



OFFICIAL REPORT
AITHISG OIFIGEIL

Scottish Commission for Public Audit

Wednesday 20 December 2017

Session 5

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SCOTTISH COMMISSION FOR PUBLIC AUDIT
2nd Meeting 2017, Session 5

COMMISSION MEMBERS

- *Jackie Baillie (Dumbarton) (Lab)
- *Colin Beattie (Midlothian North and Musselburgh) (SNP) (Chair)
- *Bill Bowman (North East Scotland) (Con) (Deputy Chair)
- *Alison Johnstone (Lothian) (Green)
- *Rona Mackay (Strathkelvin and Bearsden) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

- Russell Frith (Audit Scotland)
- Caroline Gardner (Auditor General for Scotland)
- Ian Leitch (Audit Scotland)
- Diane McGiffen (Audit Scotland)

LOCATION

The Adam Smith Room (CR5)

Scottish Commission for Public Audit

Meeting of the Commission

Wednesday 20 December 2017

[The Chair opened the meeting at 10:31]

Decision on Taking Business in Private

The Chair (Colin Beattie): Good morning and welcome to the second meeting in 2017 of the Scottish Commission for Public Audit. I ask members and witnesses to keep their questions and answers concise and to the point. I also ask everybody to make sure that all their electronic devices are on silent mode.

Agenda item 1 is a decision on taking business in private. Do members agree to take in private agenda item 4, which is consideration of the evidence heard?

Members *indicated agreement.*

Spring Budget Revision 2017-18

10:32

The Chair: Agenda item 2 is evidence on Audit Scotland's spring budget revision for 2017-18. Members have a copy of the proposed spring budget revision in their meeting papers. I welcome to the meeting Ian Leitch, chair of the board of Audit Scotland. He is accompanied by Caroline Gardner, the Auditor General for Scotland; Diane McGiffen, chief operating officer; and Russell Frith, assistant auditor general. I understand that this is a big day for Russell Frith, because it is the last time that we will see him in front of us as he is retiring. I would like to take the opportunity to thank you, Russell, for all the support that you have given the commission over the years, and to wish you well in the retirement to come.

Russell Frith (Audit Scotland): Thank you very much, chair. It has been mainly a pleasure. I think that I have missed only one, or possibly two, of the SCPA's meetings since the commission started its work. I will miss it.

Ian Leitch (Audit Scotland): Just for the record, chair, this is Russell's last official engagement. After the meeting concludes, he will not back to the office—he will go home, and he will be retired. This is his last outing. The board of Audit Scotland is extremely grateful to him for his assistance. On the other hand, I make a plea in mitigation in advance: since he is demob happy, we need to be careful what he says. *[Laughter.]*

The Chair: We have no time constraints on today's meeting, so we will make it worth his while to be here.

I start by asking the Auditor General to make a short introductory statement of perhaps a few minutes.

Caroline Gardner (Auditor General for Scotland): Thank you, chair.

As you know, our spring budget proposal requests £2.826 million to meet a non-cash pension accounting charge that will arise as a result of accounting adjustments in 2017-18. The request relates solely to pension adjustments. We are not able to plan for these due to the timing of the information that we receive from our actuaries and the Scottish Government has asked us to deal with them through the spring budget revision process. It is worth emphasising that these accounting adjustments are notional and do not generate cash movements. As you know, chair, the area tends to be complicated but we will do our best to answer questions that you and the commission may have. I will leave it there at this point.

The Chair: Thank you. I will begin by looking at the individual amount that you have highlighted. Can you confirm you have had preliminary discussions with the Scottish Government to confirm that the previously agreed arrangements with Her Majesty's Treasury remain in place? Have you advised the Scottish Government of the amount of Audit Scotland's requirement?

Caroline Gardner: The answer is yes to both questions, chair.

The Chair: I will throw it open to members for any comments or questions on this issue. Members have none, so I ask whether they are content to agree the spring budget revision 2017-18.

Members indicated agreement.

The Chair: Thank you. We will write to the Finance and Constitution Committee to inform it of our decision.

Budget Proposal 2018-19

10:35

The Chair: Agenda item 3 is evidence on Audit Scotland's budget proposal for 2018-19. Members have a copy of the budget proposal in their meeting papers. We have the same witnesses for this agenda item. I invite the chair of the board, Ian Leitch, to make a short introductory statement of perhaps five minutes, followed by a statement from the Auditor General.

Ian Leitch: Chair, my statement will be shorter than that because you have our budget proposal before you.

As members of the commission are aware, this is a time of real change for Scotland's public finances as further powers are devolved to the Scottish Parliament. Our priority in Audit Scotland is to ensure that the high quality of audit work continues across the piece and that the organisation is sufficiently resourced to take on those challenges. Our budget proposal supports that goal by identifying resources to carry out new work, as detailed in our submission, and provide support to Parliament in its scrutiny of what will become an increasingly complex financial picture.

Although some aspects of the changes are still unknown—the impact of Brexit, for example—there are other areas where we know that our work will increase, such as in relation to the creation of new bodies and the transfer of powers. Our estimate of resources in those areas is based on our experience. Work continues on the implications of the United Kingdom leaving the European Union, but at this stage the impact on audit work cannot be quantified and our budget proposal makes no specific allowance for the changes that may occur. We are keeping that area under review and we hope to be able to respond flexibly where necessary.

Our budget proposal for 2018-19 will continue to deliver real reductions in audit fees while maintaining the quality of our work.

I will hand over to Caroline Gardner in her capacity as accountable officer to give you her opening view on the budget proposal.

Caroline Gardner: Our budget proposal reflects significant change in financial powers and workload for the Parliament. The overall revenue resource requirement from the Scottish consolidated fund for 2018-19 is £7.148 million, which represents an increase of £617,000 on 2017-18, the current financial year. The main factors are work associated with the new financial powers that are coming to the Scottish Parliament and the biennial national fraud initiative, which, as

members know, produces a peak every other year. We anticipate that additional capacity will need to be phased in over the next four years as the new financial powers come on stream.

Overall, the additional resources will enable us to carry out new work, including providing assurance to the Parliament as the financial and social security powers in the Scotland Act 2016 are implemented; further work to support Parliament as the complexity of the Scottish finances and the links to economic performance increase; the audit of the Scottish Fiscal Commission, where legislation does not allow us to charge a fee for the audit; work with the National Audit Office to provide assurance on income tax and, in due course, VAT income; and the audit of further taxes and social security as these are devolved.

As ever, chair, we are happy to answer your questions.

The Chair: The most significant aspect is the additional posts. That is where the money is spent. The 9.4 per cent increase in cash terms is very substantial, given the period of austerity that we are in at the moment. Assuming that not all the new posts will be filled on 1 April 2018, can you confirm that the total additional funding assumes phased start dates for the new staff?

Caroline Gardner: Yes, chair. It is worth unpicking the people and the movements behind the numbers. We estimate that, in 2018-19, the total cost of doing the work will be about £667,000. That incorporates an element of phasing over the year. We have already started to work up towards the full capacity that we want in 2018-19 by using efficiencies from within our budget for this year. For example, we have recruited a small number of additional professional trainees during the appointment round that we have just been through.

As you will see from the four-year projections at the end of the proposal, we expect that to build up across the piece. We have factored in the fact that we will not have everybody in place and fully operational on 1 April and we are bringing some of the costs forward into 2017-18 to use the flexibility that we have built into our budget during the year.

The Chair: What is your estimate of the full-year cost of those additional posts?

Caroline Gardner: I ask Diane McGiffen to take the commission through the detail.

Diane McGiffen (Audit Scotland): The full-year costs are presented as a net additional cost in the proposal. We have looked closely at our model of resourcing and our portfolio work with the Scottish Government and the central Government sector, and we have generated efficiencies in how we

work by pulling together the teams who will doing that work. The additional funding requirement is around £380,000, and the full cost of the work is around £660,000. However, we have introduced efficiencies—we plan to adjust the focus of the teams, to take some of their current work and to apply some of the work that will be necessary for the new financial powers.

The Chair: Is £667,000 the annual cost of the eight posts?

Diane McGiffen: It would be the annual cost, but we have reduced that by delivering efficiencies. The amount for the new posts is reduced to £380,000.

The Chair: But you say in your budget proposal that the “full additional resource required” by 2021-22 is 20 staff at a cost of £1.2 million.

Diane McGiffen: I will explain the rationale behind that. We have based our planning for the new financial powers on modelling that looks at a low point, a high point and a mid point. For now, the most prudent assessment that we can make is based on the mid-range of those assumptions. The budget that you are considering today contains the largest single growth—an estimated eight full-time equivalent posts. In each of the subsequent three years, we would be looking at an additional four posts if our mid-range assumptions hold true. We will revisit those assumptions continually throughout the years, particularly as the exact timetable for rolling out the new financial powers transpires, and we will revisit annually with the commission the question whether the assumptions are holding up.

In discussion with the board, we have explicitly pitched our bid at the mid-range assumption because although we can be very certain about a lot of the work, there are still some uncertainties and a need for flexibility. We anticipate that the need for flexibility will continue for a few years to come.

Alongside all of that work, as Ian Leitch mentioned, we also have to think through the implications of Brexit for us downstream. That is one of the reasons why we intend to actively monitor our resource requirements as they transpire and be in active dialogue with the commission.

The Chair: You have indicated in the past that there have been recruitment issues. Have you taken those into account, and are you fully confident that you will be able to recruit the correct spread of skills at the salaries that you are talking about?

Diane McGiffen: We are confident at the moment. We have good data on our recruitment for this year. As you will know from our annual

report and accounts, we have revised our roles and our pay and grading structures and have created an attractive proposition for people joining the organisation that focuses on the opportunities for career development. That approach is working well for us in the market and we will keep it under review. We are conscious of some hot spots for skills and we need to be able to respond to those. We have had an active discussion with the remuneration committee about that.

The Chair: What are the hot spots?

Diane McGiffen: In general, they relate to data and information technology skills. As we move into doing more data analytics, using econometrics and so on, we will be in competition with other employers. Our focus as an employer has been on providing a good career opportunity in the round.

10:45

The Chair: When you talk about data, do you mean techies—people with IT skills?

Diane McGiffen: I mean skills in IT and in the use, presentation and analysis of data. One area of development for us has been our audit intelligence work, where we are looking at providing our auditors with really good analysis, using up-to-date data across the portfolio of work, to free them up to focus on adding value through their work. We also support our performance audit work through the data analytics project. There is a mix of both sets of skills.

The Chair: We are talking about 2018-19 today, but you are saying that by 2021-22 the staff costs will have risen to £1.2 million above where we are now. What is the progression through to 2021-22? It is only three years away.

Diane McGiffen: We are talking about a mid-range estimate of eight posts in this year, which is the largest step change, and four posts in each of the subsequent years—if the assumptions that we are working with now hold true.

The Chair: There are huge pressures happening everywhere within the audit sphere, with additional powers coming through and so on. Have you covered the Accounts Commission's needs in relation to additional work that it may have to tackle as a result of those pressures? I do not know whether there is any additional work; I am just asking whether that has been considered.

Diane McGiffen: One of the strengths of our public audit model is that Audit Scotland is the single agency that provides resources to the Auditor General and the Accounts Commission, and we are able to plan the deployment of our skilled people across different portfolios of work. The budget that you have before you takes into account the new financial powers work and the on-

going delivery of the recently revised best-value approach in local government, as well as the core financial work and the programme of performance audit work. Under our model, we deploy colleagues on work to extend their experience and skills and give them a range of opportunities, so that we build strength into their skills and experience. The plans that you have before you are based on delivering all the work that is outlined in the budget proposal.

The Chair: You have emphasised that the figures that you have given are mid-range. What is the top end of the range?

Diane McGiffen: At the top end of the range, we would be going up in future years from four full-time equivalents to possibly as many as double that. We would rather base our plans on the mid-range, which we have built up by taking into account our accumulated knowledge of the resources that need to go into auditing such things and the development of capacity to respond to a fast-changing policy environment.

Alison Johnstone (Lothian) (Green): I will ask about pay policy. Page 8 of the budget proposal assumes a 1 per cent increase in Audit Scotland's pay scales from next April, and a corresponding uplift of 1 per cent in the fees that are paid to audit firms that Audit Scotland appoints to work on its behalf. The Scottish Government, in its draft budget, as you will be aware, guarantees a minimum 3 per cent pay increase to public sector workers who earn £30,000 or less and an increase of 2 per cent for those who earn more than £30,000. Does Audit Scotland plan to revisit the budget proposals if pay awards in the public sector in Scotland generally exceed 1 per cent?

Caroline Gardner: It is worth emphasising to the commission that our budget proposal was submitted before the budget last week and before the pay policy was published. We prepared it based on the assumption, as we say in the paper, of a 1 per cent uplift in pay scales and a 1 per cent inflation cost, so 2 per cent is built in as an assumption across the piece in the figures that you have. We have started modelling what the pay policy that was published last week will mean for us; I think that we are waiting for some detail on how it will apply specifically. It will depend on the makeup of individual workforces. Diane McGiffen will add a little bit of detail for you.

Diane McGiffen: We are due to go into negotiation with our trade union in the new year. We will both look closely at the technical guidance that will come from the Scottish Government in, I think, January. In negotiations, we will look closely at how we can respond to what is, from the points of view of the Public and Commercial Services Union, which is our recognised trade union, and a wider group of colleagues, a welcome movement

on pay policy. However, we must also recognise that we have to do the right thing by our colleagues, our stakeholders and our clients. We will negotiate with the trade union based on the budget, the longer-term fees and funding options that will be available to us and efficiency options, as we respond to the opportunities that are presented by what will be in the detailed technical guidance. That is the backdrop to the negotiations in the new year.

Alison Johnstone: Is the planned 1 per cent, or whatever it is, increase in fees to appointed audit firms a contractual requirement?

Russell Frith: Yes, it is. In the tender documents we made it clear that the prices that the firms would bid were on the basis that they would, during the course of the five-year contract, receive increases equal to the base pay increase for Audit Scotland staff—in this case, an assumption of a 1 per cent increase. That 1 per cent for the firms is equivalent to just under £40,000 a year.

Alison Johnstone: What are the cost implications of a higher pay award and a higher increase in the fees that are paid to appointed auditors, assuming that those are linked?

Caroline Gardner: An additional 1 per cent over and above what we have assumed in the budget is £41,000. We estimate that another 1 per cent would be the equivalent of about £150,000 for our staff pay. It would have a significant impact in the overall budget envelope, but as Diane McGiffen said, we would seek to negotiate with our partners in PCS—as we have in the past—a package that balances the interests of staff with the value for money that we are able to offer to the public purse.

Alison Johnstone: Are you aware of the salary ratio between the highest-paid and lowest-paid staff members in Audit Scotland?

Caroline Gardner: Russell Frith will check the exact figure. I think that is about 4.5 times.

Alison Johnstone: Do you monitor that closely or take steps to close that gap?

Diane McGiffen: We publish that information in our annual report and accounts. We have consistently over the past few years geared our pay settlements to increase the lower salaries and, in particular, to increase the graduate trainee pay scale. We are an accredited living wage employer, and we have extended that to contracts for some of the services that we buy. We have looked for opportunities to gear our pay and awards system to improving pay for lower-paid staff.

Russell Frith: The disclosure in our accounts to March 2017 was that the multiple between the

median salary, which is the one that is required to be disclosed, and the highest one was 3.4 times.

Bill Bowman (North East Scotland) (Con): I will go back to what we were speaking about before. How much overtime do your staff work?

Caroline Gardner: There are two parts to the answer. People work the hours that are required to do the job but, in general, we do not pay for overtime except in specific circumstances, which Diane McGiffen can talk you through.

Diane McGiffen: The only specific circumstances in which we pay overtime are our IT colleagues working out of hours to maintain our services, to apply new systems and so on.

Bill Bowman: Have you built the other overtime—not the IT overtime—into your requirement for more staff?

Diane McGiffen: We have not built in an overtime requirement, but the requirements for new staff are built on our knowledge of what our model for resourcing teams shows, the number of hours that staff are available for, and the training and development requirements across the different levels and skills mix. There is a very detailed picture that results in the budget proposal that we have delivered to the commission.

Bill Bowman: What is your gender pay gap?

Diane McGiffen: We do not report a gender pay gap, significantly. I can come back to you on that. We analyse a wide range of statistics on gender equality, pay, access to learning and development, part-time contracts and so on. We reviewed our pay system and have implemented a new pay system that was the subject of an equality impact assessment and was proved to be sound. There are no differences in our pay that are not explained by issues other than gender.

Bill Bowman: Are you able to produce gender pay gap information?

Diane McGiffen: We have produced our annual equality report, which is available. I can forward that to the commission, if you like. We produce that annually.

The Chair: That would be helpful.

Bill Bowman: Does that report have the gender pay gap in it?

Diane McGiffen: It reports on pay, but we have a robust pay system that has been the subject of an equality impact assessment that has shown that there are no differences that arise because of gender. Any differences, which we examine annually and report on to the remuneration committee, are the result of factors other than gender, so we are in a good place.

Bill Bowman: I look forward to seeing that report.

Rona Mackay (Strathkelvin and Bearsden) (SNP): I will go back to recruitment, briefly. You talked about attracting people with the technical skills to update your data and analytics. Can you attract those people, and roughly how long will it take for them to update the data and analytics?

Diane McGiffen: We have on board colleagues who have been working on our data analytics project for a while. We have also been extending the network of colleagues inside the organisation who have an interest in or aptitude for data analytics, and we have been investing in learning and development for them. We are trying to strengthen our resilience in the area and our ability to deploy data analytic tools in our audit work.

We are currently recruiting for an IT member of the team. I do not have the results in for that yet, but we can report back on it. The IT market is very fast moving, so the data that we have from the last time we were in the market is not entirely a predictor of what will happen the next time. We have had success in bringing in secondees who have relevant experience and who have helped to develop the skills of the team. We will use our extensive network including further and higher education, other bodies and so on to advertise our recruitment, and we will specifically target our recruitment campaigns in the right areas.

We are fortunate in that Audit Scotland is a strong employer brand for people who want to work in finance in the public sector, so we have to work hard to maintain a really good well-rounded offering for colleagues. Among the things that we know are greatly valued by our existing colleagues are work-life balance and flexibility. We have to make sure that we offer a range of options and opportunities. We are particularly focused on career development and on giving people the option to come and work with us to develop their skills and experience. This year, as well as recruiting an enhanced number of graduate trainees, we have taken on the first school leaver to whom we have offered entry to the accountancy profession. We hope to develop that over the years as an additional—albeit small—route into the accounting profession.

Rona Mackay: That is useful. I will change tack and ask about your capacity to deal with the changing nature of work and your increased workload. I am thinking particularly of the great uncertainty of Brexit and about the new financial powers. Do you feel confident that you have the plans and staff in place to deal with all that?

Ian Leitch: The additional financial powers have been set out, although there is some uncertainty. The Brexit issue is more troublesome, frankly,

because we do not know what we do not know. I have used the word “preparedness” before when addressing the commission: it is all about preparedness. We have a team working on Brexit. What will it mean? Where will the costs lie? What will the costs be? What more will Westminster devolve to the Scottish Parliament? What will come directly to the Scottish Parliament under Brexit? There is a considerable degree of uncertainty. That is the area that is soft.

On the first part of the question, I think that we have set out in Diane McGiffen’s answers what we think we need next year and where we are going with the financial powers. We do not want to give figures. I said in my opening remarks that we have not made provision in that sense for Brexit because we are still working on preparedness—and not just our own preparedness. We have to anticipate, to a degree, the extent of preparedness of the bodies that we audit, and how they are geared up for Brexit. That is extremely difficult and it is one of our priorities. We have what is almost a think tank in the office working on it, and it is addressed at every board meeting. I cannot say that we have a definitive answer. If we had one, I think I would go and buy some bitcoins. I might have done that 10 years ago, but not today; they are too pricey. We are working on that, but it is really difficult.

11:00

Rona Mackay: I know that you do not have a crystal ball, but do you have a worst-case scenario? Do you say, “If this happens and that happens, it might be extreme. Can we cope with that?”

Ian Leitch: On financial powers, we have dealt with that.

Rona Mackay: I am thinking about Brexit.

Ian Leitch: On Brexit specifically, we do not have a worst-case scenario, because we do not know what we do not know. If we were to simply pluck a worst-case scenario out of the air it would mean cost. How do you put a figure on that? We have to take this bit by bit. The commission has asked questions on this in past, and rightly so. It is a question that we ask ourselves constantly. We have made provision in our budget for looking at where Brexit is going but, frankly, until the powers that be know where they are going—I say this with respect, as it is not a political point—we cannot assume to know where they are going.

It could come as a bit of a disaster scenario, in which case there would be a big hike in budgets. We think that that is unlikely. The way that things are going is that there is talk of a transition period. That would allow for some degree of planning for the audit implications, which is our interest in this

matter, not just for our preparedness but for the Government's preparedness to deal with the financial aspects of what they will be getting and our ability to audit it. We are conscious of the big issues but we are not conscious of specific answers.

Caroline Gardner: As our chair said, we are trying to take the same approach that we have taken to new financial powers since 2012, when the first Scotland Act since the Scotland Act 1998 was passed, which is to invest our time in making sure that, as the picture becomes clearer, we understand what it means for the Scottish Government and public bodies, and therefore what it means for us. We are staying close to Government to understand the sorts of planning that it is able to do at this stage, the areas that it has identified as being particularly at risk if there is a crash out of the European Union in 2019, and the sorts of preparations that it needs to make. That is not so that we can audit it at the moment, because that would not be realistic or fair, but so that if that crash out happens we can respond to it and look at the Scottish Government in the round, and look at the other choices that it is having to make about priorities and where it invests skills and time. We will continue to do that until we have more clarity on what Brexit means, as we have done with new financial powers.

Rona Mackay: That is helpful. Thank you.

Bill Bowman: Before I move on to the subject that I will ask about, I note that it is interesting that a worst case for others might be a best case for you, as an auditing body, because you will get more work and more excitement for the staff, which could help with recruiting.

Caroline Gardner: To be honest, at the moment it feels as though we have plenty of interesting work on the stocks. I hope that we have given you a flavour in the budget proposal that we are well placed for the new financial powers that are being implemented, but there is no doubt that they are a challenge for us. They are a stretch for staff and they are requiring everybody to be working at the top of their game. It is probably worth being clear that we do not have any financial incentive in increasing our workload. We cannot make a profit. We break even year on year and we recover our costs from Parliament and the bodies that fund us. We are grateful for the challenging work, but we are not looking out for more at the moment.

Bill Bowman: I will move on to audit quality, for which you have asked for an increase. You had £100,000 for it last year and you have asked for another £150,000, to take it up to £250,000. What does that actually mean? How do you spend that money? Where does it go?

Caroline Gardner: Members of the commission will remember that our budget proposal last year made mention of the fact that the procurement round that we had been through with the firms, which we have now appointed for an additional five-year period, had generated significant savings for us on top of the savings and efficiencies that we had made in ways of work across Audit Scotland. That was a good thing for the public purse, but we were very conscious that it also raised the risks of audit not being delivered to the quality that is required across the piece and we recognised the commercial pressures that the firms operate under.

Over the past couple of years we have done a couple of things to mitigate that risk. The first is to agree a new audit quality framework that governs quality assurance across all the audit work that is carried out for me and for the Accounts Commission.

The second is to put in place independent assurance of all the audit work that is carried out. That includes financial statements work done by the in-house team, which we have had in place in the past, but for the first time direct assurance on the quality of the audit work done by firms, and independent assurance rather than peer review assurance of performance audit and best-value audit work.

The third strand is an enhanced reporting regime, which the commission will see at the end of this financial year in its first developmental stage. It will marshal in one place all the evidence that we have on audit quality and compliance with the standards and the terms of the contract. We are funding that internally through the savings made from the procurement round and from restructuring of the business. We are investing in it because it is hugely important to me and the Accounts Commission, and I know that it has been a matter of concern to the SCPA as well.

Bill Bowman: What will the £250,000 actually go on?

Caroline Gardner: We have just let a contract in the past two or three weeks, after a competitive process with the Institute of Chartered Accountants of Scotland, to review every year a sample of audits carried out on my behalf and the Accounts Commission's behalf. That is a significant element of it.

Bill Bowman: Can you tell us how much that is?

Caroline Gardner: I would need to check what the—

Russell Frith: It will be around £60,000 per year.

Bill Bowman: I am trying to get up to the £250,000. Can we go through the main items?

Caroline Gardner: The contract is the new element. We are also restructuring our business to put in place a team that is specifically for audit appointments and assurance, at arm's length from people delivering audit work in Audit Scotland and elsewhere, and responsible for doing the in-house elements of the assurance work that is required, the relationships with all the appointed auditors and the annual reporting that is required across the piece. That is still unfolding and we are due to review it during 2018. That is what we have been ring fencing to invest so far, given the importance of audit quality, and we will revise that as it moves forward.

Bill Bowman: I still have £60,000 out of £250,000. Is the rest of it internal staff costs?

Caroline Gardner: Diane McGiffen can help you with the detail.

Diane McGiffen: The rest of it is staffing costs and a small consultancy budget to help us develop some of the parts of the framework for which we still need to develop mechanisms and methodologies, such as on taking feedback from clients and stakeholders about their perceptions of the quality of audit, which you will know is a very complex area. There is a core team, there is independent external assessment of the quality of audit through ICAS, and there is a consultancy budget for the further development work that is required.

Bill Bowman: How much would that consultancy budget be, roughly?

Diane McGiffen: I think that it is around £40,000.

Bill Bowman: How many people are in your team?

Diane McGiffen: There is a team of three at the moment, and we will be bringing in an additional full-time equivalent role or roles into the mix.

Bill Bowman: That sounds like quite an expensive three people to get to your £250,000.

Diane McGiffen: That is the total cost, including on-costs for the staff involved.

Bill Bowman: Are you saying that it is £150,000 for three people?

Diane McGiffen: Approximately.

Russell Frith: The average full cost of employing a member of staff is around £50,000. The staff who are involved in audit quality appraisal tend to be at the more senior end of the scale because they need to have experience in order to do the job properly.

Bill Bowman: Are those three people now designated in post? Do we know who they are?

Diane McGiffen: Yes.

Jackie Baillie (Dumbarton) (Lab): I commend you for the efficiency savings that you have already made and those that I see in your budget proposals. I know that times are tough, so being able to do that is much appreciated by the commission. You have explained the additional £150,000, so I will not go there again. The only other increase in fees was under legal and other professional fees. An increase of 10 per cent is not huge, but will you give your observations on why there is that increase?

Diane McGiffen: It is based on our anticipation of demands for additional advice in the current climate of a lot of uncertainty and fast-moving policy changes and developments and so on. Included in that heading is general consultancy support, the potential for legal advice and fees, and our ability to respond to issues or challenges that might emerge in the individual audits of bodies.

We need to plan in budgeting terms to have the capacity and flexibility to respond. We may not always spend in that particular budget heading, but without the resources we may be constrained in seeking the best advice as the year rolls on. We are anticipating that there may be more demand for specialist technical advice than there has been in previous years.

Ian Leitch: One could say that some of the reports have a degree of contention in them. It is open to the Auditor General—and the board has to make provision for the Auditor General—to get legal advice on the appropriate wording of some of the reports from time to time. That is one of the elements that we have to consider.

Jackie Baillie: Having seen some of the reports, I appreciate why that might be necessary.

Will you clarify something? If you are going to be looking at revising the pay award, will that have an impact on what you do about fees that are charged?

Caroline Gardner: It depends where we end up. As Diane McGiffen has said, it will be a negotiation. We will be working very hard to balance what is affordable within our current budget with the expectations and the need to recruit and retain the staff that we need. If we end up in a position where we simply cannot reach agreement within the budget that we have here, we will look for further efficiencies internally. That gets more difficult every year, as it does for all public bodies, but we will look at that. We will look at fee setting for the next audit year, which starts in October 2018. As a last resort, we have the

autumn and spring budget revisions to come back to you, but we work very hard to make sure that we never have to do that. We have not in the past and we will do our best to make sure that we do not in the future.

Jackie Baillie: You do not anticipate coming back even before the budget process is over.

Caroline Gardner: We have no expectation of that at all at the moment.

Jackie Baillie: That is helpful to know, so that we have certainty in what we consider.

Page 19 of the budget proposal document notes that audit fees agreed with audited bodies may be increased by 10 per cent. I understand that you used to have a provision through which you could decrease audit fees by 10 per cent. Did any public bodies receive those reductions in the past?

Russell Frith: Yes, but it was a very small number of them. When we did our review of fees and funding, we had feedback from a number of finance directors who said that we should not continue with that on a regular basis, because they felt that generally it was very difficult for them to achieve reductions. However, we have retained an annual review process. If the auditor or the audited body believe that fees should be reduced, they will be, but it will be a permanent reduction from the start of the next year.

Jackie Baillie: Out of curiosity, were those finance directors the ones who enjoyed the reductions or the ones who did not?

Russell Frith: Probably the ones who did not.

Jackie Baillie: I am not surprised at that.

So, you retain a degree of flexibility to make those reductions, but they are not available across the board anymore.

Russell Frith: They are not available on an individual within-year basis, but between years, yes, we can make them.

Jackie Baillie: That is helpful to know.

Mainland health boards will be pleased to see fee reductions of 4.3 per cent, as performance costs are going to be met centrally by the Parliament, but fees for island health boards are going remain at the same level. Why is that? I suspect that there is an obvious answer to that, but please let us know for the record.

Russell Frith: For the record, there is an obvious answer, which is that the island health boards have not been paying a contribution to the performance audit costs in recent years.

Jackie Baillie: I did not expect that answer, so it is always good to ask. Why is that the case? Did they just get missed off?

Russell Frith: It goes back a long time, to when Audit Scotland was formed. Judgments were made at the time about the relative burdens on islands versus those on mainland territorial boards.

11:15

Caroline Gardner: There is a continuing challenge for us and for small audited bodies that the starting cost of doing an audit is not very sensitive to the size of the body. The audit fees of small health boards are proportionally higher than those for larger boards, and what Russell Frith referred to was one of the mechanisms that was used in the past to try to even things out a little bit. That falls away now, as a result of the funding that is provided by the Parliament for performance audit.

Jackie Baillie: I turn to page 21 of the budget proposal document and costing audit work. You helpfully set out the hourly rates for audit work, and I welcome the transparency that you have provided. If only other public bodies took a leaf out of your book. Do the actual costs of staff and hourly rates inform future fees? Is that how you work out the schedule of future fees?

Caroline Gardner: Not quite. Russell Frith will talk you through the process.

Russell Frith: The hourly rates are the full cost of running Audit Scotland divided by the number of hours that we expect our staff to work on audit or on other direct activities. The hourly rates are based on that information. In effect, they are used as a mechanism to compare the actual costs with the amounts that we have set as the fees. You are right in saying that, over the long term, it is an iterative process, year on year.

Jackie Baillie: Can you explain to me how you monitor the productivity—I suppose that that is the word—of the audit staff? How do you determine the chargeable hours, the direct work and the indirect administration?

Russell Frith: We have a time recording system in which all staff record the activities or individual audit on which they spend their time.

Jackie Baillie: I look forward to the entry for your last appearance before the commission, which will make interesting reading.

Bill Bowman: What is the normal utilisation or chargeable percentage?

Russell Frith: It varies by staff grade from about 135 days for assistant directors, which is the lowest level, up to 200 days for senior auditors, the core audit grades.

Bill Bowman: What is the denominator?

Russell Frith: It is days.

Bill Bowman: Sorry—it is 135 days out of how many?

Caroline Gardner: It is out of about 220 days. The figure varies because different staff have different terms and conditions, but it is about 220 days.

We are currently reviewing our time recording codes. At the moment, we have different codes in different parts of the business, and it is more difficult than it ought to be to make meaningful comparisons. We will happily update the commission on that next year.

Bill Bowman: Are the rates that are quoted on page 21 the charge-out rates?

Russell Frith: Yes. Our cost rates equal our charge-out rates because we make no profit.

Bill Bowman: Yes, but if you are not charging people for the full number of hours, you are not recovering all your costs.

Russell Frith: We are, because the full costs go in at the top of the calculation. The full costs of Audit Scotland go in at the top, minus the cost of firms and one or two other things. That pool of costs is then divided by the number of days that staff work. It is a very full costing rate.

Bill Bowman: You are dividing the figure by 220 but only multiplying it by 200. Am I missing something?

Caroline Gardner: You are missing the overhead that has to be spread across all the “chargeable hours” that staff deliver.

Bill Bowman: The charge-out rates are the total costs of employment.

Caroline Gardner: They are the total cost of the organisation.

Russell Frith: They are the total cost of Audit Scotland.

Bill Bowman: Okay. The total cost of Audit Scotland for a trainee is £46 an hour. Are we looking at the same thing?

Russell Frith: Yes.

Caroline Gardner: We are looking at the same thing. I think the confusion comes in when you start talking about charge-out rates, because we are not charging staff out in that way. These are the hourly rates that are required to recover the costs of Audit Scotland against the hours of audit delivery. It is a different business model from that of a firm, where you are looking to generate more chargeable hours to generate a profit.

Bill Bowman: Is there an incentive for people to work effectively?

Caroline Gardner: There are many incentives for people to work effectively, but chargeable hours are not the most important of them.

Bill Bowman: Audit Scotland gets paid for their hours regardless of how hard they work.

Caroline Gardner: The incentives that we have are not about generating additional work; they are about doing the work to the highest quality and as efficiently as we can.

Bill Bowman: Is that set out somewhere? That would save time here.

Caroline Gardner: I am trying to think where it is set out. Our fees and funding strategy might be the best way of getting at it.

Bill Bowman: I was thinking more of staff incentives.

Caroline Gardner: Diane McGiffen might want to have a go.

Diane McGiffen: I think that the piece of work that the Auditor General referred to is currently reviewing how we use our time. There is a project that is looking in quite granular detail at all the time coding, the time recording and so on, and we are developing enhanced models for incentives to deliver a quality piece of work. We would be very happy to share that work with you when it is complete and to give you a briefing at some point on how it looks.

As the Auditor General has mentioned a couple of times, the key thing is that the public audit model has quite a different set of incentives and a different starting point from a profit-maximisation model.

Caroline Gardner: I assure the commission that a huge amount of management effort goes into comparing the time that is spent on a particular audit, the grades mix and the cost of delivering the audit against the audit fee as well as benchmarking that across other audits internally and against the cost of the audits that are done by firms. I do not want to give the impression that there are no incentives for efficiency, but the incentives are not about profits.

Bill Bowman: I was thinking about time efficiency.

Diane McGiffen: As an additional check and balance, we are currently undertaking a review of the first year of the implementation of the new best-value model in local government. That feedback to the Accounts Commission will be about not just the work, the content and the quality but also the cost of the work that we have done.

The Chair: Audit Scotland is taking on additional audit functions as a result of the devolved powers. It would be logical to think that,

if Audit Scotland is taking on part of that audit, there must be savings to the Scottish Government elsewhere, since that audit function will no longer be carried out by another body. Is there any saving that you can point to?

Caroline Gardner: It is difficult to do that across the Scottish Government and the UK Government because of the way in which the most significant of the new financial powers are being delivered. Income tax and VAT will continue to be collected by Her Majesty's Revenue and Customs, as part of its overall collection system, and our colleagues in the National Audit Office will continue to audit HMRC for its overall management and those two tax accounts. If anything, my counterpart, the Comptroller and Auditor General at Westminster, would argue that there will be more work for HMRC, rather than less, in the additional assurance that will be required for the Scottish income tax. Of course, the Scottish Parliament is looking for its own assurance on Scottish revenues, which are now a significant part of the Scottish budget.

The same will be true, to a lesser extent, of the Department for Work and Pensions, certainly during the transitional period. When the new social security agency is fully up and running and the new benefits are in place, it may be appropriate to have a look at the degree of interaction with the DWP. However, the expectation is that, because universal credit will continue to be a UK-wide benefit that will interact with many other benefits, that interface will still be there.

We are happy to keep that under review, and that is one of the commitments that we have made to the Public Audit and Post-legislative Scrutiny Committee, which has been talking about accountability and assurance over the new powers. At the moment, however, it is not easy to see where there will be a reduction elsewhere to compensate for the increase required here in Scotland.

The Chair: The top line on page 7 of your budget proposal says that the

"Scottish Parliament will be responsible for raising income of £22 billion".

The Scottish Parliament will not actually be responsible for raising it; it will be raised by the UK Government and then allocated back, which is why there is an issue about savings on audit.

Caroline Gardner: You are right. We are moving from about £4 billion of revenue that forms part of the Scottish budget other than the block grant to £22 billion other than the block grant, which is about 50 per cent of the total budget. As you know, the fiscal framework is complex and so are the administration arrangements. The Parliament rightly expects assurance about how

that is working and how Scotland's interests are being protected as part of that. I imagine that there will be an equal and equivalent interest at Westminster in the other side of that equation. One of the costs of devolving financial responsibility is the need to increase oversight and scrutiny, of which we are a small part.

The Chair: I have one or two small points that I would like to ask about. You are talking about real-terms fee reductions happening in 2018-19 and you have a history of fee reductions going back over a number of years. I realise that the fee collection is a totally separate calculation. In the present environment, is there not a danger of a perception that costs are being transferred to the Scottish Government from the audited units by charging them reduced fees?

Caroline Gardner: No. As the commission knows, we have worked hard to increase transparency. You will see within the budget proposal a sectoral breakdown of where the costs and the recovery lie. We follow that through to our financial reporting each year, and we are clear about the functions that we ask Parliament to fund, primarily because we are unable to charge an audit fee for them. There is no question at all of that happening, and I hope that the increased transparency provides the commission with that assurance.

The Chair: On page 9, under "GDP deflators", you state that you are using a GDP deflator of 1.6 per cent, which is what is officially out there. How are you going to be affected by increased inflation?

Caroline Gardner: You will see the assumptions that we have made about inflation in the budget proposal. We will need to keep those under review, as things are changing out there. In the proposal, we use deflators to give you a real-terms comparison. Looking back, it does not make a significant difference; the assumptions that we build into future budgets are more important. We will need to make sure that they are realistic and, as far as possible, offset by efficiencies that we are able to make across the business.

The Chair: You have spoken about efficiency savings of £187,000 that you are planning to make. That is 28 per cent of the estimated cost of the new powers. How realistic is that? Where will those savings come from?

Caroline Gardner: They are well planned as part of the budget. I ask Diane McGiffen to talk you through the make-up of them.

Diane McGiffen: As I said in response to an earlier question, the efficiencies will come from how we have built up the work that is required for the new financial powers along with a refocusing of some of the audit work that is already taking

place in central Government and associated bodies. There is a bit of refocusing going on to deliver efficiencies that will contribute to the new financial powers work.

We also continue to generate and look for efficiencies in our use of IT to support the audits. I mentioned that we have developed our audit intelligence project, which looks at data analytics and equips auditors with easily accessible data so that they can analyse data more efficiently.

That is the primary make-up of those efficiencies. We have a separate programme of efficiencies, and the biggest piece of work that we have going on is the one about how we use our time, which we discussed in response to an earlier question. We will be happy to share the results of that when the work is complete.

The Chair: On the IT side, you are talking about enhancing what you have to achieve savings down the line. There must have been an initial investment to achieve that.

Diane McGiffen: There was. We have already made an investment in some of the capital and other requirements to deliver data analytics. I have mentioned the data analytics staff and the learning and development that we are doing. There are a range of ways in which we are investing in that capacity, as it is a key priority for us.

We have taken our digital strategy to the board and recently had discussions about not only how we deploy auditing and digital activities in the public sector but how we build our own digital capacity. That is very much at the forefront of our development strategy.

11:30

The Chair: I turn to appendix 3, on page 17. We are talking about the audit work done, the different classes of audits and so on. We have had quite a bit of discussion on that over the years to ensure that there is no cross-subsidy and so on; a lot of work has been done on that. Paragraph 2 says:

“We have determined each sector as being a class of audits.”

Can you remind us, especially as we have new members, how a sector is established as being a class of audit?

Russell Frith: Under the Public Finance and Accountability (Scotland) Act 2000, Audit Scotland is required, as it says in paragraph 2,

“to broadly break even on audit work that is charged for taking one year with another, either for each audit, or for classes of audits.”

Early on in Audit Scotland’s life, the board decided that classes of audit was the way in which it wanted to go forward. We have defined classes

of audit as being each sector, so local government, the national health service, central Government chargeable audits and further education are classes. Scottish Water sits on its own.

Bill Bowman: Are there any Chinese walls in the organisation?

Russell Frith: In relation to audit quality, yes.

Bill Bowman: What about generally?

Caroline Gardner: Beyond that, no. As Diane McGiffen said, one of the strengths of our public audit model in Scotland is that we can look across local government, the NHS and central Government, and from top to bottom—from central Government funding right through to where money is spent on the ground. We aim to maximise that rather than to put artificial divisions within it.

Bill Bowman: You mentioned audit quality.

Russell Frith: Yes. The team that we discussed earlier, which is doing the quality appraisal work, is separate from the audit delivery teams.

Bill Bowman: How does that work? Are there physical files or computer files? How do you keep them apart?

Russell Frith: Those members of staff do not work on audits. They have their own file areas within the software and the computer systems. They report to Diane McGiffen rather than to any of the directors who are engaged in audit work.

The Chair: On the same page, paragraph 4 says:

“Audit appointments are made by the Auditor General or the Accounts Commission”.

I am curious, because that is the first time that I have heard that. I thought that the Auditor General appointed all auditors.

Caroline Gardner: No. The Accounts Commission makes appointments to all local government bodies. That is its primary function.

The Chair: Who runs the selection process?

Caroline Gardner: We run a shared procurement exercise that puts together a procurement strategy and a slate of audited bodies that have successfully tendered for the work. A portfolio is then proposed that makes up the individual appointments for me to approve for the bodies in my area and for the Accounts Commission to approve for the bodies in its area.

The Chair: Are the criteria for appointing those auditors the same as Audit Scotland uses elsewhere in the public sector?

Caroline Gardner: We run an overall, single, joined-up procurement exercise on behalf of the Accounts Commission and me as Auditor General.

The Chair: There is no difference in the criteria for choosing the auditors.

Caroline Gardner: No.

The Chair: On page 19, item 18 shows that the best-value audit and housing benefit audit is apportioned between the 32 councils on the basis of populations as at June 2015. What is the reason behind using that criterion? Surely population is a crude measure of complexity in an audit of a council.

Russell Frith: It is, and it is not meant to reflect the relative costs of the individual audits. It reflects the way in which the bodies that are being charged were funded by the Scottish Government when that work started. When the best-value audit started, the amount of money that was distributed to local government to compensate councils for the additional cost of best-value work and audit was just put through the main distribution formula. The funding was not divided up on the basis of what the actual costs might be and, therefore, we have kept that mechanism in place so that the bodies pay an amount that is approximately equal to the relative funding that they receive from the Scottish Government.

The Chair: Okay. That was an interesting point.

Are there any further questions? It seems that there are not. In that case, I thank the witnesses for their attendance and evidence, especially Russell Frith. Presumably he is rushing off now for a well-earned rest.

Ian Leitch: He is getting a life, chair.

The Chair: Once again, we wish you very good luck in your retirement.

Russell Frith: Thank you.

The Chair: I now move the meeting into private.

11:36

Meeting continued in private until 11:50.

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