

MEETING OF THE COMMISSION

Wednesday 28 October 2009

Session 3

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SCOTTISH COMMISSION FOR PUBLIC AUDIT **3rd Meeting 2009, Session 3**

CONVENER

*Angela Constance (Livingston) (SNP)

COMMISSION MEMBERS

*Robert Brown (Glasgow) (LD)

*Derek Brownlee (South of Scotland) (Con)

*George Foulkes (Lothians) (Lab)

Hugh Henry (Paisley South) (Lab)

*attended

THE FOLLOWING GAVE EVIDENCE:

Mr Robert Black (Auditor General for Scotland)

Russell Frith (Audit Scotland)

Diane McGiffen (Audit Scotland)

SECRETARY TO THE COMMISSION

Mark Brough

LOCATION

Committee Room 3

Scottish Parliament

Meeting of the Commission

Wednesday 28 October 2009

[THE CONVENER *opened the meeting at 10:33*]

Decisions on Taking Business in Private

The Convener (Angela Constance): I extend a warm welcome to members and witnesses. It is nice to have people in the public gallery for a change. This morning we have received apologies only from Hugh Henry, who does not expect to be here. I remind members, witnesses and members of the public to switch off their mobile phones.

I ask the commission to consider taking item 3 in private. That will give us a chance to reflect on the evidence that we will hear today and help us to consider our future report. Is that agreed?

Members *indicated agreement.*

The Convener: Do members also agree to consider a draft report in private at our next meeting?

Members *indicated agreement.*

The Convener: Finally, do members agree to consider in private at our next meeting a paper on the extension of the external audit contract?

Members *indicated agreement.*

Audit Scotland Budget Proposal 2010-11

10:35

The Convener: We have before us Audit Scotland's detailed budget proposal for the financial year 2010-11 and correspondence following up issues raised at our previous meeting. After it has taken evidence today, the commission will produce a report on the proposal and forward a copy to the Finance Committee, so that it can consider the report as part of overall budget scrutiny.

It gives me pleasure to welcome this morning Mr Robert Black, Auditor General for Scotland, who is the accountable officer for Audit Scotland; Mr Russell Frith, director of audit strategy at Audit Scotland; and Diane McGiffen, director of corporate services at Audit Scotland. I invite Mr Black to make a short opening statement.

Mr Robert Black (Auditor General for Scotland): Good morning. I will say just a few words, which may assist the commission. I, too, welcome the fact that there are people in the public gallery. However, in the interests of transparency, I should say that my colleagues and I have supplied most of them. We have with us colleagues from Audit Scotland and the Accounts Commission who are interested in observing proceedings and how the Scottish Commission for Public Audit works. I am sure that that will not affect how members approach questions.

As is normal, the budget that is before members today has been considered fully by the Audit Scotland board and has its support and approval. The charges implications for local government have been before the Accounts Commission; I understand from Russell Frith that there is support for what we are proposing.

I do not intend to speak at great length. We are as aware as anyone in the public sector of the pressures on public spending and the challenges that we will face in the years ahead. Of particular interest to the commission is the fact that the budget contains a 1.4 per cent increase in parliamentary funding. We have again incorporated a 2 per cent efficiency target, which we will aim to meet.

We have tried to give members a description of some of the underlying budget pressures to which we are subject and to demonstrate how we intend to contain those. Last year we gave you an indication of fee increases for a couple of years ahead. As a result of the efficiency improvements and productivity gains that we are achieving and will achieve, we will deliver a lower-than-forecast

fee increase for audited bodies, as our contribution to meeting the challenges that are ahead. We require no increase in capital funding. As ever, my colleagues Diane McGiffen and Russell Frith and I will do our best to answer your questions.

The Convener: I will start with a general question. I note that the net budget required from Parliament and the total gross administrative costs are both falling slightly year on year. I also note that staff costs, which are your biggest costs, are expected to increase significantly, by 3.2 per cent. How will that challenge be met within a relatively standstill budget?

Mr Black: I am happy to explain. The staff cost increase includes a number of different elements. We have set aside 1.5 per cent for what used to be called cost-of-living uplift. That is within the Scottish Government guidelines on pay settlements due on 1 April 2010. Extra costs associated with the planned growth in the national fraud initiative programme will affect our staffing level. The expansion in the NFI applies mainly to central Government bodies. In addition, as we describe in the supporting papers, we have had to accommodate the costs of assimilation, in order to comply with age discrimination legislation. That involves a small element of additional cost. Finally, we have introduced our new contribution-based performance system. Of itself, that does not lift our costs; nevertheless, it is built into the budget. In outline, those are the drivers for costs.

As you can see from the papers that we have submitted to the commission, the establishment does not move significantly. The base budget establishment for 2010-11 is 294 members of staff, which includes two members of the Audit Scotland board. If I have missed anything, I am sure that Diane McGiffen will fill in the gaps.

The Convener: Would you like to add anything, Ms McGiffen?

Diane McGiffen (Audit Scotland): I am happy to answer any further questions that you may have.

The Convener: What are the main budgetary pressures?

Mr Black: As we indicated in our written submissions, the main budgetary pressures are, as ever, staff costs. There are also costs associated with the implementation of the international financial reporting standards—IFRS—which will impact on audit fees, particularly in local government, and we have uplifts in our rent costs because of imminent reviews of our leases. Those are the main elements. Another element is the fact that we expect a much smaller recovery of interest on bank deposits, which is a reflection of the state of the financial markets. We

need to be prudent in deciding where we place our short-term money.

I may have missed one or two points that my colleagues may like to add.

Diane McGiffen: On cost pressures, we have talked about the staffing costs and Bob Black has described where those come from—the national fraud initiative, additional board members and so on. We face some pressures through appointed auditors, the costs of introducing the IFRS and so on. We also have rent pressures. We have a relatively small cost pressure through our investment in information technology infrastructure and its running costs, and bank interest is a significant issue in the budget because of the collapse in interest rates. Those are the key headline areas where the cost pressures come from.

The Convener: Is there enough flexibility in the budget to deal with any unexpected demands?

Mr Black: We are managing to achieve the target of 2 per cent efficiency savings for the financial year that we are talking about. However, in the future, the target will become, at best, increasingly difficult to achieve—in the most optimistic scenario. That is a reflection of the fact that about 55 per cent of our costs are staff related and the bulk of the balance of our costs relates to property, IT and the essential goods and services that are required to run the business. The problem that bodies such as Audit Scotland face is the fact that we have a statutory obligation to deliver a certain volume of activity, such as the external audit of more than 220 public bodies in Scotland. That work needs to be done to a standard that I require and which is acceptable to the Parliament. Beyond the current year, it is difficult to see how we can generate significant year-on-year efficiency savings.

The next big area in which we hope to make a move—I think that we outlined this in our written submissions—is in rationalising our property costs. We inherited a number of sites throughout Scotland and, as the commission will be aware, we were tied into property leases on those, some of which will start to run out from 2012 onwards. We will look to reduce our footprint, if you like, in terms of our floor space and the number of offices that we have. The earliest year by which we could achieve something in that area is probably 2012, when we will have an opportunity to break out of a property in Edinburgh. We will then consolidate our two existing properties in Edinburgh, which will require us to rethink fundamentally how we carry out our work because we will no longer have sufficient floor space to allow the accommodation standards per member of staff that applied before. Not only will that be an exercise in getting out of a building and redesigning our existing floor space; it

will involve reconsidering how Audit Scotland carries out its work. That is one of the reasons why small investments in things such as electronic working papers are important. Over a number of years, they will enable us to operate our business more efficiently.

10:45

The Convener: I am glad to hear that you are thinking of breaking out of Edinburgh. I recommend Livingston—of course, I should declare an interest.

Derek Brownlee (South of Scotland) (Con): The fee proposal document mentions price increases for appointed auditors. Have those increases been locked into contracts that have already been signed, or are they expected price increases based on Audit Scotland's understanding of the market?

Mr Black: Russell Frith can give you the fullest and best-informed answer to that question.

Russell Frith (Audit Scotland): The existing contracts bind us to giving increases based on the increases to one of our key salary levels—the base qualified grade, effectively. We are still giving those increases, but we have brought in an efficiency factor as well, which negates the majority of that increase.

Derek Brownlee: Obviously, we are in a slightly different financial situation now than we have been in previously, and it will get worse in the years to come. However, do you think that that aspect of the contract—linking the appointed firms' fees to the staff grade—will become fairly standard and will simply be included in future contracts? Is that the best way of appropriately benchmarking the fees?

Russell Frith: In the previous contracts, we did not have a fixed mechanism, which gave rise to difficult negotiations, year on year. For the current contracts, we decided to lock in the mechanism. We will consider whether we will do that as part of the new contracts.

Derek Brownlee: A letter that the commission received about remuneration strategy said that the "market median" was the benchmark that Audit Scotland wanted to use. I totally understand that you have to be aware of pressures outwith your organisation, given the nature of the work that you do, but by virtue of selecting that as your benchmark, you are effectively linking your largest cost to something over which you do not have direct control, because the market drives the median. What is your sense of where the market is going at the moment?

Russell Frith: The median was used as part of a benchmarking exercise as we went from our old

pay system to our new one. We are not committed to an annual mechanism that is directly linked to any other. We retain the flexibility to consider the various elements of that benchmarking group or others when setting our annual increases.

Derek Brownlee: Presumably, however, you selected that method because of reasons to do with retention and recruitment. I accept that you might not link to the median on an annual basis, but that underlying issue will remain.

Mr Black: The question is perfectly reasonable. Over the piece, we have tried to maintain a sort of soft link—if I may use that phrase—to local government. One reason for doing that is that local government is one of the major areas that we audit, so it is right that we should be able to demonstrate a relationship with it. The second reason for doing that is that, quite early in Audit Scotland's history, we had to take the view that any other comparator would quickly become unaffordable. We all know what the pattern of wage movements has been over the past 10 years, not only in the private sector but in elements of the public sector. Although we will maintain that link, the relationship will not be absolutely hard and formulaic. For the salaries exercise, we benchmarked against 14 public sector organisations within and outwith Scotland, and we are confident that the salaries that we pay are well within the envelope of what we have observed as a result of that exercise.

Derek Brownlee: Given the importance of salaries to your cost base, I was trying to get an impression of whether over the medium term rather than the coming year the cost pressures of staffing that your organisation will face are likely to move out of sync with the direction of public sector budgets, which, in the short to medium term, are clearly going to go down.

Mr Black: The short answer is that it is really too early to tell. We are entering quite unprecedented times with regard to the performance of the economy and the conditions that are going to apply more widely in the public sector. In the past, we have had to compete to attract high-quality people into our graduate trainee system, so we have had to pay the going rate for graduate trainees. Although we have been increasingly successful in that respect as Audit Scotland's profile and, dare I say it, recognition of its contribution have grown, I expect that situation to continue, because we will have to pay at least the rate that high-quality graduates are being paid in the sectors with which we have normally seen ourselves in competition. In the past, we have not compared ourselves with private firms because, generally speaking and particularly at the higher levels, remuneration in the private sector has tended to be ahead of our own. Our approach has

served us well in the past and we will, I think, continue to observe it.

As part of our continuing attempt to improve productivity—I quite prefer the word “productivity” to all this talk of efficiency gains—my Audit Scotland colleagues have, as some of our papers have pointed out, revisited how we carry out our work. Our changes, for example, to the grade mix—in other words, the mix of senior and more junior staff—will make a small contribution to getting our costs down. Of course, once the more junior members of staff achieve high performance, that will begin to come through. As a result, we reckon that we need 2 per cent for people moving through to the midpoint of the contribution-based system.

Diane McGiffen: If we set aside what used to be called cost-of-living uplifts—that is, scale-point uplifts—the progression element of our new pay system will, when fully implemented, be marginally less than that in the old system. That, combined with the elimination or phasing out of certain legacy arrangements and allowances with the implementation of the new system, will allow us to tighten the pay bill marginally.

In the budget under discussion, we have allowed for a scale-point uplift—or what would have been called a cost-of-living uplift—of 1.5 per cent, which is in line with Government assumptions. If those assumptions change and the award that we make is lower, further savings might be made. If all things remain the same and if we take into account both progression through the ranges and the scale-point uplift, our modelling suggests that, when the new system becomes business as usual, a slightly lower annual uplift will be required. As I say, the new system generally tightens everything up. As for the point about the market median, we benchmarked the ceiling of our grades with that median.

The link to the procurement of auditors and the uplift for contracts for auditors is to the cost-of-living element for one of those grades, not with the value of the salary. If we give, for example, a 1.5 per cent cost-of-living award to a grade, as we have done in the past, we would award it to all grades, so the fees for auditors would go up by 1.5 per cent, which is not linked to the value of the salary. I hope that that makes sense.

The Convener: Okay, thank you for that.

Robert Brown (Glasgow) (LD): I want to develop that point a bit. You made the point in your paper that you have a relatively young workforce and that that is part of the issue concerning moving through the grades. However, I would have thought that, with a staff complement of almost 300, there would have been some averaging out over time; some people would leave

and others would join, so there would not need to be an extra bump, except perhaps in the short term. However, that is not the impression that you are giving us.

Diane McGiffen: There is a bump in the short term, as you know from our analysis, partly because of our move to be at, or close to, our full establishment complement. That means that we have recruited a number of folk over the past wee while. We have a policy of trying to recruit into the bottom grades, unless there are exceptional reasons for not doing so, which means that people whom we have brought in have the potential to progress for a while. Recycling goes on because we have a staff population who are at the ceilings of their grades or are moving towards retirement and so on. As those people leave, we would hope that there would be a bit of recycling by their being replaced by more junior staff.

As Bob Black said, there are other factors, such as replacing more senior staff with a different skill mix and changing the components of the job. The difficulty in this area is that nothing stays the same, so we are trying to describe a moving picture. There is therefore a bit of a bump, but we hope that, in the normal process, there will be a recycling of some of those aspects.

Robert Brown: Perhaps in future years there would not need to be additional bumps, if you follow my point, because they would be absorbed.

Diane McGiffen: Yes.

Robert Brown: You talk about achieving staffing efficiencies in 2010-11; I think that that is the equivalent of 1.5 posts, if we forget about temporary staff and all that. Is that a kind of mainline budget saving? Will that be a permanent thing for years?

Diane McGiffen: Yes.

Robert Brown: I am not sure that I fully follow the staffing figures—sometimes they seem to include Audit Scotland board members and sometimes they do not, which is slightly confusing. The figures in your letter of 31 March seem to go from 264 in 2006-07 to 294 in 2007-08, then from 295 up to 298, then down to 295, although those may not be full-time equivalent posts. I would be grateful for some clarification. What is the current budget establishment? How many people do you have in post on a full-time equivalent basis? What vacancy factor do you use in setting the budget?

Diane McGiffen: I will start with the last question and work back. The vacancy factor that we used in setting the budget was 4 per cent. For the budget in 2010-11, the establishment is set overall at 294, which includes the two new board members. The average number of staff employed in 2008-09 was 293 whole-time equivalent,

compared with the budgeted establishment of 297, so you can see that we are very close, given that that is just four below the establishment complement. Obviously, some of the figures, such as the average number of folk whom we have in post, will dip and change a bit through the years. However, we have been working on that. If you look back at our figures, you will see a significant improvement on where we have been in the past, when at times we had a significant gap between our establishment figure and the number of folk in post.

If you could remind me of the beginning of the question, I will try to help with that.

Robert Brown: It concerned the current establishment figure and the vacancy rate, but I think that you may have answered it.

Diane McGiffen: The figure of 294 excludes one post that is funded by end-year flexibility, because that dips out of the budget. I am therefore talking about 294 posts, excluding one post that is funded from EYF and disappears.

Robert Brown: What is that for?

Diane McGiffen: I recognise that this does not help, because I am trying to give you a static picture, although movements are going on. I think that the EYF post is to do with the conclusion of the development of best value.

11:00

Robert Brown: Yes; I think that we know something about that.

Audit Scotland has three properties in Edinburgh—two in George Street and one in Haymarket, which you propose to get rid of in 2012. When do the leases for the George Street properties conclude?

Diane McGiffen: The leases for the two properties in George Street end at the end of 2014 and around mid-2015. That is not an accident. We have worked to get a convergence that will give us a window in which we can make some significant property changes.

The lease for the Osborne house property in Haymarket will end in 2012. We also have a break point in our lease in East Kilbride in 2012 and the lease on our very small Aberdeen office ends in 2012. We have been working on alignments so that we can make some bigger decisions.

We have benefited from long-term institutional leases. The leases on the George Street properties ran for 20 to 25 years. We have benefited from that, but it has meant that we have been locked into property by those historical decisions and we are reaching a window in which we can make some bigger decisions. We are

already exploring and thinking about the journey that we need to go on to combine offices from three to two, and then to something else.

Robert Brown: What is your longer-term strategy? One might argue that a city centre property in Edinburgh is expensive in terms of rent and rates. Is it necessary for Audit Scotland to be there as opposed to somewhere that has lower property values? I appreciate that we are talking about 2014, but what is your longer-term strategy?

Mr Black: That is an entirely reasonable policy question that we will have to address. We will also have to take into account your views and those of our other principal stakeholders, including those in the Parliament, on some of those issues. There are advantages to being in Edinburgh and close to the Parliament because some of us are called to the Parliament quite regularly and have to come here for meetings. We need to balance those factors against others.

If our office floor space were to be designed on an absolutely clean sheet, one of the options that would have to be seriously considered would be a location that was not in central Edinburgh, although there might well be an argument for having some presence here because so much of our work involves serving the Scottish Parliament. It is fair to say that, in the future, Audit Scotland will consider all options fully and take into account the different factors.

To widen the discussion further, as Diane McGiffen has indicated, the picture changes all the time. This year, for the first time, the Scottish Government has attempted an indicative carbon budget. Frankly, I do not think that any of us knows how that will work through the system and what it will mean for the cost of public services when carbon accounting is factored in. That might change things yet again.

Robert Brown: I have a final point about utility price increases. I heard people from the industry explaining why they were not passing on reductions in wholesale energy costs to domestic customers—it was all to do with the fact that the companies buy 12 to 18 months ahead. That rather suggests that energy utility costs are expected to go down. On what are your predictions on energy costs based?

Diane McGiffen: Our energy costs have gone up. We keep all our running costs under review, and we are in the process of looking at the options for securing a cheaper supply. We are in the same situation as everyone else. We have been making inroads into our use of electricity. It is not reflected in the cost of our energy consumption, but we are working to get better deals where we can.

One of the benefits of property rationalisation would be to move to more energy-efficient

buildings. Our George Street buildings are not particularly energy efficient. One of them is an old Georgian town house and such buildings are among the least efficient properties. We keep the situation under review and will look at it actively in the autumn.

Robert Brown: That is helpful.

George Foulkes (Lothians) (Lab): There is nothing about the nature of the work of Audit Scotland that requires you to be in central Edinburgh. Is that right?

Mr Black: In terms of the bulk of our work, that is absolutely correct. It is for that reason that we have staff distributed throughout Scotland. Our staff spend a lot of their time in, say, Highland Council or Aberdeen City Council and so on.

George Foulkes: We are not very far away from 2012. Presumably, you are planning to relocate and you are looking at places such as Livingston, which are cheaper and would be more efficient from your point of view.

Diane McGiffen: We are starting this in a phased way. The first thing that we are looking at is what we do in the run-up to 2012. This autumn we have set out a project plan for how we will review the property criteria that we will take into account. We are also doing some space planning. We are using the Government's guidance to organisations about the steps to go through in considering relocation and so on. That is to help us look at making the first switch, which will be to combine our Edinburgh properties. It will help us with the data that we need to look at the whole organisation.

Bob Black mentioned the carbon accounting dimension. We will be looking at our staff's travel-to-work area, which is one of the things that we have to take into account in balancing the organisation's carbon footprint. We have to take into account the travelling that we do from our current locations to do our work. If we move our locations, we will have to consider the impact of the carbon expended by folk to get to those new locations.

We are also coming up to a new round of procurement appointments in 2011, when the bodies that we are auditing will be rotated again.

A lot of planning work is going into all this. We have started that with our project plan. Over the autumn, we are focusing on the space planning and looking at the rationalisation and more efficient use of a smaller number of buildings in Edinburgh as a first step. With the information from that, we will be able to make better-informed decisions about where we want to be with our property footprint when we come to make other decisions. The property market changes all the

time. Sometimes offers come in that seem counterintuitive, given where the market is. We work closely with a property adviser on that.

George Foulkes: I want to go back to basics, if you like, and ask a more fundamental question. Robert Black described the current economic situation as unprecedented. In that circumstance, how can you ask for any uplift at all? How can you justify that?

Mr Black: In my earlier answer to the convener's question, I attempted to explain that the audit that we undertake of public bodies in Scotland is specified partly in legislation such as the local government acts and the Public Finance and Accountability (Scotland) Act 2000, which set up Audit Scotland, which means that we have statutory obligations. We also have obligations under auditing standards, of which Russell Frith is in charge, and obligations to meet the Scottish Parliament's expectations around reports about the performance, good governance and proper use of resources in Scottish public bodies. The larger part of our work, as I have explained to the commission in the past, is the core financial audit of 226 bodies in Scotland, which is done to a standard that is independently determined. Therefore, if we were to significantly alter what we are doing, we would have to request a fundamental rethink about the statutory framework within which we do our work.

George Foulkes: On the work done by Audit Scotland, with 300 staff, do you not outsource a lot of work, too, to private bodies?

Mr Black: We outsource a portion of it.

George Foulkes: How much would that be as a percentage of all the auditing done in Scotland as a whole?

Mr Black: That is an extremely difficult question to answer. Are you talking about the public sector and the private sector?

George Foulkes: Yes.

Mr Black: I do not think that we can give you an answer to that question. I try to be as helpful as I can in my answers, but it is impossible to answer that on two counts: first, we do not have the data; secondly, the nature of public audit is significantly wider and more demanding than audit in the private sector. The auditors are required to place a certificate on the accounts according to auditing and accounting standards, but in addition they have to sign off that the internal controls are appropriate and prepare final reports, which come to the Accounts Commission and me, on the overall financial management and performance of public bodies, so that I in turn can assure the Parliament—that is before we get into the area of

performance audit activity. It is genuinely a case of comparing apples and pears.

George Foulkes: I accept that. How do the private sector auditors that you commission decide what to charge?

Russell Frith: For their public sector work?

George Foulkes: Who determines the level of the charge?

Russell Frith: We set an indicative fee for every public body. The auditors can then agree the final fee with the audited body within a range of plus or minus 10 per cent of the indicative fee, based on the circumstances of the audited body. For example, if they have a particularly good or bad internal audit, that influences the amount of work that the external auditor has to do. We set the indicative fee and we leave the final fee to negotiation based on local circumstances. The indicative fees are based broadly on the costs for our in-house teams of doing the same work.

George Foulkes: But private sector auditors are doing all right; I do not remember reading about any accounting firm being in any financial difficulty. They just increase the fee that they charge every year. If we are in unprecedented economic circumstances, should you not be telling them that they need to tighten their belts? Should you not be saying to them, "We cannot keep on giving you an increase year upon year when other people are not getting an increase and are having to cut back." Auditors cannot be immune from public scrutiny in these economic circumstances.

Mr Black: I apologise, convener, if we have not explained this very clearly. The uplift that the firms achieve every year is based on the basic-scale uplift for our salary costs. In addition, we must review whether we, as a result of Government policy, are placing extra burdens upon them, and the introduction of the IFRS is undoubtedly a significant extra burden that is placed upon them by auditors. Once we have calculated that, we have applied a 2 per cent efficiency reduction to the audit fees for the next financial year, so we have quite tight control. Historically, the charges that we levy on our audited bodies are within the envelope of the charges that have been applied by, let us say, the Audit Commission in England and Wales. As I am sure commission members might recall, you commissioned an independent value-for-money study of how we do all this a few years ago. Generally speaking, that study provided you with positive assurance that we have a tight control of all this.

George Foulkes: But things have changed in the past two or three years and they are much tighter now. Let us take your 300 staff. Do they move up a grade each year—

Mr Black: No.

George Foulkes: On what basis can they move up a grade?

Diane McGiffen: The new reward system that we have implemented means that members of staff progress through a pay range on the basis of the contribution that they make to the organisation. Our old system, which was very similar to the scheme in most local government organisations, was based on an annual progression. At the end of April, members of staff progressed through increments until they reached the ceiling of their scale. Our new system does not work like that. Members of staff receive progression through a pay range on the basis of the assessment of the contribution that they have made and only satisfactory and acceptable performance receives a recognition in pay. There is the potential for members of staff to have no pay progression if their contribution has not been satisfactory—we did not have that potential before.

George Foulkes: But if we assume that they are satisfactory—I presume that most of them are—they move up a stage as well as getting an uplift for the cost of living.

Diane McGiffen: Only if there is an uplift in the cost of living.

George Foulkes: But you have just said that there will be a 1.5 per cent uplift to cover the rise in the cost of living. A lot of your staff, if they are satisfactory, will get a scale increase plus an uplift to reflect the cost of living—is that correct?

Diane McGiffen: That is correct.

11:15

George Foulkes: Is that not an astonishing amount extra, given the fact that some people are now being asked to work for less or to do more for the same amount of pay in the public sector as well as in the private sector?

Mr Black: I am not going to ask Audit Scotland unilaterally to breach the pay policy that has been set by the Government for the public sector. The 1.5 per cent uplift is consistent with the indicative pay uplift that has been set by the Government for April 2010, and we are adhering to that. Neither am I going to encourage Audit Scotland to open itself up to claims of unfair treatment of individual members of staff. If someone joins Audit Scotland and demonstrates a high level of competence and contribution, they should be paid the same as someone else in Audit Scotland who has demonstrated a high level of competence and contribution over a number of years. We cannot have a situation in which people are paid different amounts for doing exactly the same work.

As I attempted to outline earlier, we have a tighter pay system than we had before. In the previous regime, people got an automatic increase in addition to the cost of living increase to get them to a mid-point on a long scale. We have managed to negotiate with our staff and the unions to take that out and put in its place a tighter scale for our staff from the bottom to the top, in which movement from the bottom of the scale to the mid-point is based on contribution to the organisation. As I think Diane McGiffen mentioned earlier, we are reasonably confident that that will contain rather than maintain or expand the uplift cost in the pay bill in future years. The starting point for it, however, is the Government's pay policy for the public sector and the indicative adjustments that are necessary.

George Foulkes: I understand that. I might have equal concerns, such as have been expressed by other people, about huge increases in local government pay—about chief executives being paid enormous salaries that are completely unjustified. That really is outrageous when other people are having to tighten their belts. What about members of the Audit Commission? What are they paid?

Mr Black: Absolutely no one in Audit Scotland, at any level, has had a large pay increase in recent years. No one around this table has had a large pay increase in recent years. I can assure the commission of that, and I am sure that the commission would have asked questions had that been reported in the annual accounts.

George Foulkes: What about the non-executive members of the Audit Commission?

Mr Black: Non-executive members of the Audit Commission in England and Wales?

George Foulkes: No, here.

Mr Black: Here, there is the Audit Scotland board and the Accounts Commission.

George Foulkes: Sorry—I mean the Accounts Commission.

Diane McGiffen: I do not have to hand the exact figure for Accounts Commission members. They are appointed by ministers and their salary is set by the Government and updated in line with Government policy.

George Foulkes: In your budget proposal, under expenditure, you have a heading for "Staff and Commission members costs". The figure is going up by 1.1 per cent, from £15,158,000 to £15,319,000, so you must know what the Accounts Commission members are paid.

Diane McGiffen: I do know; I just do not have the figures with me at this minute.

Mr Black: We do not have that information in hand because the Accounts Commission members are appointed by the Scottish ministers—

George Foulkes: But you pay them.

Diane McGiffen: Yes.

Mr Black: The terms of their appointment are set by the Scottish ministers, but we pay them. This is an indicative figure only, rather than the absolute figure, but the payment is of the order of £7,500.

Diane McGiffen: With help from colleagues in the public gallery, I can clarify that the payment is £6,300.

George Foulkes: Do they get any additional payment, apart from the fee of £6,300?

Diane McGiffen: Their travel expenses are covered, as are any expenses that they incur during the course of their business.

George Foulkes: Such as the cost of staying overnight in Edinburgh.

Diane McGiffen: If they do that, but I do not think that many of them do.

George Foulkes: Right. Thank you.

The Convener: If it is helpful, I point out to George Foulkes that the total costs for Accounts Commission members are in the operating cost statement in appendix 1, which is on page 11 of the Audit Scotland budget proposal.

George Foulkes: Oh yes.

The witnesses might think that I am being particularly aggressive, but Robert Black himself said that we are in unprecedented circumstances and that the public sector, including non-departmental public bodies, local authorities and everyone else, has to recognise that. To submit a budget each year that automatically assumes uplifts and that things will be as they were last year and the year before indicates that, although you say that we are in unprecedented circumstances, perhaps that has not been taken into account in the way that you operate.

Mr Black: I agree absolutely with everything that Lord Foulkes says. Not for a moment would I ever produce a budget that automatically assumed that we should simply lift everything up every year. I am sorry if I have not demonstrated this adequately, but I am satisfied that Audit Scotland has been through a rigorous process to keep our costs at the minimum possible.

Robert Brown: I have a question about the introduction of the IFRS. You have assumed a rise of 6 per cent in the fees because of that. Is that a

one-off rise, as one would imagine, or will it echo in future years?

Russell Frith: With the health service and central Government, which are implementing the IFRS a year ahead of local government, there has been a 6 per cent increase in fees for two audit years, because there is a formal shadow accounts process, with two sets of accounts that have to be looked at. We expect that increase to be at least halved following the first full year of implementation, so there will be a reduction.

Robert Brown: Why does that cost not go altogether once we are on to the new system?

Russell Frith: Because IFRS-based accounts are more complicated than those that are based on the United Kingdom generally accepted accounting practice and have extensive disclosures that are not required under the UK GAAP.

The Convener: I accept that it is desirable to have the two sets of accounts during the introduction of the IFRS, but given that we are in unprecedented and challenging times financially, is that absolutely necessary?

Russell Frith: With the health service and central Government, it is a UK-wide policy. The shadow accounts have been prepared by most of the bodies concerned and they are out for audit at the moment. For local government, there is a less formal approach. We are putting in place arrangements so that the auditors and the audited bodies can agree what work is required on the comparative figures—the equivalent of shadow accounts in local government—on a case-by-case basis. We are being less prescriptive for local government, which partly reflects cost pressures.

The Convener: I read your fee strategy document with interest. It is clear that a lot of complex factors underlie how you determine the fees that are charged. Given that complexity, has any thought been given to how it could be simplified in future?

Russell Frith: Yes, it has. In parallel with our preparation for the next tender round for the appointment of firms to a number of audits, we are undertaking a review of the way in which we are funded. That involves the balance between the various aspects of funding and the way in which we charge for work, particularly in relation to local government, which is the most complex sector.

The Convener: Changing tack slightly, on page 3 of your budget proposal you state that you have been funding your contribution to the Crerar review of scrutiny by way of EYF. Can you clarify for the commission the additional costs in cash terms that have arisen from the Crerar review?

Mr Black: It is too early to be able to do that. As we indicate in our budget submission, we are looking at that at the moment. There are still two big areas of uncertainty. The first relates to how the new best value 2 regime will operate: pilots are under way in a number of local authorities. Secondly, it is not yet certain what the exact provisions of the Public Services Reform (Scotland) Bill, which Parliament is currently considering, will be. For that reason, we are using a combination of EYF and resource-releasing efficiencies to sustain our continuing commitment to Crerar. At the end of the process, we will need to find a way, with the commission, the Accounts Commission and other stakeholders, to consider objectively what the cost of the integrated scrutiny model will be and how best to fund it.

The Convener: You will have some indication of how much money you have spent on pursuing the Crerar agenda, because there are costs that you have met to date.

Diane McGiffen: Yes. It is not possible to profile the spending accurately at the moment, but we expect the on-going costs of the work to be in excess of £100,000. We cannot give you a definitive answer now because we are in the process of switching our resources for the best value 1 round to best value 2. That involves shared risk assessments with the other scrutiny bodies for every authority, which will change the nature of the audit work that we do. We have to figure out how much of doing a best value 2 audit is taken account of by the shared risk assessment, how much is additional, and how that will inform, change and streamline the work that we need to do. Until we have a few pilots under our belt, we will not know.

We have new systems. We and our scrutiny partners have not got around the table before to discuss a local authority's risk assessment—there is a learning curve for everyone. We must figure out to what extent the resources that we are investing just now will be needed for ever and to what extent they are part of learning to do things the first couple of times, after which matters will be simpler. This is an active, dynamic area of work on which we report to the Accounts Commission regularly. By the end of this financial year, we will have the results of the first pilot, the first risk assessments and so on, and we will be in a much better position to pin down costs. We will also know how much of the scrutiny co-ordination work is historical, because it is about setting things up, and what the on-going running costs are. It is too early to give a definitive answer. We know what we have spent, but we cannot yet say whether it is typical of what we will need to spend in a steady state.

Robert Brown: In part 2 of the fee strategy document, you say that you take account of a variety of issues. You indicate that one of those issues is the fact that the Government's budget was increasing, which means that

"auditors will ... be undertaking audit work ... on higher amounts of spending than in previous years."

It is not immediately obvious to me why that should add to audit costs or be a relevant factor, except in so far as it affects the number of items audited. Can you elaborate on that point?

Russell Frith: The point was made to bring out the fact that audit operates largely in arrears. There has been much discussion, including today, about future reductions. We wanted to make clear that those relate to the future. Financial audits operate retrospectively, so the budgets and expenditure that we are auditing do not reflect any possible future cuts.

Robert Brown: I follow that entirely, but I cannot quite see how it makes a difference to audit costs.

Russell Frith: In terms of volume it does not—

Mr Black: If I may come in. We would not major on the issue. Volume of spend does not translate naturally into audit costs. As Russell Frith said, it is a factor, but no more than that.

The Convener: I thank Mr Black and his team for appearing before the commission once again this morning, for giving up their time and for freely answering all questions that have been put to them. I am also grateful to the Audit Scotland employees who are sitting in the public gallery. I hope that they have found the proceedings illuminating.

11:30

Meeting continued in private until 12:02.

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