OFFICIAL REPORT
AITHISG OIFIGEIL

Scottish Commission for Public Audit

Wednesday 14 December 2022

Session 6

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SCOTTISH COMMISSION FOR PUBLIC AUDIT
2nd Meeting 2022, Session 6

COMMISSION MEMBERS

*Colin Beattie (Midlothian North and Musselburgh) (SNP) (Chair)
*Sharon Dowey (South Scotland) (Con) (Deputy Chair)
*Daniel Johnson (Edinburgh Southern) (Lab)
*Richard Leonard (Central Scotland) (Lab)
*Mark Ruskell (Mid Scotland and Fife) (Green)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Professor Alan Alexander (Audit Scotland)
Vicki Bibby (Audit Scotland)
Stephen Boyle (Auditor General for Scotland)
Stuart Dennis (Audit Scotland)
Bill Moyes (Accounts Commission)
Martin Walker (Audit Scotland)

LOCATION

The Sir Alexander Fleming Room (CR3)

Scottish Commission for Public Audit

Meeting of the Commission

Wednesday 14 December 2022

[The Chair opened the meeting at 10:32]

Decision on Taking Business in Private

The Chair (Colin Beattie): Good morning and welcome to the second meeting in 2022 of the Scottish Commission for Public Audit. I seek agreement from members to take agenda item 4 in private. Are we agreed?

Members *indicated agreement.*

Audit Scotland Spring Budget Revision 2022-23

10:33

The Chair: Agenda item 2 is Audit Scotland's 2022-23 spring budget revision. Members have a copy of the spring budget revision in the meeting papers. I welcome to the meeting Professor Alan Alexander, chair of the board of Audit Scotland; Stephen Boyle, Auditor General for Scotland; Vicki Bibby, chief operating officer at Audit Scotland; William Moyes, chair of the Accounts Commission; Martin Walker, director, corporate support at Audit Scotland; and Stuart Dennis, corporate finance manager at Audit Scotland. I welcome Vicki Bibby on her first appearance in front of the commission in her role as chief operating officer.

I invite Professor Alan Alexander and then the Auditor General to make short introductory remarks if they wish.

Professor Alan Alexander (Audit Scotland): We have none for the first agenda item, chair, if that is okay. As we have in the past, we will do an introduction to the major budget item. Is that acceptable?

The Chair: That is fine. Stephen Boyle, do you wish to add anything?

Stephen Boyle (Auditor General for Scotland): Very little, chair. Most of my remarks, like Alan Alexander's, are in respect of our 2023-24 budget proposal to the commission. However, Stuart Dennis and I are ready to answer any questions that you or commission members have on our spring budget revision request.

The Chair: Excellent. I will ask the first question on the budget revision. The commission is aware that non-cash pension accounting arrangements have arisen in previous years. On the Lothian Pension Fund, what discussions have you had with the Scottish Government to confirm that previously agreed arrangements with HM Treasury are still in place and will meet this pension adjustment?

Stephen Boyle: I am happy to start on that and I will bring Stuart Dennis in to update the commission on the specifics of the discussions that we have had.

As you will see from our paper, the on-going volatility of pension adjustments requires the commission's support to ensure that we remain within our financial requirement to break even each year. The volatility of very small changes to pension assumptions, discount rates and so forth has a very significant effect on the overall valuation. Therefore we, as an admitted body to the Lothian Pension Fund—as do any other members that cannot carry reserves—have to look for support. Stuart Dennis can update the commission on our engagement with His Majesty's Revenue and Customs and the annually managed expenditure budget position, and I am happy to broaden that out as you wish.

Stuart Dennis (Audit Scotland): The engagement with the Scottish Government happens in November each year. It requires us to let it know what our spring budget revision will be. We let the Scottish Government know that, so that it can then commence discussions for the whole of the Scottish consolidated fund, in respect of AME funding, with HM Treasury. The Scottish Government has the information in relation to our revision requirement and what are looking for.

Sharon Dowey (South Scotland) (Con): In paragraph 16 on page 3, Audit Scotland states:

> "The expectation of continuing low interest rates in the next few years will lead to large accounting adjustments in 2023/24 and beyond. In such circumstances further requests for budget revisions to meet additional pension charge adjustments will be required in the future."

Given recent interest rate increases, what impact do you anticipate on future pension charge adjustments?

Stephen Boyle: There are changes in interest rates from the historically low levels that we have seen in recent years but, although interest rates are increasing, they remain at historically low levels. Neither Stuart Dennis nor I are actuarial experts and we continue to rely on the advice and the assumption expectations that the Lothian Pension Fund provides us. The indications remain that there will be volatility in pension valuations and the assumptions that flow from that valuation.

On the overall arrangements, as we allude to in the paper, it remains our preference to engage with the SCPA at spring budget revision times, which is when we have more certainty about what the likely valuation results will be, rather than to include that in our annual budget proposal. There is something of an element of crystal ball gazing as to what the changes might mean, whether it is about interest rates or other assumptions that are used to arrive at the overall pension valuation. Based on our submission today, we are giving as clear a picture as we have at our disposal that there is likely to be remaining volatility in both interest rates and the other assumptions that are used to produce the overall valuation. As ever, we will engage with the commission as early as we possibly can once we have that information.

The Chair: Do any other commission members wish to ask any questions? Auditor General, do you want to add anything to what you have already said?

Stephen Boyle: We hope that our proposal is clear and I want to note that this is a non-cash adjustment. It is based on valuations and then accounting valuations for what our pension requirements are, based on accounting standards. We think that our proposal broadly represents the best and most transparent way in which to set out what that means, rather than including the non-cash pension adjustment requirements in our budget proposal, but we are keen to continue to engage with the commission and to keep you updated as to how that progresses.

The Chair: Thank you.

Audit Scotland Budget Proposal 2023-24

10:40

The Chair: Agenda item 3 is consideration of Audit Scotland's budget proposal for 2023-24. Members have a copy of the budget proposal in their papers. We have the same witnesses for this agenda item as we did for the previous one and, again, I will invite Professor Alan Alexander followed by the Auditor General to make any introductory remarks that they wish.

Professor Alexander: Good morning, chair and members of the commission. We are very happy to talk through the proposals and answer any questions that you have on them.

I think that it is fair to say that over the past two years we have discussed with you on several occasions the intense pressures on public services and public finances. As you know, the pandemic exacerbated many of the existing stresses on public bodies, political leaders and public managers.

In this past year we have seen, and we are now experiencing, the impacts of a land war in Europe and an economic crisis added to this, most acutely on the cost of living and pressures on household budgets. This volatility and uncertainty, and the unfolding impacts of the turbulence of the past two and a half years, will last for several more years.

All that has created significant additional pressures on Scotland's public bodies, on top of the major stresses of systemic and strategic challenges that they already faced. The response to all that has led to increases in public spending and the overhaul and re-design of public services at previously unimaginable scale and pace.

In this context, the delivery and development of high-quality, independent public audit on behalf of the Auditor General and the Accounts Commission is crucial. As you know, Audit Scotland has had to change and grow in the past few years to be able to respond to those issues and to do the bigger and more complex job that is required of us.

Audit Scotland is not immune to the pressures that I mentioned earlier. However, we have, in the construction of our proposed budget, been continuously aware of the need to be prudent while ensuring the integrity of the audit process. Our proposal is based on a series of assumptions that we will discuss today, but the external environment is more volatile than at any time in recent years.

The board of Audit Scotland has given continuous oversight and governance to the process of constructing the budget proposal, with particular emphasis on some of the risks that are affecting financial planning. That has included a board seminar in the summer, in which we looked at the budgetary position without the pressures of having to make a decision, as well as two formal considerations at board meetings of the draft budget document that you have before you today. We also touched on the broader questions of the financial and budgetary position at our regular business planning session with you in August.

The budget proposal sets out how we need to ensure that we have the capacity, skills and resources to deliver public audit that is robust, relevant and flexible. It will also enable us to further develop and deliver public audit that meets the needs of our wide and diverse groups of stakeholders and ultimately to deliver public audit that drives and supports better public spending and public services and has a positive and meaningful impact on the outcomes that people and communities experience and achieve. I think that if you asked anybody in Audit Scotland what gets them up in the morning, it is that drive for improvement in what we do in the public sector.

With your permission, I will hand over to Stephen Boyle to speak in his capacity as accountable officer for Audit Scotland.

Stephen Boyle: Good morning, chair and members. We are grateful for your time and we look forward to the conversation.

As Alan Alexander has outlined from our proposal, over the past two years the scope and scale of our responsibilities have grown at a rate not seen since we were established back in 2000. Public spending in Scotland has increased by about a fifth and public bodies are and remain stretched to an extent similarly not seen. Although the pandemic has ebbed, public bodies had neither the time nor the space that they needed before further challenges unfolded. Alan Alexander mentioned the cost of living crisis and the very real human impacts that that is having on people, businesses and, most importantly in our context, public services.

10:45

Scotland faces financial risks and issues that are bigger and more complex than they have ever been, and with the commission's support our audit work has responded. In the years ahead, as we have done over recent years, we will focus on ensuring that we have the resources, skills and capacity to fulfil the role that Scotland needs of us now and in the future. Our budget proposal reflects those ambitions.

At the heart of it is our focus on innovation and the quality of our audit work. Audit quality is the bedrock of the assurance that we look to provide to the Parliament and the public about how public money is being used. Over the past two years we have made progress in addressing previously reported issues affecting audit quality, and we will continue to do so while facing increasing complexity of public spending alongside new requirements for the auditing profession.

We are innovating with new approaches to delivering and developing our audit, including digital audit, and in ensuring flexibility and responsiveness in our audit programmes. The budget proposal supports the further steps that we need to take in innovating and in audit quality.

Through all our audit developments in recent years, both planned and reactive, we have continued to deliver annual audits of almost 300 public sector entities as well as performance audits on matters of significant public interest. As ever, that has not been easy and it is important for me to thank Audit Scotland staff as well as staff in the audit firms that we work alongside and to pay tribute to their work.

Our resource requirement for 2023-24 is £12.2 million, an increase of £563,000. That is a rise of 4.8 per cent in cash terms but a decrease of 9.1 per cent in real terms. From our previous discussions, our budget has decreased in real terms by around a fifth over the past decade, so while the volume of work that we do has increased, our total proposed budget of £34.993 million equates to 0.06 per cent of Scotland's public sector budget. Our work will focus on key issues such as inequalities, the experiences of our most vulnerable citizens and climate change, as well as how communities can shape the services that they receive.

The largest portion of our resource requirement from the Parliament is the fees for those bodies that we cannot directly charge. I am happy to say a bit more about that over the course of our discussion. While in part that reflects the creation of new bodies, for the most part it is to cover the increasing costs and resources required to deliver the audit. The scope of the work, the ways of working and the regulatory requirements on auditors, led in some part by the reviews in recent years of the wider profession, have all expanded.

We are clear that the Scottish public audit model provides the Parliament with an independent and robust service. The five-yearly change in appointments and the competitive procurement of audit services from external firms were both completed in the past year. All auditors will meet the new requirements. That has meant that the cost of audit is rising for public bodies. As our budget indicates, some of that cost is reflected in the fee increases for those bodies that we are able to directly charge.

We are, as are all public bodies, trying to manage the difficult job of agreeing pay awards that are equitable and reflect the pressure on household budgets and the cost of living, while also being responsible and fair to public finances. Again, as with others, we will remain subject to an inflationary environment in the short term, which carries risk on both pay and non-pay costs. We will continue to liaise with the commission on that issue as we navigate the next year and beyond.

Chair, as ever, we are grateful for the commission's time and we are very much looking forward to engaging with you and answering your questions.

The Chair: Thank you. I will go straight into questions, the first of which is a fairly obvious one. There are significant cost pressures identified in the 2023-24 budget proposal, particularly in the way of cost of living pay increases for in-house staff. You are looking to uplift to the April 2022 pay award an amount of £658,000 and for a further provision of £615,000 for the April 2023 pay award. Why are two years of pay awards required in the 2023-24 budget proposal? We assume that there was provision in the 2022-23 budget proposal and you have not sought further cash for that year. How does that work?

Stephen Boyle: I am happy to start on that and I will bring in Vicki Bibby in a moment to speak a bit further as she wishes.

You are right. In effect, one of the biggest risks that we are carrying is the uncertainty around pay awards for public sector workers, including our own. I referenced very briefly in my opening remarks that it is both fair and equitable that we are able to reflect the cost of living pressures that our colleagues are experiencing while also making sure that we can continue to retain and attract high-quality auditors to deliver public audit services.

Our budget proposal that the commission considered in January 2022 for 2022-23 had assumptions of around 2 per cent for pay uplift. Following negotiations with our trade union partners, we settled on a pay award of 5 per cent in the current financial year. It is our expectation that that will flow through into next year's budget and we have a further assumption in the 2023-24 proposals that you have before you of a further cost of living increase. There is an undoubted risk that the assumptions that we have in the proposal may or may not be sufficient to reflect the market conditions at the time.

We have dealt with the risk up until now, and including last year's budget, through management contingency arrangements, but I should say that there is real volatility. The proposal that we present to the commission today looks to set out the relief that we felt in being able to agree a pay award, recognising that that is not the case in many other public sector industries at the moment, and that we are carrying uncertainty into next year's budget proposal. I will pause and Vicki Bibby might want to give a bit more detail on where we are at.

Vicki Bibby (Audit Scotland): Thank you. At risk of repeating what Stephen Boyle said, the 2022-23 budget had a 2 per cent pay uplift in it and we settled on 5 per cent with staff. It was good that we settled, both for staff, who had the money in their pockets and also for us, in that we had greater clarity on our budget. The extra 3 per cent equated to £658,000 for 2022-23. We were able to fund that in-year, this year, through savings on slippage of recruitment and elsewhere, so we did not need to come back to the commission and ask for the additional cash. However, those are one-off savings that will not recur. The flow-through of that pay uplift will hit the 2023-24 budget and, on top of that, we have the proposed uplift for 2023-24, on which we have not yet started negotiations.

We consider that as a big risk in our budget. We have probably pitched the April 2023 figure too low, we reckon, and we want to be quite explicit about that. We do not know where things will settle and we have not started negotiations, so that is one of the biggest vulnerabilities in our budget. The 2023-24 budget proposal has contingency in it and if the pay award is higher than budgeted for, we propose to fund it from contingency, but we want to highlight that that is a risk. I hope that that explains why we have two years of pay awards coming through; the first one was funded from non-recurring savings.

The Chair: Audit Scotland usually sticks approximately to Scottish Government guidelines on pay rises and so on. You have adhered to that over the years. Presumably, you have now departed from that to negotiate pay rises based on an industry norm.

Stephen Boyle: I can say a wee bit further about that and Vicki Bibby may want to say a bit more.

We reference in our budget proposal that, largely as you describe, Audit Scotland takes very clear reference from Scottish Government public sector pay policy as to expected pay awards, although as an independent body we are not bound by those arrangements, as many civil servants are.

We also received a pay claim from a trade union of 10 per cent and, largely as I think you described, chair, we entered into negotiations with it to arrive at what was a fair and, I hope, affordable pay settlement, given the differential that we experienced and then the current cost of living arrangements. We took reference from the negotiations of Government pay policy as well as the pay settlements in other parts of the public sector. Notably, local government bodies settled with their workers shortly before Audit Scotland did.

It is perhaps of interest to the commission that Audit Scotland members were balloted by their union alongside other Public and Commercial Services Union areas across the whole of the United Kingdom. Audit Scotland staff were the only part of the PCS network that voted to accept the pay award. We are very relieved that we are in these circumstances and not facing the prospect of industrial action and disruption to our service.

The Chair: How much is the contingency that you are retaining, which you hope to dip into if you have to go a bit higher on pay next time?

Stephen Boyle: Vicki Bibby might want to say a bit more on how this is operating.

Vicki Bibby: For the overall budget, the proposition is a £500,000 contingency, on the basis that Audit Scotland cannot hold reserves, which I understand has been raised with the commission before. We think that that is a prudent contingency for the 2023-24 pay award. Looking at where we have pitched our budget, it is quite low compared to where we know other organisations are pitching their 2023-24 budgets. Other areas for the contingency will be other non-pay inflation. For example, we have just received an alert that our rates revaluation will cost the organisation an additional £75,000.

What we want to do with the budget is manage those inflationary pressures within what we are asking from the commission. We will look to do that through the contingency and other efficiencies within the budget, but we want to be transparent about the risks and our appetite to manage those risks within the budget.

The Chair: It is not a huge contingency, given all the risks out there. Mark Ruskell has a supplementary question.

Mark Ruskell (Mid Scotland and Fife) (Green): Is there a difference between what you pay your staff and what the private sector bodies that are delivering similar work pay their staff? How are you managing that? You have spoken about the negotiation with union colleagues during which 10 per cent was put on the table, and I am interested in the other ways in which you are supporting retention and making employment with you an attractive proposition compared to working for a private body.

Vicki Bibby: We have very productive relationships with PCS and we have quite open discussions around those issues. The pay award was not just financial. To talk about the financial side of it, though, we agreed a 5 per cent uplift or, for the lower end of pay, £2,000. If you look at, say, the local government settlement, there is a cap on it. In discussions with the union, we agreed that it would not be appropriate to have a cap because of the competitive environment with the external firms and our ability to retain staff.

11:00

We know that some firms—although in some ways it is bottom loading—have reached 10 per cent pay awards and are also looking at working four-day weeks over the summer periods. As part of our negotiations, we agreed to look at the four-day working week. We have not committed to doing it, but in partnership we will certainly look at the benefits and the studies that have been done in these areas.

We offer our staff flexible working packages, which are well received. We have regular staff consultations and a number of staff surveys, so we have good working relationships. I have touched on the pension. We are an admitted body into the local government pension scheme. We believe that we offer staff a competitive proposition.

However, given the recruitment market at the moment and that we are seeing a number of clients struggling for financial expertise within their areas, we certainly cannot be complacent. The on-going discussions with the PCS and our staff are very important. That is why we have highlighted the risk in the budget around where we have pitched next year's pay award, because it probably is on the low side.

Mark Ruskell: If I were working for your organisation and I saw a private sector body that was paying more, what would encourage me to continue to work for you?

Stephen Boyle: Vicki Bibby is right, Mr Ruskell, that our offer is not just salary based. We have many colleagues who have worked their entire career with us and others who devote decades of service. People join Audit Scotland because of the ethos that they share about delivering good value for public spending and supporting improvement in how public services are operating. We cannot take that for granted and we need to carefully manage that so that there does not become a chasm between what our offer is relative to that of other public bodies.

Vicki Bibby has quite rightly described our pension arrangements, our flexible working arrangements, the relationships that we have with our trade unions, and the overall environment that we want to give colleagues in Audit Scotland. It is all part of our retention strategy.

We are also looking at the metrics for our turnover rates, as well as the level of applicants that we are getting. It is fair to say that the volume of applications is dropping slightly and our turnover, as I think we discussed in a recent session with the commission, is also increasing marginally. We need to continue to keep a close eye on that. There will inevitably be increased risk when some of the private sector firms are offering pay settlements of 10 per cent and we are settling at 5 per cent. If that differential continues into the longer term, it will become a much more difficult proposition for us to manage.

Vicki Bibby: We are also being very clear with our staff that we have a different proposition from the private firms. We believe that our unique selling point is that we are here to make a difference and that we can make a difference for the communities of Scotland and the public. At the graduate recruitment fairs we highlight that that is a real selling point. We are also looking at our role of being an anchor institution for the public sector, expanding our modern apprenticeships and our school leaver programmes and looking at different pathways into the work, not just relying on, say, the traditional graduate route in but looking at other opportunities for tackling inequalities.

Mark Ruskell: That sounds attractive and, for anybody wanting a career where they can make a difference on those key issues—inequalities, climate and improving society—that is great, but is there not a challenge inherent in your blended model of both in-house and private sector delivery? Someone could be doing the work in the private sector and potentially be getting better pay for it. I am being devil's advocate here.

Stephen Boyle: That is a perfectly valid challenge. It has been a long time since I worked in an audit firm, Mr Ruskell, but they are quite different environments from what we are looking to offer our colleagues, particularly the overall volume of benefits. The work that you are doing might be the same, but you are very unlikely to have a defined benefit pension scheme, the extent of flexible working and probably some of the certainty that we can offer our colleagues too. While encouraging people to work across Audit Scotland in financial audit and performance audit, people are able to specialise and work in dedicated teams. They broadly have certainty that they can support their career development and the responsibilities that they have outside of work. We look to manage all those competing requirements.

The key message that we want to give the commission today is that we are not complacent about those risks. We understand that we remain in a competitive environment for skills. I will endorse the point that Vicki Bibby made. There is a real onus on us to make sure that we broaden out our entry points into the organisation, that we are not just saying that you have to have a 2:1 degree to come and join Audit Scotland, that we broaden out our modern apprenticeships and the various entry points and routes into a career in audit. That is a focus for us in the year ahead.

Daniel Johnson (Edinburgh Southern) (Lab): I will dig a little bit further into salary increases—and the contingency, since it has been mentioned. In response to Mr Ruskell's questions you have been talking about the qualitative aspects. Given that you are accountants, can I ask you about the numbers? In particular, your industry is widely understood, with clear transferable skills. How have you compared your salary uplifts to industry norms? What are industry salary increases running at?

Vicki Bibby: It is not as transparent as, for example, comparing ourselves with some of the big four accountancy firms. PricewaterhouseCoopers has said quite publicly that there has been a 10 per cent increase, but that is not right across the board and, as I said earlier, they are looking at different increases. I think that we are quite similar to some of the medium-sized firms, but they have not yet published figures with which we can make a direct in-year comparison. As part of the procurement exercise, we have quite close working relationships with the firms, on a more bi-lateral basis. There is information sharing, but we have to be very careful because of their commercial basis.

The metrics that we want to look at are those for our people leaving us and the attraction number. We still have 48 graduates coming in. We are not losing many people to industry at the moment, but we want to be careful and keep a close eye on that. We speak with other agencies across the United Kingdom and they are experiencing a lot of loss to the firms, particularly at the graduate recruitment stage and at audit manager and senior manager level. We are not experiencing that but we are not being complacent. We know that that is a risk.

The question was about our offering compared to that of the firms. I do not have that information. That has not been shared with us.

Daniel Johnson: My question is not about individual firms and your comparison to them, but to the profession as a whole. Given that it is a regulated profession and that there are industry bodies, I assume that industry-wide salary surveys are carried out. Do you use those and do you undertake a formal benchmarking process? If so, could you set out how that operates?

Stephen Boyle: I am happy to speak a bit further about that. Yes, we do use salary scales, which are regularly published by Hays and others. We reference those—as do our trade union partners I should say, Mr Johnson. When they submit pay claims, that is part of the overall consideration.

Vicki Bibby covered the firms, but it is as relevant to say that people will join Audit Scotland from and leave it to go to other parts of the public sector, which is potentially as much of a valid comparison. Whether it is a finance role in the national health service or one in central or local Government, we will be as likely to see that as a career path as going to join an accountancy firm; perhaps even more so.

We mentioned earlier that we have settled a pay claim this year that is consistent with local government and is also likely to be higher than some of the pay settlements. The Scottish Government public sector pay policy affords flexibility to public bodies to settle their pay but it is down to individual public bodies. Consequently, the reliability of some of the salary scales in numbers reduces to an extent as a result of that.

Daniel Johnson: There are obviously benchmarks. I could not find the most recent figures, but the previous year that Hays produced was, I think, 3 per cent. It would be useful to understand where Audit Scotland stands on that and, indeed, your rationale for when you step away, which is ultimately the purpose of a benchmarking exercise.

Stephen Boyle: There are more options for us to do. You can very clearly tell from our proposal and our responses this morning that we are relieved that we have been able to resolve our pay arrangements this year. At the moment, in terms of our overall pay and reward package, we do not plan to do a whole-scale review of grade rates within the organisation. I do not think that we are in that place at the moment, based on the metrics of our recruitment and retention arrangements. Our offer being wider than just the salary is giving us some comfort—not complacency. In particular, our pension arrangements and the flexible working offer that we make to our employees as well as prospective hires are giving us some security, but only some. To reassure the commission, it is something that we are keeping under close review.

Daniel Johnson: The other things that obviously impact on that salary line are the overall numbers and your turnover. Can I clarify what the turnover numbers are? I see that in appendix 4 there is a 2 per cent vacancy turnover assumption. Is that the assumption and how is that borne out compared to the actual turnover rate over the last period?

Stephen Boyle: Vicki Bibby might want to say a bit more about this. As I mentioned, our turnover is increasing. It takes time to recruit people but it takes longer, typically, for us to bring somebody into the organisation than the notice period worked by the person who is leaving the organisation.

We want to be casting our net as widely as possible; consequently, there are pluses and minuses. In having fair, transparent and open competition, we want to bring a diverse group of people into Audit Scotland and that is taking longer than it is for people to work their notice and leave. That has led us to a point that 2 per cent is about right in efficiency savings. It can vary in what that means for overall turnover, but our turnover is higher than the 2 per cent. Colleagues may wish to elaborate.

Martin Walker (Audit Scotland): In 2021-22, our voluntary turnover was just over 6 per cent. Of course, the turnover and the vacancy rate assumptions that we make are not exactly the same thing. We are talking about two slightly different things. That particular year was probably higher than we have been used to in the past. The pending change to the audit appointments and, as people are aware, changes at the senior level in Audit Scotland maybe means that that is not a truly representative figure. As Stephen Boyle said, we keep a close eye on that.

We are doing okay at the moment but there are certainly risks there. As Stephen Boyle and Vicki Bibby have both said, if the rates change and if the demand for certain expertise in the market starts to widen that gap, there is no doubt that that will be a bit of a challenge for us.

Daniel Johnson: If you have been running at 6 per cent, is 2 per cent a safe assumption?

Stephen Boyle: I think that it is safe to say that we would be reluctant to go as high as that for our financial assumption—that we will continue operating at 6 per cent turnover. Martin Walker is right; turnover and vacancy rate are not exactly the same in what they might mean.

11:15

Daniel Johnson: Four per cent delta is quite large if your actuals are at 6 per cent but your plan in front of us is 2 per cent.

Stephen Boyle: An element of this is about the nature of how our budget is constructed and how we operate. That we must break even each year means that we have to have some certainty. In managing some of that risk, us going as high as even 4 or 6 per cent would be an additional risk that I would feel uncomfortable recommending in our budget proposal, through our board and to the commission. However, if we were operating at higher than 4 or 6 per cent in turnover rates, there are probably a couple of things that we would want to do. We would look at what that means for our financial assumptions and perhaps also at how we were bringing people into the organisation. I alluded earlier to the fact that some employment markets are moving incredibly quickly. For example, in our digital services and information technology department, we found that the pace at which recruitment for those services was moving was faster than we were able to keep up with. We have had to look closely at how we engage in that recruitment market so that we are able to access the skills. We have applied some modification to our recruitment arrangements to allow us to bring people in.

By way of anecdote, in some of those services, within a week, jobs are advertised, recruited to and people start. Public bodies historically have not operated as quickly as that to sustain access to those services.

Daniel Johnson: I could ask more questions about the assumptions and your people budget line, but in the interests of time I will move on.

Given that the question of a contingency has been raised, can I ask you for some further details about how the £500,000 figure—that is not an exact quote—has been arrived at? Is that derived from your risk register? If not, what is the methodology for how it is arrived at? What proportion of the contingency is ascribed to the potential risks around salary costs and salary increases?

Stephen Boyle: I am happy to start on this and Vicki Bibby and Stuart Dennis might also want to say a bit more about how precise that figure is and what supports it.

The answer largely is that it is not a precise science that we have arrived at a figure of £500,000 of contingency. Fundamentally, Audit Scotland has to break even each year. We are not able to hold reserves because of the way in which we are constituted. In the most basic terms—aside from reputational damage—our accounts would be qualified in the event that we failed to break even. That is not a position in which any of us would want to find ourselves.

We look to have a contingency buffer to support volatility in our financial arrangements. In the early stages of the pandemic, it became clear that our £300,000 contingency would be insufficient to cope with the change in the progress of audit work, which effectively is our biggest variable. Stuart Dennis can happily say more about that. We spend a lot of time focusing on what we call work in progress, which is the main variable for us in expenditure and income. That is a measure of how much work has been completed.

Complexity also derives from the fact that we report, as all public bodies do, to a March year end for financial results, but the audit year does not follow that pattern. The audit year for NHS audits runs to the end of June, local government audits into September-October time, and for some central Government bodies it is right through to the end of December. Managing all those variables, as we saw through the pandemic, means that it is not entirely predictable how an audit will progress; staff in public bodies need to be available to support the audit and then there are our own arrangements to take account of. That is the set of variables that we are dealing with. It is not a precise science, but we think that that £500,000 gives us enough of a buffer to cope with some of the variables.

Stuart Dennis might want to come in and say a bit more about some of the precise detail within that.

Stuart Dennis: I will highlight a couple of points in the conversation. The 2 per cent vacancy factor—and I know this was probably highlighted in some of the answers—represents the whole year. We will get times where it rises up to maybe 6 per cent or whatever, but we have applied 2 per cent over the whole year. The timing of when vacancies occur might mean that the actual percentage in turnover is higher, but within the overall span of things that 2 per cent for the whole year will be within a financial envelope.

On the contingency, the risk—and I think that it is included in the report—is that every 1 per cent increase in pay represents about £220,000 on our pay bill. Obviously, that is quite a big risk that we are trying to manage. The contingency was previously at £300,000 and during Covid we increased it to £500,000, especially with all the risks around that.

Those risks are continuing and more so. I think that Vicki Bibby mentioned earlier that there are cost of living pressures and other things that we have to try to absorb as well. We are taking on board within the risk register all the various things that we need to do to be able to manage within the budget that we have put before you today. There are absolutely risks within the budget, just to emphasise that, but we feel that the £500,000 is reasonable. It represents just under 1.5 per cent of our total budget, so we feel that it is a fair representation of what we would need without having to come back for any additional funding.

Daniel Johnson: I have probably used up more than my time, but I will ask one very blunt, bottom-line question. The overall budget request of £34.9 million represents a 4.8 per cent increase on your previous year's budget. That 4.8 per cent seems incredibly close to the gross domestic product deflator of 4.8 per cent for the coming financial year. I want to understand whether that was your starting point or is it a bottom-up? I hope you do not mind my asking this question. I am sure that auditors would agree with me that you should always take a closer look at coincidences when they occur and when numbers seem to match each other.

Stephen Boyle: I am happy to assure you, Mr Johnson, that it is entirely coincidental that the two figures match.

Daniel Johnson: Okay. Thank you very much. [*Interruption.*] I obviously have the chair looking at that now; I am finished, chair.

Professor Alexander: May I make one point as a result of the previous interchanges? Mr Johnson, you talked about risk being important. I assure the commission that a very large percentage of what I would call the governance time of the board is spent on risk, through the audit committee and the board itself. We are quite seized about what the risks are and how they need to be managed. We try to manage them in the most economical way. There is nothing here that we could not justify for the risks that we have assessed.

To give you an example, one of the continuing red risks that we have is how we deal with cybersecurity. We talk about that regularly. If you are looking for a hot employment market, that is where you find it. It is very hot among auditors as well, but it is really hot in cybersecurity. We are all over that. The numbers in the budget proposal, given the assumptions that we have had to make, are as good as they can be at this stage.

Sharon Dowey: Audit Scotland is required to directly charge certain audited bodies but relies on the Parliament to fund audit work for those bodies that it cannot bill directly. In paragraph 70, Audit Scotland states that it requires to increase fees by 19.4 per cent to break even. Could you explain the difference between the increase in fees to be billed for chargeable audits versus the resource sought from the Parliament that is used to meet the costs of non-chargeable audits, which is only a 4.8 per cent increase? That is quite a significant difference.

Stephen Boyle: It is, and I suspect that a number of my colleagues will want to contribute to answering your question, deputy chair.

At the most fundamental level, we can charge some bodies and not others, depending on the legislation that accompanies the creation of that public body. For example, one of the key contributors to our additional request to the commission today from the consolidated fund is as a consequence of the creation of Scottish Rail Holdings as a public body and its associated audit requirements. We are not able to charge Scottish Rail Holdings a fee.

On the wider aspects—I am sure that Professor Alexander might want to say a bit more about some of the fee arrangements as a result of the procurement, given the very important role he played in chairing some of our procurement exercises—every five years we market test the cost of audit through public tender for audit firms. We do that so that we are able to have a comparison in terms of our own cost base, but also so that we are able to continue accessing expertise from audit firms, again subject to our overall quality environment. After a long, thorough process, we ended up with the appointment of five audit firms to deliver audit services for the next five years.

We gave a number of real considerations to the prices that we received as well as the quality of the bids. We interviewed all the submissions and there was lots for us to follow through, not just regarding the audits that they will be providing annually, but the sharing of skills and intelligence that we need to support both my requirements and those of the Accounts Commission over the next five years. We think that it gives us price certainty and predictability in an audit market that elsewhere in the UK has been incredibly volatile. We do not have to look too hard to see what happens when there is not that certainty. The local government audit environment in England, for example, has been incredibly challenging. There has been a set of circumstances in which they, by coincidence, have also gone to the market for audit services from firms and have seen their prices for those audit services increase by 150 per cent. Yes, our prices are increasing, but there is variation. Sorry, Professor Alexander, I will stop in a second.

The last context, deputy chair, is that by legislation, where Audit Scotland can charge a fee, it must charge on a sectoral basis and we have to break even on that basis. That is reflected in the variation by sector that we have as a result of market testing. We do not want to cross-subsidise by sector and the submissions that we received from the firms reflect both the variation and difference. The non-chargeable element that you referred to is as a consequence of the nature of the bids that we received by sector.

I am sure that others will want to come in and say a bit more about this, starting with Alan Alexander.

Professor Alexander: I think that I have mentioned to the commission the value that we place on the intelligence that we get from having a mixed market approach to how we do the audits of the public sector. We started the process of seeking to engage auditors for a further five years back in 2019 and the board then asked me to chair the steering group. It was very clear at the beginning of that process that we had no certainty that the market would come out for the work that we were offering. There was always the possibility that they would decide that they could not live with what we could pay. In fact, one of the big four accountancy firms pulled out at a very early stage.

All that market intelligence feeds into how we price things and how we construct our budget. We get a lot of information on comparability through the way in which we manage the external contracts. As it happened, as Stephen Boyle mentioned earlier, five firms came out, we assessed their bids and each of them has a portfolio of audits that they will be beginning about now.

11:30

There is one other aspect of this that feeds into the budget. The way in which we have structured the contracts is a five-year appointment for each of the firms. The uplift that they can expect year on year is pegged to the uplift in Audit Scotland’s staff costs. That seems to me to be an effective way of maintaining discipline and also maintaining the value of comparability and market intelligence.

Sharon Dowey: Is there any risk that non-chargeable audited bodies are being cross-subsidised by the bodies that are billed for their audit work?

Stephen Boyle: We are managing that risk very carefully so that that is not the case. Stuart Dennis might want to say a bit more about precisely how we do this, but we are absolutely clear that we are not cross-subsidising between different sectors of public bodies. Stuart Dennis manages that very carefully.

Stuart Dennis: Absolutely. The sector analysis is robust to make sure that there is no cross-subsidisation. As Stephen Boyle and Professor Alexander said, the way in which we did the procurement gave us very useful market information about the cost of audit. You will see different percentage increases across different sectors and it is low in the non-chargeable sector, but we collected that information as part of our exercise to see that the cost of audit is a fair representation of the market at the moment. That is the approach that we have taken, so there is no cross-subsidy at all.

Sharon Dowey: Further analysis of the increase in fees is provided in appendix 3 on page 23. Audit fees to be charged to further education colleges are expected to increase by 57.5 per cent from 2022-23 to 2023-24. Can you explain why there will be such a significant increase in the fees to be paid by that sector in particular?

Stephen Boyle: I am happy to start on that, but Stuart Dennis might want to come in, too. Fundamentally, there is no cross-subsidisation; I hope that we have not laboured that point. Ultimately, this is about the market cost to deliver services to different sectors of the public sector. Historically, auditors of further education colleges have not broken even, given what it costs to deliver a standards-compliant audit and to meet the requirements of the code of audit practice that is set by the Auditor General and the Accounts Commission. That is coupled with the fact that, in the previous procurement round, audit firms gave significant discounts on the cost of delivering audits for all the reasons that we spoke about, such as the increasing costs relating to pay and other services. That has led to the costs for some sectors being significantly higher than the prevailing rate of inflation. There is therefore a variety of factors.

Overall, although the percentage increase is much higher than it is for other sectors, the comparable audit fee remains a lot lower than it is in other settings. We can support the commission by providing further information on that if it wishes.

I will check with Stuart Dennis and other colleagues whether there is anything that I have not addressed properly.

Stuart Dennis: Every point has been covered. The reason for the increase relates to the code of audit practice and international auditing standards. That is the information that we have as the market; that is how much it costs to audit that sector.

Daniel Johnson: I am not sure that I entirely follow what you have just set out. When you talk about market costs, are you saying that, in essence, the costs of the next-best alternative are forgone—in other words, if you went to the market, that is what would be charged—or are you saying that it is just 57.5 per cent more expensive to audit a college because of the nature of the work and the things that you have to verify? If so, could you explain that? Are you saying that there has been a change in circumstances in that sector compared with others and compared with previous years?

Ultimately, we are saying that the costs are going up. Has there been a change in what you are required to audit? What makes doing an audit of a college more than a half more expensive than it was previously, compared with audits of local government and the NHS? If you were to ask me to guess, I would have said that what they do is more complicated than what a college does and, therefore, they would be more complicated to audit. Where does the cost come from?

Stephen Boyle: I am happy to elaborate and clarify as best I can. All the factors that you have mentioned are relevant to why the cost is increasing. Auditors who work in-house for Audit Scotland and those in other firms have told us—we know this through our own monitoring—that it cost more to comply with the international standards on auditing, and to meet the requirements of the code of audit practice and the increasing quality requirements that are applied to the auditing profession, than the fees that were available to deliver those audits. For the previous five-year appointment round, auditors for some audits—notably, those involving the college sector—have not been able to break even, given what it costs to deliver the audit.

I mentioned the fact that, in the previous procurement round, which was six years ago, audit firms offered discounts to secure work by Audit Scotland. When we structured the tender exercise this year, we were not able to cross-subsidise by sector, for all the reasons that we gave to the deputy chair, so the bids that we receive reflect what auditors say it will take to deliver those services, not just this year but for the next five years, so there is price certainty.

I know that an increase in costs this year is a hard sell, Mr Johnson, but if public bodies were to go to the market for audit services, they would be unlikely to secure a contract for five years, so they would be carrying a degree of risk.

All those factors have led to an increase in the audit fees for that particular sector. It is the case that they are considerably lower than they would be for NHS and local government bodies, given their scale, but there is a cut-off point relating to what it takes to deliver a quality audit, and the prices that were being charged previously were below that line.

Daniel Johnson: With the revised standards, it takes more effort to get to that point for colleges than it does for other bodies. Fundamentally, is that what you are saying? That then reflects the bids that you get from the private sector. Is that the fundamental driver?

Stephen Boyle: It is not that it takes more effort; it takes effort for every sector. However, to get to that minimum line, there was a bigger gap than was the case—

Daniel Johnson: What is it about the college sector that requires that much? It is such a substantial amount more.

Stephen Boyle: I want to be absolutely clear: the issue is not specific to the college sector, but it relates to the fees that we charge to the college sector. That is also the case for central Government bodies, some of which are small bodies, but the legislation still requires that they get a quality audit. The rates that were being charged to deliver that quality audit were not sufficient to adequately break even. Yes, there is increasing complexity in some parts of the college sector, which has gone through regionalisation and so on, but it is not the case that that is directly attributable. The bids that we receive require us to break even, and that is reflected in the rates.

Daniel Johnson: Do you check the bids against what you think it would cost you to do the work yourself?

Stephen Boyle: We do. I can bring in Vicki Bibby on that point. Audit Scotland has not done as many college audits as the firms have for many years; we have done only a handful of those in-house. In relation to bringing us up to that point, and based on our own analysis, we similarly struggled to break even on particular college audit jobs by virtue of the required quality standards.

Daniel Johnson: Why is there a 60 per cent gap?

Stephen Boyle: Part of it is about catch-up, but it also reflects the fact that the tender is for five years. Audit Scotland and other audit firms are capturing some price certainty over the course of the next five years. I will pause there, but I am sure that Vicki Bibby will want to elaborate.

Vicki Bibby: I absolutely agree with everything that has been said, but I emphasise that the relationship between the cost and the size of the organisation is not completely linear. Compared with, say, local government, some FE colleges are much smaller organisations. As Stephen Boyle said, there is a minimum cost to complying with all the new standards, and some of the smaller bodies have to pay more, proportionately, to get up to that standard. After that, the relationship between the size of the body and the fees is a bit more linear. However, in the college sector, in relation to where we have been and where we are now, with the minimum cost of an audit that complies with all the new standards, the relationship is not linear. A lot of colleges have to move up to that baseline. I hope that that helps.

Daniel Johnson: Yes. Are you able to share with the commission in writing the standards that have driven the increase? I will not ask you to enumerate them now.

Stephen Boyle: We are happy to do that.

The Chair: I will bring in Richard Leonard, who has a supplementary question.

Richard Leonard (Central Scotland) (Lab): Yes, and then I will go on to my next question.

The reason why we are interested in those costs is because, from one year to the next, there is a massive increase of 57.5 per cent. That sounds massive. Does that tell us that there has been a failure in the preceding period? It sounds a lot more than an adjustment; it sounds like a substantial leap in the fees that are charged to FE colleges.

Stephen Boyle: I will pass to Stuart Dennis in a second to say whether we have information at our disposal, but I will say a bit more about what it is likely to mean for an individual college, given that the scale of audit fee charged to some colleges is much less than it is in some of our other public bodies. Percentage-wise, it is significant but, in terms of actual public spending, it is not quite as acute as it looks.

To address your wider point, the requirements on auditors are changing in terms of quality standards and senior input into audits. The commission will be familiar with some of the failures that there have been in the audit profession, largely in commercial settings. The regulatory environment in which we operate has led to an increasing focus on quality, more time spent on file reviews, more after-the-fact quality reviews and more senior input into audits. All of that drives costs higher in the auditing profession.

I do not wish to labour the point but, when we reference the price that we have received against some of the factors that apply in other parts of the UK, we still see a differential in the market that we have here, and that is alongside the fact that we are pleased—and somewhat relieved—that we have a market for audit services in Scotland. There was some doubt about that given that, as the chair mentioned, one of the big four accountancy firms declined to engage in the market. There is a variety of factors, but quality standards are the most significant.

Stuart, do you have any information to support that or some examples of the change in price?

Stuart Dennis: I do not have the exact figures, but they are all of the sort of size that has been mentioned. The 57 per cent is a lot in percentage terms. When it comes to the actual financials, we can provide that information for the commission to have a look at.

As Stephen Boyle says, the reason for the increase is that that is what we require to break even. As part of the procurement exercise, as we covered in the previous conversation, we did in-house costing as well. For all the bodies that we are responsible for auditing, we had a comparison and a benchmark to measure what we got in from the firms. That came out with reasonable figures for which we could award the contracts. I am happy to provide more details on the actual pounds in relation to the increases.

11:45

Richard Leonard: That would be useful.

I will move on to another area on which we want to challenge you a little. On page 6, paragraph 10 summarises the net increase that you are looking for. Roughly £563,000 is the net additional figure that you are looking for in uplift from the Parliament. By my calculations, about half of that is as a result of an increase in funding support to the Accounts Commission. Could you maybe elaborate on why that significant increase is there?

Stephen Boyle: With your consent, Mr Leonard, I will pass to Bill Moyes, who is best placed to take the commission through that.

Bill Moyes (Accounts Commission): To give a bit of context, when I was appointed, the minister made clear to me that he was happy with the audit of local government, but he was not happy with the commission's impact. He wanted us to make much more impact than we were making. He wanted to be confident that he was getting independent and objective assessments of financial stability and service quality and that, where there were problems, we were fixing them.

The objective that has been set for the commission is to go and make more impact and make sure that there are no serious problems in local authorities that we are not hitting. In our view, that meant that we had to increase our profile with the Parliament and that we had to be able to demonstrate that our work is having a lasting impact on service quality. To do that, we needed more dedicated resource. At that stage, two or maybe three members of staff of Audit Scotland were dedicated to supporting the Accounts Commission.

We have decided, first, to have a change programme in the Accounts Commission that will tackle some of the deficiencies that I and the commission felt existed in our organisation and our running. We particularly wished to appoint a controller of audit. Previously, certainly for some years, the role of controller of audit was undertaken by one person who was also the director of performance and best value. As far as the commission is concerned, it is no longer viable to have it split like that, because of the workload, and the planned workload. We plan to do quite a lot more to challenge local authorities where we see problems and make sure that they get on with sorting out the problems that they have. A big part of the increase to the Accounts Commission is the cost of a controller of audit.

Richard Leonard: How much of that £250,000 goes into the salary of the new controller of audit and how much goes into other areas of expenditure?

Bill Moyes: The controller of audit costs £155,000, so roughly half the increase goes there.

Richard Leonard: I presume that there is currently a resource in Audit Scotland—that is where the post has resided, although I do not know what the current configuration is.

Bill Moyes: Yes, that is right. In the past, the post was covered by someone who also had another job to do, which was performance and best value. The Accounts Commission is clear that that was not delivering the service that we needed to meet the minister's challenge and to make sure that we were tackling issues in local authorities.

Richard Leonard: But the proposal has come to this commission from the board of Audit Scotland.

Bill Moyes: Yes, because, under the legislation, the Accounts Commission is dependent entirely on Audit Scotland for services and resourcing. We do not carry a budget of our own; we are dependent on Audit Scotland funding for what we need.

Richard Leonard: Okay. You have described that the increase will meet the salary of a controller of audit. What is the rest of the additional expenditure for?

Bill Moyes: We want to create a small secretariat for the Accounts Commission, which we do not have at present. We have two or possibly three people, and we want to add a couple more posts to do mainly analytical work on the performance of local authorities and to help us with stakeholder relations and finding out what is going on. From memory, that is about £65,000. We need to improve our website, because it is tangled up with Audit Scotland's website. We need to build our presence a bit better, but those are relatively small sums of money.

Richard Leonard: You say that it is tangled up, but a lot of the work that you do either is work that you commission Audit Scotland to do or is badged as a joint report.

Bill Moyes: Yes, and there are strengths and weaknesses in that. If we want to increase our public profile and our profile with the Parliament and the Government and so on—as we think we have to do—we need to have a much more easily accessible website and documentation. When I started, I found it quite difficult to find information about the commission and on what it was doing and achieving. We want to pull that apart a little and make sure that our website is a lot clearer than it is at present.

Richard Leonard: As a commission, we have a strategic interest in the relationship between the Accounts Commission and Audit Scotland. You talk about pulling apart. It is not a separation that we are talking about, is it?

Bill Moyes: No, by no means—it is a clarification. We think, and the Government thinks, that it is important that our work is understood and acknowledged and open to challenge. At the moment, there are times when it is hard to understand where Audit Scotland stops and the Accounts Commission begins. That is the kind of thing that we want to clarify a bit.

Richard Leonard: I have one final process question. I presume that this is the will of the Government minister who is responsible for local government. How does that work in the environment of the Audit Scotland board, for example? Does the minister sit on the board or is a directive issued to the board? Are you the missionary for the minister on that board, Mr Moyes?

Bill Moyes: No—not quite. It is a complex role being a board member of the organisation whose job is to provide services to the Accounts Commission. If we were drafting the legislation now, one might draft it slightly differently. The minister does not sit on the board. The minister comes along more or less once a year to the Accounts Commission—he did so just the other week—to talk to us and to steer us. In the end, we report to the minister. He is clear that he does not wish to be involved in detail in our analysis of a particular local authority, the conclusions that we reach or the work that we expect the local authority to do to remedy deficiencies in its performance. He is clear that we should do all that independently. However, his steer remains that we need to be more impactful than we have been, and we take that seriously.

Richard Leonard: Okay. I will ask the Auditor General or Alan Alexander if they want to come in. For completeness, is the discussion that you have had with the minister a matter of public record? Is it minuted, for example?

Bill Moyes: I do not think so. He spoke to me one on one when I was appointed, and he has been along to the Accounts Commission a couple of times in the past year. The discussions are not minuted as such, but he would acknowledge fairly openly that that is what he is telling us he would like to see.

Richard Leonard: Okay—thanks.

Professor Alexander: The statutory responsibility of Audit Scotland through its board is to provide services to the Auditor General and to the Accounts Commission. The line that you are discussing, Mr Leonard, has been part of the consideration that the board, and particularly the independent members of the board, has given to the construction of the budget. Some of this is a one-off to fund the changes to which Bill Moyes has referred but, in the construction of the budget, the amount of due diligence that has been carried out by the audit committee and the board is the same as has applied across the entire budget. As long as what the Accounts Commission wishes to do is within its statutory responsibilities, our responsibility is to exercise due diligence at board level, and that is what we have done. This is the number that we have come up with in this particular budget proposal.

Richard Leonard: To go back to my original question on the controller of audit post, that was housed inside Audit Scotland's budget, and it will now be transferred to the Accounts Commission. You are asking us for a net increase, which in part is constituted by the additional cost of that salary. Is that not simply an internal transfer from a salary ascribed to Audit Scotland that will now in future, if the budget is passed, be ascribed to the Accounts Commission?

Stephen Boyle: I am happy to pick that up. As Bill Moyes said, the role of controller of audit has fluctuated within Audit Scotland for the past 20 years. Prior to Audit Scotland's creation, the controller of audit of the Accounts Commission, as it was, was a stand-alone post and, subsequently, where it has sat has varied. As Bill Moyes rightly mentioned, in recent years, it has been alongside the responsibilities of the director of performance audit and best value. However, as Bill Moyes has set out today and since he took up the post, given the Accounts Commission's ambition to be more visible and more impactful, it has settled on the position that the controller of audit should become a stand-alone role to deliver the commission's requirements.

Audit Scotland exists, at its most basic function, to provide services to the Accounts Commission and the Auditor General—parking for a moment the complexity of our governance arrangements with Bill Moyes and me as board members of Audit Scotland. That has led us to the point that there is no separate budget per se for the Accounts Commission. An Audit Scotland budget provides those services but, in the budget proposal, we seek to be transparent, because that represents quite a material change in how Audit Scotland will function and will provide services to the Accounts Commission.

Richard Leonard: Can I move on to another area that we want to ask about? Reference is made in the proposal to efficiency improvements. In paragraph 19 on page 8, the proposal says:

> "Action has already been implemented to secure efficiency improvements in the delivery of audit work, particularly in relation to financial statements audits."

Will you describe some of the features of those efficiency improvements and how they relate to the fees charged to the bodies that are being audited?

Stephen Boyle: I am happy to start on that and I will bring in Vicki Bibby in a moment. Fundamentally, we want to be efficient in all the work that we do. We continually look for ways that we can improve both the quality and the timeliness of our work. Its timeliness is still impacted by the pandemic. Even today, as we approach the end of December, we are still working on completion of 2021-22 audits in advance of some of the statutory deadlines, particularly for central Government bodies. We are still playing an element of catch-up as an organisation.

We are also looking to ensure that our audit methodology is efficient and that it meets the increasing bar of quality standards. There are many changes, and I will happily come back to the commission in response to Mr Johnson's question about the changes in standards. I do not want to go into too much detail, but one of the most significant changes that is coming is a new auditing standard on the use of IT audit. That is having a material impact on how we go about our audit work and our methodology. We are applying that and absorbing it, but we are also asking what it means for how we can be more efficient.

In recent discussions with the commission, we have spoken about digital auditing and how we are making better use of digital tools and techniques. It is a twin-track thing. It supports the quality of our work, because we are getting to the heart of some of the material transactions that public bodies with an audit interest are doing. We are also asking whether we can do that work more quickly and efficiently so that it results in faster audit reporting and, potentially, reduced audit costs.

At the moment, we are not quite in a position where we can say, "If we complete this methodology analysis, it will lead to an X per cent reduction in audit costs". We are being really careful. However, we say in the budget proposal that, if there is a material change, we will reflect that in the audit fees that we charge, and similarly through future budget proposals.

I am sure that Vicki Bibby will want to comment.

Vicki Bibby: I hope that what we are doing will reassure you. We do not want to keep saying to ourselves or to clients that, with the new standards and the innovations that are coming on in the industry, we will just add on and add on. We constantly review our audit approach to ensure that we are auditing in the right areas and that we have an appropriate risk base for our audit work. You will know that we have developed our innovation and quality team to look at that.

12:00

In particular, we are quite clear that the auditor of today is different from the auditor of five years ago, but the auditor of five years to come will be very different from the auditor of today with all the innovations. We want to work closely with the firms that we have procured services around to speak to them about the research and development investment that they have available to them to build on and to look at the way we do our audits.

Our executive director for innovation and quality is working right across the organisation to make sure not only that we keep up to date, but that we are at the forefront in how we audit. Otherwise, we could come under the pressure of just adding on and adding on. That is not what innovation, particularly around digital, tries to do for us. We are very active in this space. I hope that that reassures you that we are looking at how we can be as efficient as possible in delivering our budget.

Another example is how we audit climate change for the bodies. We weave that into the work that we do, again on a risk basis and given the scrutiny requirements, in order to be as efficient as possible. That work will always be on-going, but with the new director of innovation and quality, we are putting a clear focus on that work.

Richard Leonard: I have one final question as a follow-up to that. Do you do anything to incentivise the audited bodies to help you to carry out a more efficient audit of their work?

Stephen Boyle: The annual audit plan that goes to each audited body sets out how the audit will work, the responsibilities of the auditor, their expectations, the anticipated timescale, and how they will address risk. The plan states that there is a requirement to be prepared, to all intents and purposes. That requirement is not always met, and in those circumstances there is something of a punitive measure. Otherwise, Audit Scotland—and, in effect, the public purse—will absorb that inefficiency. There is a provision for the auditor to charge some additional fees in those circumstances.

We do not say, "If you are very well prepared, it will result in an X per cent reduction in your audit fee", largely because of the fixed nature of our costs. We do not operate with those variables. If we get to a more stable environment after the effects of the pandemic have washed through, and having applied some of the innovations and digital approaches, we will be happy to look at that and think about an incentive model, but we are perhaps a couple of years away from being able to enact such an approach.

Richard Leonard: We are still in the age of sticks and not carrots.

Stephen Boyle: To a degree.

Mark Ruskell: I want to ask you about the strategic improvement programme and how the long-term estate strategy aligns with the future operating model. Vicki, you alluded to a rates review of your main premises. We were fortunate enough to visit you in the summer and you have very nice offices. I am thinking about how that aligns with the future operating strategy for space and location and what you might be planning.

Vicki Bibby: It is a live issue. As you will know, Audit Scotland is not alone in that regard. Every organisation in the world, probably, is looking at the impacts of Covid on ways of working. We are looking at how we can realise the benefits and get an appropriate balance of in-office space and client-facing space.

We are actively looking at how individuals can do their work, but also at how we can work collectively as an organisation and as a team. Home working does not lend itself to that 100 per cent. We have talked about different pathways including those for graduates, modern apprentices and school leavers. How do they learn not just the technical skills of being an accountant or an auditor, but the wider skills that are really important to us? We are trying to balance those things.

We have touched on tackling climate change and inequalities, and hybrid working has benefits for that. Another aspect is the financial impact and where we could make savings in our estate strategy. We have lease break points for our offices of 2025 in Edinburgh and 2027 in Glasgow, so we are actively looking at options. We have been working with organisations to consider what it will mean if coming into the office is more about having collaborative space so that we can maximise the benefits of people coming together.

We have been actively discussing the matter with the board and looking at our metrics on staff coming into the office. We think that it is a wee bit early to rely on those metrics completely in deciding on our future working model, but a key priority for us in 2023 will be to think about what the right balance will be and the gains that we can get from hybrid working. That will involve a balance with people working at home, but it is also about people working together. It is not about people working exclusively from home.

We are aware of the importance of audit being client facing. It is important to be out with clients to get the more nuanced parts of that engagement. However, it also requires the clients to work out what their position is. There is no point in all auditors going out to organisations if the clients are mainly home based, so we have to work that through as well.

Mark Ruskell: I understand how ways of working might change but, to put it bluntly, is there a case for looking at smaller, cheaper, different locations outside Edinburgh? I do not know.

Vicki Bibby: We are looking at that. As I said, we have our lease break in 2025 and there are options. We are actively speaking with landlords. We have to do that with staff. It is absolutely right that we do it with them. In the work that we are doing, we have union representatives as part of that on-going discussion.

It is a question of balance. We are clear that there are financial savings to be made and that we can make positive climate change and net zero impacts by reducing our office capacity, but it cannot be done at the expense of delivering a high quality of audit. That is the balance that we are looking at.

Mark Ruskell: Quality is key, as well as customer satisfaction and client satisfaction.

Vicki Bibby: Absolutely.

Professor Alexander: I have said to the board on a number of occasions that, on this issue, it is more important to get it right than to get it soon. There are a lot of easy assumptions about how the world of work has been changed by the pandemic. It sure as hell was changed, but we are in no position yet to say how permanent that is. We have to make a well-informed judgment on that before we can harvest any efficiencies.

We are certainly clear that there is a strong possibility that, over the short to medium term, we can reduce the costs of the estate that we occupy. It is made slightly more difficult by the fact that we do not own any of it, so there will be negotiations and discussions to both wind down and wind up if that is the position that we get to.

Stephen Boyle: I agree with everything that Vicki Bibby and Alan Alexander have said. One of the features that we will see over the next few years across all public sector bodies is really close examination of their estates. It is set out as one of the Scottish Government's public sector reform efficiency proposals in the resource spending review. We will perhaps see more on that over the next couple of days and more detail on it through the budget.

That perhaps affords us some opportunities to consider how we use our estate and where we are based. We have three or four sites across Scotland at the moment. We can fully expect to have a presence across the country. We will continue to track how people's working practices evolve and consider whether that means that we should have smaller microsites in different parts of Scotland, engaging with other public bodies in order to have that presence. Everything that Alan

Alexander and Vicki Bibby said is right. We will track it, but we will not leap into a decision given the number of variables at the moment.

Mark Ruskell: I understand. I will move neatly on to the impact of Covid. There has been a delay in auditing work. Can you give an assessment of where you are as an organisation in catching up on that? It would also be useful if you could talk about clarity in Covid funding as well.

Stephen Boyle: I will bring colleagues in. Martin Walker can talk about our delivery arrangements for the financial audit and our audit programme, and Vicki Bibby can touch on the Covid funding.

As a headline, we are still feeling the effects of the pandemic in terms of delivery, and it is absolutely the case that public bodies are, too. As I mentioned in my introductory remarks, although the impacts of the virus on public health have ebbed, they linger strongly with regard to public service delivery. We are still in that place with our audit work too.

Martin Walker: We have always looked at our response to Covid from two angles: our audit response and our own organisational response.

On the audit response, early in the pandemic we set out our approach to what we were going to cover and what the areas of focus might be around that. We set up a Covid-19 hub and, since the pandemic hit, we have put out 20 specific publications on Covid. Of course, as you would expect, the impact of Covid on individual audit organisations features where appropriate in those audit reports as well as things like the NHS overview report and so on. We have had a clear focus on that from the audit perspective.

On the organisational impact, as with other organisations, it has been an evolving situation. Clearly, in the early stages of lockdown, we experienced the shock and awe that hit everybody in society. We were able to transition quickly because of the business continuity arrangements that we had in place. That meant that the impact on us as an organisation was probably far less than it could have been had those arrangements not been in place—indeed, that was the case with many other organisations that we audit.

There is no doubt that the pandemic continues to have an impact on the delivery of audit. This year, our objective was to return to something much closer to pre-pandemic deadlines in delivering the audits. We are doing okay on that but we are not quite back to where we would like to be. For example, as of this morning, all the health audits were completed to schedule. Local government audits were at 81 per cent completion and central Government audits were at 84 per cent completion. Of course, the deadline for those has not arrived yet; that is the end of this month.

We are seeing some return to the situation we would like to be in, but probably not as much as we would like. We find that there are still lingering effects on us as an organisation and on the bodies that we audit. Earlier, Stephen Boyle was talking about the readiness of organisations, the readiness of the accounts and so on. Of course, we cannot do the audit until those are in there.

The last thing that I would say on our organisational response is that, throughout the pandemic, we prioritised the health, safety and wellbeing of our colleagues. That has been borne through in the amount of time lost and the amount of sickness that has been accorded to Covid. We deliberately took a people-focused approach to that. We have invested in communicating with colleagues right across the course of the pandemic and so on. The different engagements that we have had with people and some of the surveys that we have run tell us that people have quite appreciated that.

However, we are not out of the woods yet. One of the things that has impacted on the delivery deadlines for the audit was what we referred to in-house as the snow plough effect. The initial effect of the pandemic has rolled through into subsequent years. It takes longer to get the first year done and that means a slightly later start to the second year and so we are playing catch-up in that year as well. That is probably where we are at the moment. We have not been able to fully catch up. Certainly, there is no doubt that people are working hard to do so.

12:15

Vicki Bibby: On the Covid funding side, our position is that this budget that is presented to you—and indeed last year's budget—does not have any Covid funding in it. I will take a moment to explain that. In 2021, we asked for an additional £1.5 million of funding to cover the loss of income, because of the timing of the audits due to Covid. We received that and have paid it back to the tune of £1.4 million of underspends in each year—£700,000 in 2020-21 and in 2021-22. Our budget last year had what we called a contingency of £2.4 million—£400,000 of that was for the pay award and £500,000 was for contingency. That left £1.5 million of contingency.

Picking up on Mr Johnson's earlier point, having numbers being the same can confuse. That £1.5 million involved building our capacity as an organisation, and £1.2 million of that was for additional auditors. We have recruited 24 additional auditors as a result. They are on permanent contracts, so it is a recurring cost, not a one-off cost. Some £300,000 of that concerned the new financial powers and the increased quality, and we have recruited a number of staff in relation to that.

I would be happy to follow up on that with a breakdown of what that £1.5 million is, but it involves recurring costs—I must clarify that we do not see that as one-off £1.5 million Covid funding. We paid that back. The additional funding was around on-going building of capacity of what we feel is needed to deliver on the capacity financial powers and quality that future audit requires. That was in last year's budget, which we are rolling forward, and it is baselined—we are not calling that contingency any more. The only contingency that we have in the budget is the £500,000 that we have spoken about. If it helps to clarify, I am happy to make that more explicit in a breakdown of what that recurring spend.

Mark Ruskell: Thank you.

The Chair: Do any other members have any questions that they would like to ask?

Daniel Johnson: One of the issues that I stood out when I was reading through the document concerned your plans on innovation. The budget proposal outlines a reduction in capital requirement from £250,000 in 2022-23 to £150,000 in 2023-24. Given the increasing burdens and complexity—and, indeed, additional people you need—I might have expected you to have an associated increase in your capital requirement with regard to IT systems and automation to deal with that. What is the explanation for the reducing capital requirement?

Stephen Boyle: That issue is important, as you quite rightly say. We are predominantly a people business but, nonetheless, we still require capital to support the delivery of our services. That does not reflect what we think will be a pattern for future years. In previous years, we have invested in digital hardware, as Martin Walker rightly mentioned. We did a lot of that in the early stages of the pandemic so that colleagues could work remotely. Not for this year's budget but likely for the following year and the year after that, one of our investments will be not so much our offices but our electronic working papers. We are scoping that programme at the moment, so that will be a feature of next year's budget. The current situation reflects something of a lull in that investment.

Daniel Johnson: I have just one final question and I am afraid that it is a bit of a cheeky one, to be honest. I could not help but note on page 22 what looks awfully like a rate card to me. What is your target number of chargeable hours per year for a chargeable person, for a whole-time equivalent? I know that, even if it is not expressed in those terms, that issue will be at the forefront of your minds when you are constructing rate cards.

Stephen Boyle: The terminology that we use within the organisation is the utilisation rate, and that varies by grade. Trainees have a lower utilisation rate because we invest in their learning and development through their professional qualifications. It tends to go on a bit of a bell-shaped curve. For our newly-qualified roles, senior auditors tend to have the highest utilisation rate and that then falls as colleagues become more involved in engagement and corporate activities as they progress to more senior grades in the organisation.

I do not have at my fingertips the precision around that and what that means but, largely, we use that information carefully and we track it carefully in relation to the productivity of colleagues on individual grades. All of that informs our management information about how we support colleagues and how we deliver audits and it is also useful information about our cost base. I am happy to come back to the commission in writing to set that out in more detail for you.

Daniel Johnson: That would be helpful. Certainly in a previous life, I was used to a utilisation rate of between 60 and 80 per cent. It would be interesting and useful to know what parameters you are using.

The Chair: I have a couple of questions to probably wind up our discussion. On page 9, paragraph 31, you say:

> "Specific areas of our administrative budget have no inflation applied".

Which areas are those?

Stephen Boyle: I will ask Stuart Dennis to provide that detail, if he can. I understand the nature of the question, given the cost of living challenges that we are experiencing. If we have that information, we can share it with you. If not, we will come back to you with it.

Stuart Dennis: Appendix 1 summarises areas such as staff recruitment, internal audit and external audit, and you will see that they remain static. There is not a huge increase in IT, either. There are numerous areas where we have not applied any inflation at all and we look at that as a saving.

The Chair: Since you have drawn our attention to appendix 1, I note that legal and professional fees seem to have gone up substantially.

Stuart Dennis: They have come down from £840,000 to £752,000, and that is—

The Chair: Yes, but they went up to £840,000 from £600,000-odd.

Stuart Dennis: That concerns the national fraud initiative. We have to contribute £220,000 every two years. Next year we do not have that, but it will be a requirement in 2024-25.

The Chair: Thank you. I have one final question. You have touched on hybrid models of working and so on. I know from past discussions that that is an active issue. However, is the overall delivery model under consideration at all? What costs and benefits are there for having the audit work provided by in-house teams versus outside people? Are you looking at the whole possibilities in terms of how to deliver services?

Stephen Boyle: We carried out a two-year project that led to the culmination of the development of the code of audit practice and the procurement of audit services. That was central to our thinking about the model that exists for the delivery of public audit services and the provision of in-house teams and those of firms. The Accounts Commission and the Auditor General—both me and my predecessor—and the Audit Scotland board weighed up the cost benefit of that question and came to the position that operating a mixed market in Scotland gave us the best balance of efficiency, access to expertise and predictability in the delivery of services.

Other models exist. We are unique, though, in having an Auditor General, an Accounts Commission and a public audit agency, but the extent to which private firms are used varies elsewhere in the UK, as does the certification model that exists. In the National Audit Office, for example, it is still largely the case that the Comptroller and Auditor General certifies all the audits that it undertakes, whereas in Scotland we appoint auditors in their own name to certify the delivery of public audits.

We keep the issue under close review but, at the moment, we have a code of audit practice plus our procurement arrangements in place for the next five years. That does not allow for the possibility of there being a market shock, as we experienced the best part of 20 years ago, when one of the providers decided to pull out of the market, but we are not in those circumstances. Although it feels like a number of years away, we are already beginning to think about how we will undertake the next delivery of the code and procurement. Closely monitoring quality and value for money remains central to our thinking.

The Chair: Okay. If members have no other questions to ask at this point, I will conclude the evidence-taking session by thanking everybody, the witnesses in particular, for attending today.

That concludes the public part of the meeting. Members may want a couple of minutes for a comfort break before we crack on with the private session.

So I do not forget, I wish all the witnesses a happy Christmas and a great new year. All the best.

12:26

Meeting continued in private until 12:52.

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