OFFICIAL REPORT
AITHISG OIFIGEIL

Scottish Commission for Public Audit

Wednesday 15 January 2020

Session 5

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SCOTTISH COMMISSION FOR PUBLIC AUDIT
1st Meeting 2020, Session 5

COMMISSION MEMBERS

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

*attended

THE FOLLOWING ALSO PARTICIPATED:

Stuart Dennis (Audit Scotland)
Caroline Gardner (Auditor General for Scotland)
Ian Leitch (Audit Scotland)
Diane McGiffen (Audit Scotland)

LOCATION

The Adam Smith Room (CR5)

Scottish Commission for Public Audit

Meeting of the Commission

Wednesday 15 January 2020

[The Chair opened the meeting at 11:45]

Decision on Taking Business in Private

The Chair (Colin Beattie): Good morning, everybody, and welcome to the first meeting in 2020 of the Scottish Commission for Public Audit. As always, I ask members and witnesses to keep questions and answers concise and to the point; I also remind people to put electronic devices on silent mode.

Under agenda item 1, I seek members' agreement to take items 4 and 5 in private. Is that agreed?

Members *indicated agreement.*

Spring Budget Revision 2019-20

The Chair: Item 2 is consideration of Audit Scotland's spring budget revision for 2019-20, a copy of which members have in their meeting papers. I welcome to the meeting Ian Leitch, chair of the board of Audit Scotland, who is, of course, accompanied by Caroline Gardner, the Auditor General for Scotland. They are joined by, from Audit Scotland, Diane McGiffen, chief operating officer, and Stuart Dennis, corporate finance manager.

Today is a very significant day, because this is Ian Leitch's last appearance in front of the commission before he demits office. I put on record the commission's thanks to Ian for his hard work and the great efforts that he has put in as chair of the board over the past period, which are really appreciated.

I invite Ian Leitch and Caroline Gardner to make some short introductory remarks.

Ian Leitch (Audit Scotland): Thank you for those nice comments, chair. My introductory remarks will be very brief, given that this is my last appearance before the commission, barring some unforeseen circumstance, and I have been cautioned not to get demob happy as a consequence. I would be happy to talk through the proposals and answer any questions that members have on our budget.

As you are well aware, we live in unique if not thoroughly interesting times. We have been going through a period of significant change, and there are more changes on the horizon. Although the full implications of the United Kingdom's withdrawal from the European Union are still very unclear, it will have a profound impact on Scotland's public sector, which includes Audit Scotland. In the short term, beyond the current and the coming financial year, it could have a profound impact on our budgets if, for example, there is no replacement for the European agricultural fund account audit fee. That would account for approximately £1 million of our income. Obviously, we need to take great care and look at our responsibilities in that regard.

Like others, we are having to steer our organisation through the current situation and manage the increases in our responsibilities, and the wider risks and uncertainties, in that environment. In doing so, we are balancing our recognition of the limitations on public resources and the need to provide a cost-effective audit service with the need to continue to improve the quality of audit and cater for Scotland's growing powers and public spending. Our budget reflects those factors throughout and aims to ensure that

Audit Scotland is as well placed as it can be for what comes next.

With your permission, chair, I will hand over to Caroline Gardner in her capacity as accountable officer.

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

I will step back from Ian Leitch's general introduction to focus on the spring budget revision initially, after which we will pause.

As members know, each year we bring a proposal to the commission for the annually managed expenditure funding to cover the non-cash pension charges that we need to meet in respect of the local government superannuation scheme. The overall AME cover for Scotland is redetermined once a year through the spring budget revision, and we have a routine process for coming to the commission at this point in the year.

Unlike in previous years, this year there are two elements to our proposal, the first of which is due to a reduction in the discount rate since our budget proposal for 2019-20 was submitted to the commission in December 2018. Based on the actuary's report that we received in April 2019, we estimate that the pension service cost for this year will be £4.1 million higher than the available budget.

The second results from the impact of the McCloud case on pension liabilities. In June last year, the United Kingdom Government was refused leave to appeal the decision in that case, and the affected employees will need to be compensated. The costs of that are unclear, although the UK Government estimates that they might be around £4 billion UK-wide. Initial estimates by the local government pension scheme actuary indicate that the potential past service cost for Audit Scotland might be in the region of £2 million, but the figure could be significantly higher or lower depending on the agreement that is finally reached. It is also expected that the in-year pension benefit cost will increase from the original forecast.

As we are unable to carry forward reserves, any significant shortfall would leave us with a final outturn deficit at the end of the financial year. Therefore, the Scottish Government finance directorate has advised us to request sufficient AME budget cover to meet potential movements in the non-cash pension charge.

In our proposal, we have, therefore, requested the £4.1 million that was forecast by the actuary in April, plus a further £5.9 million to cover any liabilities that are linked to the McCloud case. Obviously, any budget cover that is unused cannot be used for any other purpose and will be returned to the Scottish Government for recycling in the usual way.

We will pause there, chair, and Stuart Dennis and I will do our best to answer the commission's questions, recognising that this is a particularly complicated aspect of our accounting.

The Chair: Over as many years as I can remember, with one year's exception, it seems that there have been adjustments for pension deficits; they seem to accumulate every year. I realise that there is an actuarial calculation behind that and that changes to long-term interest rates impact on that calculation. However, when will we come to an end to providing for pensions?

Caroline Gardner: I completely recognise your concern. If we look back at the 20-year history of Audit Scotland since it was established back in 2000, we see that, for the first 10 years or so, the picture was the other way round, and we returned funding to the consolidated fund, because it was not required. However, since about 2012, the movements have been in an adverse direction and they are getting bigger, as you can see from our proposal.

It is almost all down to movements in the discount rate. Stuart Dennis can keep me straight on this. A very small movement in the discount rate leads to quite a large change in the liabilities. Since last year, we have seen a reduction from 0.3 per cent to minus 0.1 per cent in the discount rate that is used to value future pension liabilities, which has a significant impact on the non-cash accounting charge that we need to make through our income and expenditure account. That will reverse at some point in the future, but none of us knows when that will be.

The Chair: The frustrating thing is that all that money going into the pension fund does not increase the pension that staff will receive.

Caroline Gardner: It is important for us to be clear that the accounting charge that we are talking about does not go into the pension fund. What goes into the pension fund is employer—and employee—contributions, which we budget for and routinely meet year in, year out. That is what will meet the pension liability in the future.

Under international accounting standards, we are required to put through our income and expenditure account an accounting charge that reflects the change in the liabilities for the future, as best as they can be estimated, which depend on things such as life expectancy. They also depend, very heavily, on the discount rate. When the discount rate changes, the value of the liabilities changes, without having any impact on the pension that our employees will receive, as you said. Those are purely accounting adjustments that are related to the relevant account standard.

The Chair: With regard to the Lothian Pension Fund, which is where liability falls, one of the most important assurances that we need is about the discussions that you have had with the Scottish Government to confirm that the previously agreed arrangements with Her Majesty's Treasury remain in place to meet the pension adjustment.

Caroline Gardner: Two separate sets of discussions go on every year. There are the discussions that our corporate finance manager, Stuart Dennis, has with the Lothian Pension Fund and the actuary who values the liabilities. That leads to the agreement on the future rates of contributions that we and our staff make and on the accounting adjustments that we are talking about. Each year, the board looks at those closely to ensure that we are confident that the level of contributions and any top-up payments that we make are managing the liabilities.

Alongside that, Stuart engages with the Scottish Government on the amount of AME cover that we should be adjusting to cover the accounting charge—not a cash charge—to ensure that our accounts do not have a deficit at the end of the year. The Scottish Government is comfortable with the proposal that we are making this year, which reflects the level of uncertainty that is involved. The board is comfortable that the contributions that we are making to the Lothian Pension Fund are, over the long term, adequate to meet the liabilities that are being incurred as staff deliver their pensionable service. Stuart Dennis may wish to add something to that.

Stuart Dennis (Audit Scotland): That is correct. There is a triennial valuation and the next one will be due from the start of April this year. That valuation is used to work out what contribution rates there will be from the employer. That is a cash adjustment. As the Auditor General says, this is purely an accounting adjustment to recognise the future liability. We then have a separate valuation to work out the employer's contributions.

Bill Bowman (North East Scotland) (Con): On the £5.9 million figure, I think that the Auditor General said in her introduction that the Scottish Government wants Audit Scotland to make an adjustment sufficient to meet the non-cash shortfall. The actuary suggested a figure of £2 million, but I think that the Auditor General said that it could be significantly less or significantly more. How exactly did the £5.9 million figure come about?

Caroline Gardner: The initial estimate from the actuary of the potential past service cost that may be affected by the McCloud judgment is £2 million. That is an initial assessment before any negotiations have been entered into around what the agreement might be for compensating the pension scheme members who were affected. The actuary has indicated that there is a lot of uncertainty around the estimate in both directions.

On top of that, though, we expect that the in-year pension benefit will also increase as a result of the McCloud judgment, so we have the £2 million figure plus an unknown number and then quite a large band of uncertainty either side of that aggregate number.

As the commission knows, Audit Scotland is not able to hold reserves so any increase in our liability that has to go through the accounts would lead to an unbudgeted deficit unless we have AME cover. That would clearly not be a good position to be in for us or for the commission as the body that oversees our finances. We have the £2 million plus an unknown number for past pension cost and then the uncertain range either side of it.

Bill Bowman: But you have quantified the number. Is there a piece of paper that shows all the figures that add up to £5.9 million?

Caroline Gardner: To be frank, Mr Bowman, it is £2 million plus an unknown number. The only other parameters that we have are a significant degree of uncertainty from the actuary. You can see that we have taken £4.1 million plus £5.9 million to come up with a round number of £10 million. It is the best estimate that we can make at this stage and the Government has indicated that it thinks that that is an appropriate course of action for us to take.

Bill Bowman: Thank you for your frankness on that. Has the Government given you instructions or written acknowledgment that it is happy for you to have that number in the budget?

Caroline Gardner: The Government has not given us an indication of the number that we should include. It knows that we are proposing a figure of £10 million to cover both the £4.1 million past service cost and the McCloud figure. It also knows that any budget cover that is not required will simply be recycled into the system in the usual way.

Bill Bowman: Excuse me for pursuing the issue, but I have been in the position where an organisation has told me that the funding body is very aware of everything and is quite in agreement but then it turns out that it is not. Do you have some form of formal arrangement with the Government that it will accept the £3.9 million figure?

Caroline Gardner: Stuart Dennis can talk through the discussions that he has had with the Scottish Government.

Stuart Dennis: Initially, I had discussions about the uncertainty of this arrangement. On top of that, every year, we submit details to the Scottish Government of our AME cover requirement. It then uses that as a tool to negotiate with HM Treasury. The Scottish Government is aware that this is what we are looking for and there has been no feedback to say that this is out of the ordinary, so that is what we expect—

Bill Bowman: Would you not be more comfortable if you wrote to the Scottish Government or had a formal exchange with it to say, “This is what we are putting in and we trust that you are comfortable with it,” for example?

Stuart Dennis: I have an email audit trail to the Scottish Government submitting our requirement and an explanation of the reasoning behind that. The Scottish Government has accepted that as part of the whole of the Scottish negotiations for AME cover in the spring budget revision.

Bill Bowman: If you did not make this adjustment, and what you had was wrong, would it not just be part of another budget adjustment?

12:00

Caroline Gardner: No, because the proposal that we are making now relates to 2019-20. When we complete our final accounts for the current financial year between April and May, anything for which we do not have budget cover would lead to an unbudgeted overspend, which is clearly not the position that I want to be in as the Auditor General and the accountable officer.

Bill Bowman: I have one final question for you with your Auditor General hat on. Will you be seeing other organisations doing this?

Caroline Gardner: Very few organisations are in the same position as us. Audit Scotland is unusual because almost all our staff are members of the local government pension scheme, which is a funded defined benefit scheme and so needs to be accounted for under international accounting standard—IAS—19. At the same time, we have to prepare our accounts under the Scottish financial reporting manual, and we cannot carry reserves. Those three things mean that we are one of the few organisations that needs to make AME provision in quite this way. Most local authorities can carry reserves that they can use to cover the accounting adjustment, and most central Government bodies are members of the principal civil service pension scheme, which is unfunded and whose liabilities and assets are not broken down by body. As Stuart Dennis says, the AME process is common to us and the other people who require it, but our particular circumstances are quite unusual.

Bill Bowman: On one final final point, have you spoken to your auditors about accepting this level of unquantifiable unknown in your accounts?

Caroline Gardner: I will ask Stuart Dennis to come in in a moment, but the commission will be aware that, in our annual report and accounts of last year, we had a contingent liability for the McCloud judgment. That is now starting to crystallise and we are now into a slightly more certain picture. We hope that that will develop in the future. Stuart Dennis has been talking to our auditors since this first became an issue.

Stuart Dennis: Yes, I have been in negotiation and discussions with our auditors about this issue.

Bill Bowman: Is that it?

Caroline Gardner: As I understand the accounting requirements and why they apply to us in this particular way, our auditors will be concerned that we have AME budget cover for the figure, and that we are going through an appropriate process to estimate how large the figure will be. They recognise the degree of uncertainty that is involved.

Jenny Marra (North East Scotland) (Lab): On the same topic, has Audit Scotland received any information about when the full implications of the McCloud judgment will be known, including the likelihood of increased employer contributions for staff pensions?

Caroline Gardner: Diane McGiffen is in a position to answer that.

Diane McGiffen (Audit Scotland): As you can imagine, from an auditing perspective, we have auditors engaged in this core work. The latest information that we have relating to the Chartered Institute of Public Finance and Accountancy’s consideration of the issue is that clarity is not expected until later in 2021, and it will possibly go into 2021-22. That is what is being said at the moment, and it might change, but we have to operate with the best information that we have in great uncertainty. CIPFA is having a meeting about this on Monday, and there might be further papers or briefings after that.

The Chair: As there are no further questions from members, I thank the witnesses for their contributions and move on.

Budget Proposal 2020-21

12:03

The Chair: We have the same witnesses for item 3, which is Audit Scotland's budget proposal for 2020-21. Members have a copy of the proposal in their papers. I invite the chair of the board, Ian Leitch, to make short introductory remarks, if he wishes, followed by the Auditor General.

Ian Leitch: I have nothing to add to what I have said. As accountable officer, the Auditor General will lead on this item.

Caroline Gardner: Thank you. As members know, we have been planning for some time for our new responsibilities, following the Scotland acts and devolution of significant new financial powers to the Scottish Parliament.

Today's budget proposal for 2020-21 reflects the third year of our four-year plan. We have now taken on some of our biggest new responsibilities, including the audit of Social Security Scotland and Scotland's new tax-raising powers. Our total proposed budget for 2020-21 would be an increase by 4.7 per cent in real terms to £27.1 million, which equates to 0.06 per cent of Scotland's public sector budget.

Our resource requirement for 2020/21 is £8.865 million, which would be an increase of £1.273 million, or 14.9 per cent in real terms. Several factors contribute to that increase: for example, we are unable to charge fees for most of the new bodies that we audit, which include some of the biggest and most complex public bodies in Scotland, and restructuring means that some of the bodies for which we previously charged fees now come under the Scottish consolidated fund and are therefore no longer chargeable.

We continue to focus on delivering value for money as we build the skills and capacity that we need to support Parliament and fulfil our statutory responsibilities, building on the efficiencies that we have achieved in previous years.

Like all public services, we continue to operate in an environment of significant uncertainty, as the Ian Leitch has said. We will continue to monitor events closely and keep in touch with the commission as appropriate. We will do our best to answer the commission's questions.

Jenny Marra: I think that you are acutely aware that you are requesting quite a big increase in Audit Scotland's budget at a time when—thinking back to our work on the Public Audit and Post-legislative Scrutiny Committee—several public bodies are having to do more with less. That said, I fully appreciate that the devolved powers are putting a lot more pressure on resources, and that a lot of intricate work is required, especially in relation to the new powers over social security.

You said that Audit Scotland's ability to charge fees has been reduced because more bodies come under the Scottish consolidated fund. Can you tell us why?

Caroline Gardner: Certainly. There are two elements to that. As the commission knows, we can charge an audit fee to some bodies. About three quarters of our overall income comes from that source. We are unable to charge other bodies because of where they sit in relation to the Scottish consolidated fund, as is set out in the Public Finance and Accountability (Scotland) Act 2000.

Most of the new bodies that we have taken on responsibility for this year, including Social Security Scotland, Revenue Scotland and the Scottish Fiscal Commission, sit in that category: we cannot charge them a fee, therefore the cost of the audit falls on the funds that the SCPA approves and oversees for us each year. That is the biggest part of the shift that you see.

At the same time, there has been restructuring in the public sector. For example, the forestry bodies have come out of the fee-charging category and have moved into the group of bodies that we cannot charge. Again, that represents an increased call on the funding that the commission approves for us.

Those two factors together account for a significant part of the increase to the proposed budget.

Jenny Marra: Okay. Thank you very much. I will move on to the discrepancy between your budget forecast and your request to increase the budget by £538,000. What has changed? Why did the three-year projection underestimate what you need?

Caroline Gardner: The commission knows that we have put in place a four-year plan to respond to the Scotland acts, as the new powers come into being. In that plan, we have shown a range of estimates—a low point, a mid-point and a high point. You are right—the figures that we have put forward this year are towards the upper end of the range for 2020-2021. A couple of things account for that. The first is the scale of the change that we have seen, particularly in relation to social security, where complex arrangements have been put in place for delivering the new social security responsibilities—there are different arrangements for different benefits and significant reliance on the delivery systems of the Department for Work and Pensions at United Kingdom level. All those things have led to extra work. Jenny Marra, in her role as convener of the Public Audit and Post-legislative Scrutiny Committee, will recall that Audit Scotland qualified the accounts of Social Security Scotland this year, which reflected that complexity.

The second factor is the pace of change. A number of benefits have been brought forward and new benefits, including the new child payment, have been introduced on tight timescales, which meant that we had to ramp up our capacity to carry out the audit of Social Security Scotland more quickly than we had expected, when we first put the plan together.

Jenny Marra: It sounds as though some of Social Security Scotland's teething problems are having a much wider impact. Is your answer that the increase of half a million pounds is solely attributable to the social security system?

Caroline Gardner: It is not solely attributable to that. Certainly, decisions that the Government has made about how social security is delivered and timescales have meant that we have had to move to the upper end of our range of estimates for this year, rather than being around the mid-point, as we were in the previous two years.

Do you want to add to that, Stuart?

Stuart Dennis: I do not, really. You have covered the main reason why we have had to go to the higher end of the business case that we originally presented to the SCPA back in 2018-19.

Jenny Marra: Auditor General, as you come towards the end of your tenure, do you see the figure increasing again because of the social security situation?

Caroline Gardner: I would say that that will not happen because of social security. To an extent, what we are seeing is a timing issue rather than an increase in the overall volume of work. We are getting a clearer picture of the situation and we are building capacity, so I would not expect the budget to continue to increase due to social security.

However, as the chair of the Audit Scotland board said in his opening remarks, we still face a fair amount of uncertainty. Immediately, that is due to EU withdrawal. We do not know what funding will be returned to Scotland rather than to the UK, as we head through the transition period. Also, the constitutional position is clearly still not stable, with there being disagreement between the Scottish and UK Governments about another referendum. None of us knows what might come out of that conversation, as we saw with the Scotland Act 2016 after the referendum in 2014. That is the sort of uncertainty that I highlight for the future.

Jenny Marra: On value for money, Audit Scotland's budget now equates to 0.06 per cent of the public sector budget. How does that percentage compare with the figure in previous years and what conclusions can you draw from it?

Caroline Gardner: Stuart Dennis might be able to give you those figures now. However, if I may, I will offer a different comparison. As you said, I am coming towards the end of my term as Auditor General, and I have been looking back over our budget compared to the Scottish budget over a longer period. In the past 15 years, in cash terms, our budget has risen from £24 million in 2005-06 to a proposed £27 million in 2020-21. In real terms, that is a reduction of about 17 per cent: we have made really significant savings over that period. At the same time, the total Scottish public sector spending that we audit has risen from £27 billion to £42 billion, so there has been a steep increase in what we are auditing and a 17 per cent reduction in real terms in the cost of doing it. I offer the commission the assurance that we take very seriously our responsibility for value for money.

Jenny Marra: That is an impressive assurance, well expressed.

Do other bodies that you audit use that figure of the percentage of the public sector budget to which their budget equates? If so, how does Audit Scotland compare to those bodies?

Caroline Gardner: I am not aware of other public bodies using that figure. Historically, the National Audit Office has used a ratio of every pound that it spends to the pounds that it saves. The NAO has been reviewing that approach, because it does not do justice to the range of work that the body does. We cannot make a direct comparison because our baseline has been different, given the previous absence of social security spending and the absence of defence spending, which is where lots of the savings that the NAO has generated have come from.

Jenny Marra: Forgive me, but I meant my question to be about other audit bodies, such as the NAO. Does it make a similar comparison?

Caroline Gardner: The NAO expresses it in terms of pounds saved per pound spent, but it is not straightforward for us to make a comparison in that way because of differences between what the bodies do, in particular in relation to defence spending, on which, historically, a high level of savings have been identified.

Bill Bowman: I have questions on staff and staff numbers. Your budget states that the capital funding requirement for 2020-21 is £150,000, which is the same as for the current year and, looking forward, for the following couple of years. Given the planned increase in staff members of 6.6 whole-time equivalents in 2020-21 and a further projected increase in headcount, with an additional 24.5 by 2024-25, how do you assure yourself that current and projected capital funding is adequate and sustainable?

12:15

Diane McGiffen: We have a detailed budget planning process for information technology hardware, which is where the largest amount of capital requirement would go, and for software and software licenses. Our need for the capital budget has been stable despite growth, because since we moved a lot or our IT services to the cloud, more of our IT costs are in revenue funding.

We keep a close eye on our workforce planning and our resource planning. At the moment, we have incorporated in our capital proposals resources for new staffing. If there were to be any other significant shifts, we might have to change the projections, but our first port of call would be to prioritise in the capital budget any additional work.

We have more resourcing and equipment than we need to meet the establishment at the moment. That ensures that, when we bring in temporary staff, or short-term secondments or placements, we can provide those people with equipment. There is a body of resource that is available to support what we are doing.

Bill Bowman: I do not know exactly what equipment staff members have. If they have a laptop, is that paid for from the capital budget, or do you just class it as an expense when you replace it? How do you deal with such things?

Diane McGiffen: Stuart Dennis can explain the accounting treatment of such things.

Stuart Dennis: That expenditure comes from the capital budget. We have a replacement programme that involves on-going updating and replacement of laptops. We also have sufficient capacity to enable us to give laptops to temporary staff, if required.

Bill Bowman: Is that the biggest item in your capital expenditure?

Diane McGiffen: The biggest part of our IT capital expenditure is laptops, yes. Again, though, over time, the price of individual pieces of IT equipment has come down. Through good procurement practice, we are able to secure good pricing for the IT equipment that we buy and therefore to deliver value for money.

Bill Bowman: Is that the main part of your capital spend?

Diane McGiffen: It has not always been, because, in the past, we have requested capital funding to refurbish buildings or to make adjustments to our accommodation. We have no plans to do that from the current budget, but if we needed to rethink our property footprint, we would come back to the commission with a presentation to discuss our needs. In this budget proposal, our main requirements are around IT resourcing and other equipment.

Bill Bowman: So, you expect to spend the £150,000.

Diane McGiffen: Yes.

Bill Bowman: Your other main asset is your staff. Where in the budget revision document do you discuss the productivity or efficiency of staff? You can increase headcount for a particular reason, but the output as a result of that increase could be affected by other issues, such as people working harder or in a less productive manner. How do we get a feel for what the increase in headcount means?

Diane McGiffen: The Auditor General has outlined the real-terms reduction in our funding and resourcing requirements over time, as well as the growth in the number of bodies that we audit. If you take those things together, you will see that, over time, we are continually auditing more, and our real-price resource requirement has been reducing.

On an operational basis, all our audits have a notional allocation of days related to the fee. Managers at business-group level and at audit level are involved in daily and weekly discussions about the resources and efficiency that are required to complete audits, and they compare that data against other data that we have in the business and the data that we use for benchmarking. We examine our time recording information and continually prioritise and allocate resources to achieve efficiency.

We recently reported on that through our audit committee, and the issue is a regular subject of discussion at board meetings, and quarterly at the Public Audit and Post-legislative Scrutiny Committee, when we present our in-year results, which relate to the progress that we are making in our work, our expenditure on that and the allocation of resources to it.

Bill Bowman: To follow up Jenny Marra's point about Social Security Scotland, I presume that you will have spent more time on the first year of the organisation than you would have hoped to, and you will become more efficient as you get to know it and other elements of new work.

Is there any particular measure that relates to how you look at your staff efficiency that it would be useful for us to see?

Diane McGiffen: We publish quarterly performance reports, which are on our website and are presented to the board, scrutinised by the audit committee at Audit Scotland and discussed by the board. They might be helpful in showing members the suite of key performance indicators that we regularly use to track all aspects of the business. We would be very happy to have an offline discussion with members once they have had the chance to digest those reports. They contain a comprehensive suite of measures, and the audit committee and the board look at all of that in the round.

Bill Bowman: How do you balance a drive to efficiency with the maintenance of quality?

Diane McGiffen: You have put your finger right on the task that we are all involved in on a daily basis. There is an independent look at the quality of our work, there are peer reviews and internal reviews of its quality, and we have data and information about our use of resources. We continually look at that quality internally as a business in business groups that report to the management team, the audit committee and the board. We also report back through our annual quality report to the commissioners of audit, the Auditor General for Scotland and the Accounts Commission on what the quality of the audit has been. We have in place a whole system of processes that lead to the ability to form a view on the quality of the work that we have delivered on behalf of the Auditor General and the Accounts Commission.

Ian Leitch: The board takes that very seriously. In the current climate in the commercial sector in which audit's capability of reporting properly is under some suspicion, we have our audit quality framework, which members know about, the independent testing by the Institute of Chartered Accountants of Scotland, and internal mechanisms for checking. We are absolutely concerned about ensuring that the public sector audit model in Scotland is the best that it can be, and certainly the best in the UK. The board has very much got a grip of that.

Alison Johnstone (Lothian) (Green): I want to follow on from Bill Bowman's questions about staffing numbers. My question is more about the make-up of the staff complement and the gender balance within it.

In its 2018-19 budget bid, Audit Scotland highlighted the equal pay review from April 2015 to March 2016, which found that the gender pay gap for Audit Scotland was that women earned around 4.5 per cent less than men. At that time, the commission sought information on the pay ratio between the highest-paid and lowest-paid staff members in Audit Scotland. The assistant auditor general, Russell Frith, stated:

> "The disclosure in our accounts to March 2017 was that the multiple between the median salary, which is the one that is required to be disclosed, and the highest one was 3.4 times."—[*Official Report*, *Scottish Commission for Public Audit*, 20 December 2017; c 9-10.]

In our budget report for 2018-19, we very much welcomed the active measures that had been taken to monitor pay ratios and the gender pay gap in the organisation. Do you anticipate that the pay proposals in the current budget proposal will further reduce the gender pay gap and the pay ratios?

Caroline Gardner: I will answer that question first; Diane McGiffen may want to come in after that.

As the commission knows, we have fixed cycles for reporting pay ratios and the gender pay gap. The cycles are slightly different. The pay ratio is included in our annual report and accounts each year, and we report the gender pay gap every two years, in line with the requirements that have been placed on us.

I expect that the pay ratio for the 2018-19 financial year, which will be published in June this year, will show a reduction. In broad terms, I think that that is because the movement of pay for staff in Audit Scotland has been more significant as a result of how pay progression works in the organisation than it has been for the most highly paid person in the organisation, whose pay is set differently. My pay is set on a different basis by the Scottish Parliamentary Corporate Body. Therefore, I expect the ratio to have reduced again.

The gender pay gap is always more difficult for us to predict because, although we take our responsibilities for equal pay in the broadest sense very seriously, the gender pay gap is, as the commission will know, very sensitive to changes in the composition of the workforce. Last time round, it grew slightly, largely because a large number of the trainee auditors whom we recruited—more than half that influx—were women, and although those people will become highly paid professionals in the future, they were at the bottom end of our pay scales at that point in time. Therefore, the pay gap increased at that point, but we expect it to come down over a longer period. We do not yet know whether it will have done over the two-year period in question.

Diane McGiffen might want to add to that.

Diane McGiffen: In two months' time, in March, follow-up information will be available when we follow up on the report that we published on our gender pay gap in 2018. I have suggested to the secretary to the commission that there might be an opportunity to discuss the issue at our session in June, when the commission will have much more current information available.

As the Auditor General said, our most recent report showed that the median pay gap was driven largely by an increase in the number of women who joined our professional trainee scheme, which is a great thing. The gender split there was that 57 per cent of the professional trainees who joined us were women. What will influence the next report is what the balance of men and women has been in the most recent intake. We monitor that over time and are very careful to understand what it means. You will know that gender pay gap reports look at the upper quartile, the upper middle quartile, the lower middle quartile and the lower quartile.

The main entry route into Audit Scotland is through the graduate trainee scheme. As that involves a significant number of people each year, it has a significant impact on our figures. We will be able to give you a fuller analysis of where we are now in two months' time, when we produce our next report, and we would be very happy to do that.

Alison Johnstone: You mentioned that women made up 57 per cent of the graduate intake. How did that come about? Was it the result of a proactive measure? Has work been done behind the scenes to ensure that women are attracted to the profession?

Diane McGiffen: We have done a lot of work to ensure that our roles are attractive to a diverse range of applicants. Although we have not been able to make a direct correlation between our activity and the outcome from the point of view of the offers that we make and the number of appointments, we look at all those figures through our diversity monitoring reports. We look at the gender mix of the applicants that we get for all roles, including graduate trainees, and the levels of interest that we get. We also analyse the gender balance of the candidates who are shortlisted and of those to whom offers are made. Once people join us, we also look at the gender balance when it comes to training opportunities, adjusted working hours and so on. We take a detailed look at all those factors in managing the business.

Although I could not say that a direct correlation can be made between our activity in that area and the outcomes, we work very hard to encourage a diverse range of people to come and join us. In addition, we are making sure that we are an attractive employer with a good culture, and that Audit Scotland is a good place to work, with a view to reaching as many people as possible and having a diverse workforce. By and large, we have been good at doing that.

Alison Johnstone: As you will appreciate, attracting a diverse workforce is about more than salary; it is also about flexibility. For example, we know that 92 per cent of single parents are women. Is there an opportunity for people who require a bit more flexibility to get involved in the profession? Is that message getting out there?

Diane McGiffen: We are doing our best to get that message out there on our own behalf, and I think that it is of growing interest to many in the profession, including firms that are doing a lot of work to retain women, in particular, and to encourage women who have left the profession to return.

Audit Scotland has a very strong offering when it comes to flexible working practices. We also have our time, place and travel policy, which I might have discussed previously. In conjunction with people's teams and their managers, it provides a great deal of autonomy over where, how and when people work, so that they can manage all those life events and circumstances that mean that, for some, it is much preferable to start slightly later or slightly earlier, because of other responsibilities that they have. Over the past couple of years, we have also been working on our carers accreditation to ensure that we support people with all types of caring responsibilities. We will have a focus on that over the next 12 months.

We have a strong offering. We know from feedback from colleagues and our annual survey that people who work at Audit Scotland really value flexible working. Because we cannot lead on salary, we know that the package in the round—offering a great workplace environment, flexible working and so on—has to be one of the ways in which we attract and retain colleagues, so we work hard at that.

12:30

The Chair: I am conscious of time, so I remind everyone to keep their questions and answers fairly tight.

Rona Mackay (Strathkelvin and Bearsden) (SNP): I will ask the panel about national performance audits.

In your annual report, you say that 11 section 22 and section 102 reports were issued in 2018-19, which was

"the most we have ever produced in a single year".

I apologise if you covered this earlier and I missed it, but can you say why you had to produce so many reports last year and what the most significant issues were?

Caroline Gardner: Certainly. Section 22 reports, which are my area of responsibility, and section 102 reports on local government are produced in response to things that happen in public bodies, which are often things that have gone wrong. Alongside that, we have a planned programme of work, so we are clear that we intend to do work on social security, educational outcomes, health and social care integration and so on. That is planned rather than reactive work, in which we have to respond to issues as they emerge. Tomorrow, for example, I will brief the Public Audit and Post-legislative Scrutiny Committee on events at NHS Lothian and Bòrd na Gàidhlig. We never know exactly how much of such work there will be, so we make a planning assumption and broadly assume that there will be seven or eight cases each year. They take different amounts of resource, depending on the size and complexity of the issue.

If there are more than seven or eight issues that we consider deserve to be reported on, we do that by flexing the amount of work elsewhere, either by delaying a piece of work, taking longer to complete it, reducing its scope or, in extreme circumstances, taking it out of the programme altogether. So far, we have always been able to manage things by flexing the rest of the programme, which ensures that we complete all the work that we want to do. However, you are right: the situation is unpredictable and we need to manage it in real time as issues arise each year.

Rona Mackay: How has that impacted on your budgeting proposals for 2020-21? Has it had a huge impact?

Caroline Gardner: It has not had a big impact on our proposals. We have managed to contain it in the overall programme. A couple of planned pieces of work have taken a bit longer than expected in order to make space for section 22 reports. You will have noted in our proposal that we have maintained the management contingency of £300,000, the purpose of which is to enable us to respond to unexpected things that we cannot plan for at the beginning of the year. This issue is one of those things.

Rona Mackay: You talked about postponing certain work in the light of other things that you have to make provision for. Could you give us a timescale for that? Would a programmed performance audit be deferred for years or months?

Caroline Gardner: It varies. I am sorry to give you an answer of "It depends," but it really does depend. When small additional amounts of resource are required, it might be as simple as delaying publication of a planned piece of work by three months. In that case, we simply push publication back a bit to give that team time to complete work on the section 22 report and provide the support to Parliament that is involved, and they then go back and complete the planned work. In other cases, in the light of all the calls on our time, it might mean simply saying that something becomes a lower priority and we put it on the back burner in the planning for the overall performance audit programme.

We plan the programme firmly for one year, with indications of what is coming for a couple of years beyond that. The commission and I quite often say that although a particular issue felt like a priority when we first put it into the programme, it has now drifted down the running order.

Rona Mackay: So you consider the priorities and make a judgment call on them.

Caroline Gardner: That is right.

Alison Johnstone: I want to inquire further about other administrative costs, which are on page 14 of the budget proposal.

Audit Scotland advises us that an additional £220,000 of funding is required in 2020-21 for the national fraud initiative. I would like to better understand what payments will be made using that additional resource. Will the funds be used to recruit additional staff to administer the NFI or to pay for services relating to the NFI?

Caroline Gardner: I may ask Stuart Dennis to add to this but, as you know, the national fraud initiative is carried out every two years and is a service that we provide to public bodies right across Scotland. The initiative involves data matching to look for data that suggests that duplicate payments or payments that are not warranted may be being made, and it is carried out UK wide and is currently run by the Cabinet Office. We make a payment to the Cabinet Office to cover the number of bodies in Scotland and the number of data matches that will be carried out here. It is a service that is provided.

The Chair: I have a quick question on the national fraud initiative. I assume that the money is under the "Legal & Professional Fees" budget line.

Caroline Gardner: I think that it is under "Other administrative costs".

Stuart Dennis: In the detail in appendix 1, it is under "Legal & Professional Fees".

The Chair: On page 14, Audit Scotland identifies individual cost pressures in its overall administrative costs budget, which include a requirement for an additional £25,000 to bring "travel and subsistence" costs

"in line with audit requirements".

How has that cost arisen and what steps have been taken to ensure that travel costs take account of carbon impact and other factors?

Diane McGiffen: We have a detailed way of managing travel and subsistence costs, and we review closely the patterns of travel and the costs. Over the past year, we have noticed in the cycle of audits that, in deployment of people, more costs have been associated with people staying away in order to be more efficient—they have stayed in audit locations for prolonged periods rather than travelling there multiple times. There is a combination of things.

We publish annually a report on our carbon footprint, with the most recent such report having been published in June last year, I think. We have a strong track record of reducing our carbon footprint. Given the restriction on time, I can send the commission a link to the detail on that.

Over time, we have managed down our carbon emissions from travel, and we are in the process of resetting the objectives. We have a smaller car fleet now than we had previously—the chair of the commission will be familiar with our past discussions on that.

On the emissions cycle, there has been a switch from air travel to rail travel and we promote active travel. We have a cycle-to-work scheme and we have a strong commitment to efficient travel using public transport where possible. I mentioned our time, place and travel policy, which encourages thoughtful use of videoconferencing through Skype and so on, in order to minimise travel and enable people to take control of that. I can send the commission a link to the published details on all that.

The Chair: That would be useful.

On page 19, Audit Scotland sets out the 2020-21 proposed income and expenditure budget sector by sector, and demonstrates how expenditure lines are funded either from fees that have been charged to audited bodies or from funding from Parliament. Approximately 68 per cent of Audit Scotland's income derives from fees, with the remaining 32 per cent being provided by Parliament. According to appendix 2 on page 19, it is proposed that 74 per cent of Audit Scotland's governance costs and 40 per cent of its corporate services and overheads costs be met from parliamentary funding. How does Audit Scotland determine the level of parliamentary funding to be apportioned to each sector?

Caroline Gardner: Ian Leitch has made it one of the defining missions of his time as chair of Audit Scotland to get more clarity and certainty into how those necessary cost allocations are carried out. Our approach is summarised in our funding and fees strategy, which we have previously shared with the commission.

There are two levels of cost, some of which are easy to identify as belonging to a particular sector. Let us take the direct audit fee. We know that the time of someone who is auditing the City of Edinburgh Council should be charged to local government. However, in an integrated organisation like Audit Scotland, many costs have to be allocated. Examples include building costs and, as you have identified, governance costs.

The funding and fees strategy is underpinned by clearly argued and agreed allocation mechanisms for each category of costs. In some cases, that reflects clear time-recording information; in other cases, it reflects explicit assumptions about how the costs are allocated. All that goes into a big spreadsheet that Stuart Dennis is in charge of. It breaks down our costs among the sectors in the report.

As we discussed in answer to Jenny Marra's earlier question, there are changes from year to year: bodies occasionally move from one sector to another, particularly from chargeable to non-chargeable central Government bodies. However, the underlying assumptions remain the same and are revisited on a regular cycle by the board in order to make sure that they remain appropriate, as the world changes.

The Chair: You will be aware that the commission has in the past been concerned about cross-subsidies and their impact. What consideration is given to whether Parliament-approved funding should be used to fund certain sectors rather than others? For example, should the Accounts Commission's costs be met solely from local government fees? How do you work all that out?

Caroline Gardner: That is all covered by the allocation formula that underpins the funding and fees strategy. Stuart Dennis will keep me straight. I think that it is clear that the costs of Account Commission members are all met by local government as part of the overall allocation of costs to the local government sector. For other costs, for which it is less clear where they should sit—for example, the costs of the Audit Scotland management team—a working assumption is used to allocate costs among the different sectors on a fair and transparent basis. The board looks at that each year, to make sure that it is comfortable that we are applying it properly and that the figures that come out at the bottom make sense. The assumption is reviewed from time to time to make sure that it remains up to date and appropriate.

Ian Leitch: The chair of the commission will recollect that the critical thing was to make sure that there were no silo cross-subsidies—that is, that local government was not being subsidised by the health sector, or, perhaps worst still, the other way round. That is why we went into this operation some years ago, when we involved the commission fully in our consultation of all our audited bodies on how we would do that. There might be some subsidy in a silo—for example, you would not want the full costs of an audit on far-flung islands to be met wholly by the local authorities in which they sit, so a certain amount of pooling of costs will happen in that silo—but any suggestion of one silo slipping into another subsidy must be avoided. There are clear demarcation lines.

On the margins, the management costs have to be considered. We keep a close eye on that, because we regard fees strategy as being important to our credibility. That is why it is so closely observed.

The Chair: I have a couple of odd questions to ask. I see—perhaps for the first time—no reference to efficiency savings in your report. You have always been very good at making efficiency savings.

Caroline Gardner: We have not set out explicit efficiency savings this time in the way that we did previously. That is partly because we are in a growth situation—and we are at the top end of that. We know that the growth has been offset by efficiencies that we have made elsewhere. Stuart Dennis will talk you through how that works and the underlying detail of the proposal.

Stuart Dennis: Where there has been growth in respect of new financial powers, an efficiency is built in: we are asking for an increase, but there is associated efficiency. On top of that, the £6.2 million efficiency savings that we have made since 2014-15 continue to flow forwards.

We are always looking at efficient ways of working. In this case, we have not specifically identified them by setting out what we are looking to achieve, but the budget has efficiency savings built in.

The Chair: You have internal targets for savings in the business.

Stuart Dennis: Yes, we look to do everything on a value-for-money and efficiency basis.

The Chair: You do not allocate a percentage to the different departments, or whatever, to achieve.

Stuart Dennis: No.

12:45

Caroline Gardner: We have not done that this time. As the commission knows, in previous years we have generated significant efficiency savings by focusing on specific issues, but we do not apply a blanket 5 per cent or 1 per cent efficiency saving assumption, because we think that to do so is not appropriate. We would not recommend that approach being taken to audited bodies and we do not take it to Audit Scotland.

The Chair: How do you measure savings?

Caroline Gardner: We do that by examining what we achieve for the cost of achieving it. Diane McGiffen can talk you through how we do that in the budget process overall.

Diane McGiffen: As I mentioned in an earlier answer, we have recently reported extensively on that to our own audit committee.

The budgeting process starts early on. We start with a blank sheet of paper. We consider what are our needs, including our growth needs, and we consider our on-going efficiency savings. We have programmes of work and programmes of development that are delivering efficiencies. Primarily, those involve looking at the cost of our people and the procurement of firms, in relation to which there are on-going savings in the life cycle of the contract that we have. Over time, we have looked at all our areas of expenditure and we have delivered significant savings, in particular from our property portfolio and from our move.

We continue to do that. At a business planning level, each business group is looking at how it can be more efficient in terms of its staff mix and skills mix, and how it uses people. In addition, because we have been growing and taking on more audit responsibilities, we are looking at how we can meet the new audit responsibilities in a way that delivers quality and value for money. We have reported on some of that in previous budget submissions.

We also report in our annual report and accounts on the efficiencies that we have achieved each year. Information on that will come to the commission in June this year, as part of the annual report and accounts. That is part of our daily work.

There is a strong challenge process when it comes to budgeting. There is challenge at business group level, at management team level and at the audit committee and the board, where we look at movement over time, planned efficiencies, capacity, the pressures that we face and the ways in which we are developing for growth.

The increase this year in our requirement to meet our new responsibilities, which we discussed earlier, has been driven partly by some prudent requests in relation to our new responsibilities in previous years. We previously consciously decided to make a mid-point request, rather than a request that was further up the range of options that we had. We take a prudent approach to growth and costing, and a significant challenge process is built into the system.

The Chair: I realise that we are out of time, but according to paragraph 54 on page 14 of the budget proposal document, the Office for National Statistics has reclassified Audit Scotland. Does that have any implications about which we should be concerned?

Caroline Gardner: We have done as much due diligence on that as we have been able to do. We believe that there are no implications that we or the commission need to be concerned about, and we are keeping a close eye on the situation.

The Chair: Do members have any other questions?

Bill Bowman: I have a final question, which follows up on the chair's strong remarks about audit quality.

The budget proposal includes provision

"of £250,000 to support audit quality inspection and reporting",

which is the same level as last year. It was stated in the "Quality of public audit in Scotland: Annual report 2018/19" that 57 per cent of Audit Scotland's staff believe that the training or development that they receive enables a high-quality audit to be carried out, which means that 43 per cent of staff do not believe that they get enough training, which is in the context of the organisation increasing in size and its workload increasing. Should you be putting more into the budget under quality support?

Diane McGiffen: The budget line that you are referring to relates to the independent team that looks at the quality of audit.

Bill Bowman: I understand that, but it looks at what Audit Scotland has done.

Diane McGiffen: Yes, but the investment in quality in our delivery is reflected in our learning and development budget lines, in the way in which we recruit and model staff, and in other programmes of work in the budget. In other words, the money to support quality does not lie in a single place. The budget line that you mentioned relates to the team that reviews the work and reports in public on that. The investment in quality is built into learning and development, so—

Bill Bowman: But you are doing more, so do you need more support to enable you to look at the output?

Diane McGiffen: In this budget, we are planning to continue a programme of work that we have mapped out to meet the five-year audit appointment cycle that we are in. We will take stock of the scale of that when we look at the outcome of the next round of audit appointments and the split.

At the moment, we have active processes in place to manage quality. We report to the Accounts Commission, the board and the Auditor General on in-year risks, and we are very engaged in the wider discussions on the audit profession. At this stage, that does not indicate to us that we need to change the programme of work under the budget line to which you refer. Our investment in quality and development is built into all the other budget lines.

The Chair: As we have no further questions, I thank members for their attendance. I again note that it is Ian Leitch's last meeting with the commission. Congratulations on surviving it, Ian. We wish you well.

Ian Leitch: If I could be familiar for a moment, Colin, I would like to thank you for the kindness and courtesy that you and your colleagues have shown over the time that I have been in post. It has been not only fascinating and challenging, but thoroughly enjoyable.

You will have seen today and on many previous occasions—I will spare their blushes—what highly competent people we have: the Auditor General, Caroline Gardner, and Diane McGiffen are superbly capable people, and I leave them in the very capable hands of the new chairman. All that remains for me to do—to misquote "The Two Ronnies"—is to say that it's goodbye from me and hello from him. [*Laughter*.] Thank you very much.

The Chair: Thank you, Ian.

12:51

Meeting continued in private until 12:56.

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The deadline for corrections to this edition is:

Monday 17 February 2020

Published in Edinburgh by the Scottish Parliamentary Corporate Body, the Scottish Parliament, Edinburgh, EH99 1SP

The Scottish Parliament
Pàrlamaid na h-Alba