1.4%)”,

while the second says that it will deliver

“a cost reduction (efficiency) target amounting to 1.5% of our 2014/15 expenditure budget”.

How do those two objectives relate to each other?

Caroline Gardner: They both reflect our continuing commitment to apply pressure on our operating costs. As the SCPA knows—because we keep telling you—we have completed a four-year programme that has reduced the cost of audit by more than 20 per cent. That is the large cost reduction that we can make; rationalising our property will be the next big contribution.

The two points that you have highlighted relate to our continued pressure on running costs in areas such as IT and printing, which the convener has just explored. The first bullet point relates to the areas in which we already know we can reduce our running costs further, and I will ask Diane McGiffen to talk you through that a bit more. The second relates to our target for making efficiencies during the year as part of that exercise of good financial discipline.

Diane, can you give us a bit more detail on how both of those work?

Diane McGiffen: Yes. We are continuing to make savings in our underlying staffing structure as savings flow through from restructuring that has taken place, and we continue to look for efficiencies and savings in all of our running costs. We thought that this year it would be helpful to separate out the changes in volume that are reflected in the budget because of the new responsibilities that stem from our other costs.

Alex Johnstone: This sounds like a simple question, but I take it that those two bullet points are concerned with two quite separate issues, and that there is no element of overlap or possible duplication.

Caroline Gardner: It is not double counting. As Diane McGiffen said, the reduction in gross administration costs comes from our continuing moves to change the skills mix to make it more appropriate and areas where we have reduced our costs in things such as IT procurement. The efficiency target is exactly that—it is a target for making further efficiencies during the year in areas where we are confident that we can achieve them. The two are complementary and related to each other in that way, but they are not double counting.

Angus MacDonald: You mentioned in your introductory remarks that Audit Scotland is seeking additional revenue funding of £37,000 in 2015-16, which as the proposal states is

“directly attributable to the creation of Revenue Scotland and Food Standards Scotland.”

The £37,000 covers part of a full-year audit of the two new bodies, whose first accounts will not be prepared until March 2016. However, the combined audit fee of £110,000 seems a bit high for two organisations with an estimated spend of £20 million. Can you provide some background on

how the estimated annual audit fees for the two new bodies were arrived at?

Caroline Gardner: Certainly. I will ask Russell Frith to talk you through the detail in a moment, but first I should probably reiterate the point that I made in response to Mr Johnstone that the audit fee that is charged to each body is not simply the cost of auditing that body's financial statements, because of the wider responsibilities that we have, not least in reporting to the Public Audit Committee of this Parliament.

I ask Russell Frith to say a little about the make-up of the fees.

Russell Frith: Mr MacDonald is right about Revenue Scotland's administrative spend but, in addition, it will collect £440 million of devolved taxes, and the audit fee includes the fees for auditing the collection of the new property and landfill taxes. Those audits will involve looking at how brand-new systems are operating. Revenue Scotland is a significantly larger organisation than its revenue spend would indicate, and it takes the bulk of that £110,000 total. The figure for food standards Scotland is about £30,000, which is very much an estimate. When we made it, we were not entirely sure of the total scope of the body's activity, and the figure will be refined as we get closer to its actual start date.

Angus MacDonald: Thank you—that certainly explains that.

On page 8—

Hugh Henry (Renfrewshire South) (Lab): I am sorry, but can I ask a question about Revenue Scotland? How significant are the additional audit costs associated with any changes to taxation powers going to be?

Caroline Gardner: At the moment, we do not know how significant the changes will be, because we do not know what further tax powers or other fiscal powers might be devolved to the Scottish Parliament. In my response to Lord Smith, I have said that one thing that we can help with is ensuring that good governance and accountability arrangements are in place. That will help to ensure that the additional audit cost is kept as proportionate as it can be. At this stage, we are looking at developments in the discussion about the further powers that should be devolved and are developing our thinking about what that might mean for audit, and we will play that into future budget submissions to this commission as the picture becomes clearer to us.

Hugh Henry: Do the costs reflect changes that have already been agreed, such as those that came from the Calman commission?

Caroline Gardner: In the proposal, we have reflected the changes that come from the

implementation of the Scotland Act 2012, because they are known. We have made no allowance for any further devolution that might happen as a result of the Smith commission and the discussions that follow it.

Hugh Henry: Right—okay.

Angus MacDonald: The convener touched on your overall property rationalisation strategy. On page 8, you identify an estimated additional requirement for £360,000 of property costs as a result of double running the current office locations while the new office is being prepared. I will understand if this is commercially sensitive, but have you negotiated any incentives such as a rent-free period or assistance with fit-out costs for the new office accommodation?

10:45

Caroline Gardner: Those are exactly the elements of the negotiation that we are now carrying out. To give the commission some comfort, the estimates in the document are based on discussions that we have had over a period with a small number of landlords for specific buildings. With the board now having agreed a business case, we are able to move into negotiation with a particular landlord for a specific site. The issues to which you referred are very much what we would expect to be part of that negotiation. Diane McGiffen might want to add something.

Diane McGiffen: We have worked very hard to minimise the double-running costs that we would incur. In discussion with our board over the past few years, we have planned this so that we are exiting both buildings that we currently occupy at the very end of the lease. We considered at various points different models for relocating and different timeframes. The one that we now have means that we will take on a new lease for an office in spring next year, work to fit it out in the summer and relocate in September, which will give us time to decommission the two offices that we currently occupy by the end of the year. That relocation process will take place in the shortest time period possible for us concurrently to continue running and delivering the business, fit out the new office and move with minimal disruption. We will curtail the double-running period as much as possible, but double running will still be necessary while we fit out the new office. It is a one-off cost associated with the move.

Angus MacDonald: Okay. Thank you.

On the decommissioning of the older offices, has sufficient provision been made within the budget for any additional costs associated with

returning the current Edinburgh offices to their landlords?

Caroline Gardner: Yes. We provide for those costs during the period of the leases. We are confident that our provision is adequate to cover the costs, and we might be able to release some of it back into our accounts for 2015-16. I do not want to commit to that at this stage, but we are comfortable that our provision will cover the costs involved.

Angus MacDonald: Okay. Thank you.

John Pentland: On page 10, Audit Scotland estimates that an additional £80,000 will be required to meet

“Increased travel costs supporting the new audits”,

which equates to a 9.3 per cent increase on the previous year. Given that Audit Scotland has already advised that 12 additional staff are being sought to meet the extra workload and that it generally has a staff presence across Scotland, do you think that the travel costs appear to be disproportionately high for the new audit work?

Caroline Gardner: I fully accept that, at first glance, they look high. The underlying reason is the additional work that is required for us to audit the European agricultural funds. I ask Russell Frith to talk you through the way that that works in practice.

Russell Frith: As the commission is aware, we are seeking more staff largely to do the additional work that is required for the European agricultural funds audits. The particular nature of the additional work that the European Union is requiring auditors to do requires site visits. The vast majority of the increase in work is the result of additional on-site visits to farms and agricultural businesses all over Scotland, many of which are in more remote places. That out-of-the-office travel is the reason for the significant increase in travel costs. As several of those visits are likely to be for several days at a time, it is likely that people will leave the office and stay in places for days or, indeed, a whole week.

John Pentland: Because the travel costs are associated with work on the European agricultural funds and the 30 new joint integration bodies for health and social care, could they be recharged to the audited bodies?

Russell Frith: In the case of the audit of the agricultural funds, the costs are part of the fee calculation.

The joint integration boards are likely to be small bodies and we would expect those audits to be combined with the audits of either the council or the health board, depending on where the administrative systems are held. Auditing the joint

integration boards is likely to lead to only a marginal increase in travel costs.

Diane McGiffen: I can provide assurance about the underlying management of our travel costs. In June, we published a report on the results of our five-year carbon reduction plan. We set an initial target of reducing our business travel by 10 per cent. However, by 2013-14, car mileage was 30 per cent lower than it had been in 2008-09. Some of that is due to the fact that we have fewer staff, but it is also due to our travel management and planning.

Although you are seeing an increase this year because of the additional volume of work, the underlying picture is positive and moving in the right direction, with much more consideration given to planning and targeting journeys. We have been reducing our carbon footprint overall. The information on that is available in our published report on our progress against our carbon reduction plan.

We are in the process of developing the next round of our carbon reduction plan, and we will be looking closely at business mileage and how we travel to conduct our work, to make sure that that approach is as efficient as possible and supports our business needs, but that it continues to help us reduce our carbon footprint.

John Pentland: Does Audit Scotland use pool cars or do employees use their own cars?

Diane McGiffen: We use a mix: some employees use their own cars, and we have a car fleet for some business roles. We also have a strong push towards public transport use.

We have been looking at our car fleet and how to reduce its membership and carbon footprint. You will find details of that in "Carbon Scrutiny", which shows progress on our five-year plan and the reductions that we have made.

We have increased the use of public transport. Last year, we consolidated our East Kilbride staff into the Glasgow office. That has made a significant contribution towards a shift to rail use between offices and buildings rather than people using cars to travel between Edinburgh and East Kilbride. We are continuing to see efficiencies.

We will be looking at all such issues as we prepare our next carbon management plan.

Alex Johnstone: In appendix 1 on page 18, some of the figures make for interesting reading. I want to ask about one or two of the more volatile figures that appear.

Under the heading "Audit support—external fees", it seems that fees will fall from £705,000 in 2014-15 to £465,000 in 2015-16, which is a 34 per

cent drop. What is that budget line used for? Why has it decreased so dramatically?

Caroline Gardner: You will understand that, as well as doing the planned work that we carry out every year—the audits of 220 or so public bodies, the programme of planned performance audit work, the best-value work and so on—we also need to be able to respond to specific issues as they emerge. Whether an issue arises that is of significant public concern, such as our work on waiting times, or there is an issue in a particular body, we need to be able to respond in a timely way and, often, with specific expertise.

The budget line that you mention is a big part of how we make sure that we are able to respond. The figures for 2012-13 and 2013-14 show the actual spend. We had a high year in 2012-13 and a lower one in 2013-14. Because of the work that we have done in reducing our core staffing and core costs, it is important that we protect that for future years, so that we can work things through and ensure that we do not limit our ability to respond to issues as they occur.

The national fraud initiative is the other significant cost that comes from that budget line. That is a biennial exercise that we take part in with audit bodies across the United Kingdom. We pay our share of the costs, and there is a peak every two years because of how the work is carried out.

I am pleased to say that the investment that we make in that work is significantly more than the cost of doing it, but that does not show up in our accounts in the same way that the cost of doing it does.

Russell, do you want to add to that at all?

Russell Frith: That is absolutely right. The amount involved is about £220,000. The cost peaks every second year, and 2014-15 is one of those peak years.

Alex Johnstone: The same table shows a budgeted increase in legal and professional fees from £141,000 to £176,000 in 2015-16, which is a 25 per cent rise. What are you anticipating there?

Caroline Gardner: I am looking at Diane McGiffen and Russell Frith to see who has the figures at their fingertips.

Part of what we see in that figure is the legal and other fees that are associated with the move to the new Edinburgh office, which is an unusual and one-off event for us. We are making sure that we are properly advised by legal advisers and people who will help us make best use of the building and manage the project as well as we can. That is likely to be a significant part of it.

Russell Frith can help with any other detail that may be useful.

Russell Frith: There is a series of small things across different parts of the organisation that are quite unpredictable at the beginning of the year, but Caroline Gardner has explained the main difference between this year and next.

Alex Johnstone: We regularly pick out training and development costs as being of interest. This time there is a rise from £405,000 in the current year to £478,000 in 2015-16, which is an 18 per cent rise. What do you anticipate in that figure?

Caroline Gardner: In a moment I will ask Diane McGiffen to give you some detail of how the figure is made up, but I will start by reiterating our commitment to ensuring that our staff not only have the professional skills that they need to do their work but get continuing professional development to ensure that we can continue to meet the expectations placed on us at a time when there is pressure on our resources.

Diane, can you talk us through what is happening with that budget line?

Diane McGiffen: The key difference in this budget is the provision that we are making for costs that are associated with looking at our grading structure, roles and so on. We have made significant changes over the past few years to the size and shape of the organisation and it is time for us to look at our roles and grading structure. There is a bit of additional resourcing in there to get expert advice on that.

Under the “Training & organisational development” heading, you will find the costs of our professional trainee scheme, which are just under £100,000. We currently have 39 trainees with us, with 13 starting this month. As you know, we are a training organisation with a great history of providing professional training opportunities. That is a component of the costs you see there.

The rest of the costs are in the investment that we make in ensuring that our auditors are professionally competent, up to date with professional accounting and auditing standards and developing and enhancing the skills that are needed to conduct audits, produce reports and present the work that we produce to the public, the Parliament and so on. There is a range of continuing professional development in there.

The proportion of our staff who are professionally qualified and members of professional associations means that we have a significant commitment to continuing professional development, so people can remain committed and engaged in professional institutes. Across the piece, we are providing an excellent mix of training and development to help the reduced number of staff that we have meet our additional and new responsibilities.

Alex Johnstone: I am looking at the income side of the same table. I noticed that under “Miscellaneous income” last year there was a figure of £164,000, yet the projected figure for this year and the year after is zero. What has gone wrong there?

Caroline Gardner: I do not think that anything has gone wrong, but you are right that the figure has moved around. The underlying factor is the extent to which we are seconding staff to other organisations and receiving payment back for them, but Russell Frith has the detail at his fingertips.

Russell Frith: That is absolutely right: it is secondment income. We tend not to assume a budget for any net income, on the basis that if we are seconding staff out and receiving income for it, in most cases we will backfill that role in some way that we will have to pay for, either from a secondment in or through temporary recruitment.

The net impact on the budget is likely to be zero. When it comes to accounting for the actuals we will reflect the income, which, as you can see, was only £43,000 the year before and £164,000 last year, and the gross cost of the staff is shown on the top line.

11:00

Alex Johnstone: Thank you. Moving to a different subject—

Hugh Henry: Before we move on, convener, could I come in on the issue that Alex Johnstone raised, on other costs under the heading “Audit support—external fees”? Mr Frith explained that, every second year, there would be an increase in costs, but the actual costs for 2013-14 were £225,000 and the proposed budget for 2015-16 would be £465,000. Those two years are comparable years, rather than 2013-14 and 2014-15. Why the extra £200,000?

Caroline Gardner: I think that you are seeing the interaction of both points that we raised in response to the earlier question. There is about £200,000 going in and coming out and going in again for the national fraud initiative, but there is a deliberate attempt to protect the resources to ensure that we can respond to unexpected audit requirements as they may emerge during the year through a consultancy budget, which can either give us additional resource or expert skills and experience to allow us to carry out that work within the tight overall resource allowance that we now have to do the work that is required of us.

Hugh Henry: What would you anticipate the budget for 2016-17 to be?

Caroline Gardner: In 2016-17, we will have to fund the national fraud initiative again, assuming

that it continues in its current form, and we will also be looking closely at what we think is the right level of resource to include to allow us to respond to issues as they emerge during the year. You might expect the budget to go up a little from this year's, but I am not saying that there will be an automatic addition of the full cost of the national fraud initiative. We look at the budget as a whole and ensure that we are flexing it to respond to what we think the requirements may be, and we look at it in the context of the overall sick leave staff budget for the organisation as a whole.

Hugh Henry: Thank you.

Alex Johnstone: On a different subject, we have discussed in previous years the issues surrounding the amalgamation of the police forces and the fire and rescue services around Scotland. As we heard, there were some initial, and perhaps additional, up-front costs, but it was anticipated that audit costs and resource activity would be reduced over time. Are we now beginning to see some benefit in terms of the audit costs for those organisations?

Caroline Gardner: It is early to see the full impact of those amalgamations. We know, for example, that Police Scotland and the Scottish Police Authority are still running a number of different finance and payroll systems, as well as other underlying systems that mean that more audit work is required than would otherwise be the case. Russell Frith has a close view of the audit fee requirement for both the SPA and the Scottish Fire and Rescue Service, and I shall ask him to give you a bit more detail.

Russell Frith: You are absolutely right, Mr Johnstone. The assumption that we made was that, once the new bodies were up and running in steady state, the total audit cost for police and fire would come down by about 50 per cent from what it was prior to reorganisation.

That has not happened in the first year, for some of the reasons that were explained to Mr Pentland earlier. The police service has for the whole of the first year retained nine separate fixed asset ledgers relating back to the previous bodies, and it is a similar situation with payroll, so the auditors have to do considerably more work than we would expect in a steady state.

Once all those systems have moved over to new single systems, the audit fees will come down. Our original estimate was that they would come down to about 50 per cent.

Alex Johnstone: So, fingers crossed. I look forward to asking the question once again some other time.

John Pentland: Would it be possible for the commission to be given a breakdown of what

Scottish Government bodies are charged? Could we identify how much you charge Police Scotland, for example, and the other bodies? It would be quite interesting to see that breakdown.

Caroline Gardner: Certainly. That would be no problem.

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

Hugh Henry: I refer to the paragraph on pay on page 7 of the budget proposal. It states that there is

"a 2% increase in pay scales in April 2014 followed by a freeze for one year at the April 2014 rates."

Why have you adopted that strategy rather than having an even 1 per cent each year?

Caroline Gardner: We are very conscious of our need to demonstrate both proper financial discipline and financial management, and to ensure that we are able to attract and keep the staff whom we need to do our work. As part of that, we look at the overall rewards strategy that we are able to offer and ensure that we are absolutely in line with the Government's pay policy, but we also look at what matters to our staff and how we make the most of it.

Diane McGiffen can talk through the discussions that we had and the decision that the board made.

Diane McGiffen: We discuss our pay settlement every year with the Public and Commercial Services Union, which is our recognised trade union. It asked us to consider within the pay constraints under which we are operating what scope there was for flexibility. It highlighted a couple of awards that had been made in other public sector bodies, which had moved from single-year settlements to two-year settlements. Although the amount of money is not different, we made the proposition to the PCS about receiving the award up front over two years. Although it was not comfortable with the overall settlement, it was comfortable that, within the constraints, that approach might be beneficial to staff, and I think that that is how it has turned out.

Hugh Henry: Okay. Thank you.

The Convener: I have a couple of brief questions.

I go back to the European agricultural funds and the six additional staff. We talked about travel expenses and so on, but there are obviously other expenses related to that—for example, in relation to the office space and equipment that are used. Is that all bundled into the costs that are being claimed back so that there is zero cost at the end of the day?

Caroline Gardner: Absolutely. We have made our best efforts to estimate the full cost of doing the work. That cost is incorporated in the budget, and we are negotiating full cost recovery with the UK administration bodies, so there should be zero impact on our overall costs in Scotland.

The Convener: Good. I am sure that you will monitor that.

Caroline Gardner: Absolutely—very closely.

The Convener: In the first paragraph on page 7 of the budget proposal, you talk about best-value audits. If I recall correctly, at the previous meeting we talked about the reduction in the number of best-value audits. It is clear that they are quite important. By highlighting that, you have obviously endorsed that fact. Where are we going on that? Within the budget, are you budgeting for an increase in the number of best-value audits?

Caroline Gardner: Best-value audits are a responsibility of the Accounts Commission and are carried out by Audit Scotland, but I am sure that Douglas Sinclair would be happy for me to answer on his behalf.

On where we are now, we have been carrying out community planning audits that encompass some of the responsibilities for best value, but we have been looking at them on a slightly wider field. We are about to complete the last of the five that are due in 2014, and the Accounts Commission is currently reviewing where it will go next with its best-value responsibilities and community planning.

That has all been done within the existing resources that are available for audit, and the Accounts Commission is carefully considering where it can best have an impact in improving best-value community planning and the overall operation of the local authority bodies for which it is responsible. I think that it is planning to consult on that early in 2015.

The Convener: Just to be clear, I am assuming that you have included in your budget whatever the Accounts Commission has contracted with you, so best-value audits and so on will already be in your budget.

Caroline Gardner: Absolutely. Douglas Sinclair, as chair of the Accounts Commission, is a member of the board of Audit Scotland. That is where all this comes together.

The Convener: Okay.

In the last paragraph on page 9 of the budget proposal, you talk about offsetting the increased cost of staff by “grade mix changes”. I think that members have previously raised a general concern about your getting the right mix of staff and that we are not just saving money by getting

rid of experienced people and bringing in trainees or people with reduced experience. Can you continue to reassure us on that point? This is the second year that that has appeared in the budget.

Caroline Gardner: As you would expect, convener, I take very seriously the need to ensure that our overall staffing complement is the right number and the right mix to be able to deliver all the audit responsibilities that we have. Our approach has been to ensure that we are developing staff to take on as much responsibility as they can do, and delegating appropriately so that people take responsibility for their audit work and judgments, while ensuring that the organisation as a whole works in a way that is more joined up than it might have been in the past.

I am confident that the grade-mix changes are appropriate, but you are right, in that a point will come when we will have done as much of that as we can do and we are where we need to be.

John Pentland: Will the 12 or so trainees who are about to start be given the opportunity to take on one of the agricultural fund jobs?

Caroline Gardner: We need to take on new bodies—new minds and new pairs of hands—to do the work, because there is a significant increase in the volume of work that we have to carry out. More broadly, we are keen to ensure that all our trainees get as wide as possible a range of experience with us. As Diane McGiffen said, we do a good job of attracting excellent trainees. They are bright young people, who are full of enthusiasm and very committed to what we do, and we want to ensure that we build on and grow that ability and enthusiasm across the whole range of work that we do, including the agricultural funding work. That is a real commitment for us.

The Convener: If members have no more questions, does Audit Scotland want to add anything at this point?

John Maclean: On the property, it might give you comfort to know that last week all three non-execs visited the preferred location. They had access to the business case, and at the board meeting they spent a long time asking and getting reassurance on questions that were similar to the ones that you have been asking.

In addition to the benefits that will come from having an attractive and efficient new property, as opposed to the current inefficient property system, there is a staff benefit in having an attractive—but not extravagant—working environment, because we are going to come under pressure from private sector payroll costs in due course.

The private sector is recovering somewhat and there are signs that it is offering better terms and conditions. If we are to attract and retain the

people that we need and remain as efficient as we are trying to be, initiatives such as an attractive working environment and the training that Diane McGiffen mentioned are needed and indicate how we are working hard to make the roles attractive relative to the private sector.

The Convener: Thank you all for attending. That concludes the public part of the meeting.

11:13

Meeting continued in private until 11:20.

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