Dear Ms Duffy

Matters arising from the Finance Committee meeting on 16 May 2006

Following the meeting of the Finance Committee yesterday, Audit Scotland would like to ensure that the Finance Committee is aware of the key facts that demonstrate our commitment to achieving value for money in our use of resources.

Audit Scotland is held to account in a detailed and rigorous fashion through statutory arrangements put in place by the Scotland Act and by the Parliament through the Public Finance and Accountability Act. The Scottish Commission for Public Audit (SCPA) is central to these arrangements. The records of the Commission’s meetings, which are not part of the official report, demonstrate the robust and appropriate role that it plays. In addition, the Audit Committee, which has an interest in policy matters relating to audit, has said in its submission to your inquiry that it considers “that the statutory arrangements for the financial scrutiny of Audit Scotland are robust and effective, although, as with all legislation, they should be subject to periodic review, within the context of the P F and A Act.”

We are committed to giving a full and open account to Parliament of how we use our resources, and it is important that the Finance Committee has accurate information about the factors influencing the movements in our budget over recent years.

Budgets

**Total operating costs (£000s)**

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<tr>
<td>Actual</td>
<td>15,543</td>
<td>16,038</td>
<td>20,599</td>
<td>20,972</td>
<td>24,912</td>
<td>24,041</td>
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Amount of total operating costs from the Scottish Consolidated Fund (£000)

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<tr>
<td>Amount</td>
<td>4,200</td>
<td>4,383</td>
<td>6,122</td>
<td>5,266</td>
<td>6,164</td>
<td>6,525</td>
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Audit Scotland was formed in April 2000, after extensive consideration of potential audit arrangements by the Constitutional Steering Group and the Financial Issues Advisory Group. We started work with inherited staffing from the merged predecessor organisations, the Accounts Commission and the NAO Scottish office. This did not meet the full requirements of our new statutory responsibilities and subsequent years reflect the build up of our capacity. Three quarters of our operating costs in any year are covered by fees and charges.

The increase in our expenditure in 2002-03 is almost entirely due to a change in our VAT status. Up to that point we were able to recover our input VAT; due to a decision by HM Customs and Excise in 2002, we have since been required to recognise VAT as a cost.

The movement between 2003-04 and 2004-05 is due in large part to the introduction of the statutory duty of Best Value in local government, reflected in both our budget and our staffing trend. The Accounts Commission has a duty to audit the achievement of Best Value in councils under the Local Government in Scotland Act 2003. The annual cost of this was £1.2 million. The approach incorporates reliance on the findings of Inspectorates, which ensures that its costs are tightly contained and minimises the burden on councils.

Over the same period, we have been given responsibility for a range of new audits, including further education colleges, Scottish Water and new agencies such as Transport Scotland.

In 2000-01, total managed expenditure of the Scottish Executive was £18 billion. In 2005-06, planned spending is just over £27 billion, an increase of 50 per cent. As Executive spending has increased, so have the requirements for audit and therefore our costs to meet this new level of demand. Our total operating costs in 2004-05 were £24.9 million. According to the audited accounts of the National Audit Office and the Audit Commission, their combined operating costs in that year were £310 million.

We apply the best value principles to everything that we do in managing our own resources. For example, over two financial years (2004-05 and 2005-06), we reduced audit charges to the NHS in Scotland by 10 per cent. At the same time, we significantly improved the audit outputs to NHS bodies and to Parliament. This is seen in the improved financial and performance overview reporting to Parliament, which did not exist before 2000. We have a programme of quality and best value reviews internally and there is a full programme of internal audit work, carried out by an external firm of accountants, and covering the full range of our activities. This internal audit programme is set by, and reported to, Audit Scotland’s Audit Committee.

Audit Scotland was required to adopt TUPE principles in setting the salaries of staff transferred from predecessor organisations, and has adopted centrally negotiated local government pay scales. Because we are a relatively young organisation, with many staff near the bottom of their pay scales, our staff costs are projected to increase by 4.2 per cent over the next year. We have advised the SCPA that we will restrict our budget request for next year to 3 per cent, by absorbing increased staffing costs beyond that level through efficiency savings.
The largest part of our income comes from charges to audited bodies. We benchmark our charging regime using confidential information from the Audit Commission and the National Audit Office. We also have intelligence on the fees charged by audit firms in the market place. We are confident that our charges compare favourably those of other audit agencies, and are significantly lower than the fees of the firms in their other markets. We believe that the SCPA may be considering a VFM review of our charging regime and we would welcome this. Thirty per cent of our audit activity is put to competitive tender in the private sector, following full EU procurement rules. This ensures that there is a mixed market for public audit provision in Scotland and enables us to benchmark and contain the overall cost of public audit.

We believe that the current governance arrangements, which are defined in statute and centre upon the role of the SCPA, are robust and effective. The Audit Scotland Board is prescribed in statute. One of its main functions is to enable the Auditor General for Scotland and the Accounts Commission to be served by a single audit agency, with consequent gains in efficiency and effectiveness. Our budget and Annual Report are submitted to and scrutinised by the SCPA. Our next annual report will be published early this summer, and will give a full account of our use of resources and our performance.

In the meantime, we would draw to the Committee’s attention the results of our latest anti-fraud initiative which is published today. We discovered £15 million of fraudulent and inappropriate payments and forward savings on pension costs. The waste uncovered by this single project is over twice the net resources provided by Parliament to Audit Scotland.

We hope this information is helpful in the context of our discussions yesterday.

We may provide you with further information once we have considered the content of the Official Report.

Yours sincerely

Diane McGiffen
Director of Corporate Services