AGENDA

3rd Meeting, 2007 (Session 3)

28 November 2007

The Commission will meet at 10.30 am in Committee Room 6.

1. Decisions on taking business in private: The Commission will consider whether to take agenda item 3, and future consideration of a draft report on Audit Scotland's Budget Proposal for 2008-09, in private.

2. Audit Scotland’s Budget Proposal for 2008-09 and Autumn Budget Revision 2007-08: The Commission will take evidence from—

   Robert Black, Auditor General for Scotland;

   Russell Frith, Director of Audit Strategy; and

   Diane McGiffen, Director of Corporate Services, Audit Scotland.

3. Audit Scotland evidence: The Commission will consider the evidence taken at agenda item 2 to inform the preparation of its report on Audit Scotland’s Budget Proposal for 2008-09.

Mark Brough
Secretary to the Commission
The papers for this meeting are:

**Agenda Item 2**

Audit Scotland’s Budget Proposal for 2008-09 and Autumn Budget Revision 2007-08  
[Link to SCPA/S3/07/03/1]

Letter from Audit Scotland (dated 12 October 2007), supplementary to evidence at the SCPA meeting on 19 September 2007  
[Link to SCPA/S3/07/03/2]

Letter from Audit Scotland (dated 31 October 2007) regarding its international work  
[Link to SCPA/S3/07/03/3]

Briefing Paper [*PRIVATE PAPER – for Members only*]  
[Link to SCPA/S3/07/03/4]
Dear Convener

AUDIT SCOTLAND BUDGET FOR 2008-09 AND AUTUMN BUDGET REVISION 2007-08

In accordance with our agreement with the Commission I am writing to provide the SCPA with our formal proposal for Audit Scotland's Budget for 2008-09 and our proposal for the Autumn Budget Revision for 2007-08.

We estimate that we will require a total of £7.250M for 2008-09 comprising £6.717M to cover our net revenue expenditure and £0.533M to cover capital expenditure. These represent an increase of 2% on the approved amounts for 2007-08 and are the same as the amounts discussed in outline with the Commission on 19th September.

I look forward to discussing the Budget proposal with the Commission later in the year.

Yours sincerely

Robert W Black
Auditor General for Scotland
Budget Proposal 2008/09
Introduction

Audit Scotland provides services to the Auditor General for Scotland and the Accounts Commission. The principal activities of Audit Scotland are to carry out the annual external audit of around 200 public bodies and to carry out a programme of performance audit studies across all parts of the public sector in Scotland.

Audit Scotland’s funding comes partly from charges to audited bodies and partly from the Scottish Consolidated Fund. Audit Scotland is required to submit its budget proposals to the Scottish Commission for Public Audit (SCPA) for their consideration. The SCPA then make a report to the Scottish Parliament as part of the annual Budget Act approval process.

This paper represents Audit Scotland’s budget proposals for the 2008/09 financial year. A separate paper provides information on Audit Scotland’s proposal for the Autumn Budget Revision for 2007/08.

Business

The business operations and developments are set out in the Corporate Plan 2007-10. Briefly the core business is:

- To deliver the annual audit of around 200 public bodies including the Scottish Government, Executive Agencies, Non Departmental Public Bodies, NHS Boards, Local Authorities and Further Education Colleges
- To deliver a programme of performance audit studies, Best Value audits and overview reports for the Auditor General and the Accounts Commission
- To prepare reports on issues of public concern arising during the year at the request of the Auditor General or the Accounts Commission
- To contribute to the development of public sector policies and practices and to accounting and auditing standards

The environment in which Audit Scotland operates continues to change. Some of the principal factors affecting Audit Scotland’s work are:

- The continuing need for public services to provide improved public services more efficiently
- The tightening budgetary environment
- The impact of best value legislation in local government and the application of best value principles across all public services
- The extent and respective roles of audit, regulation and inspection
- The introduction of International Financial Reporting Standards to central government and the NHS from 2008/09
Priorities for development of the business include:

- Consolidating and refining the revised risk based audit approach to annual audit work including enhancing the links with other work such as Best Value audits

- Completing the first round of Best Value audits in local government, development of Best Value work in other sectors and consideration of the scope of the second round of Best Value audits in local government

- Implementing an electronic documents and records management system

- Responding to the Scottish Government’s scrutiny review and the efficient government programme

### Summary of Resource Requirements

<table>
<thead>
<tr>
<th>Summary of resource requirements</th>
<th>2008/09</th>
<th>2007/08</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£000</td>
<td>£000</td>
</tr>
<tr>
<td>Direct costs</td>
<td>20,594</td>
<td>20,172</td>
</tr>
<tr>
<td>Indirect costs</td>
<td>5,363</td>
<td>5,707</td>
</tr>
<tr>
<td><strong>Total Net Expenditure</strong></td>
<td><strong>25,957</strong></td>
<td><strong>25,879</strong></td>
</tr>
<tr>
<td>Income from charges to audited bodies</td>
<td>19,240</td>
<td>19,294</td>
</tr>
<tr>
<td><strong>Net Operating Cost</strong></td>
<td><strong>6,717</strong></td>
<td><strong>6,585</strong></td>
</tr>
<tr>
<td>Capital</td>
<td>533</td>
<td>523</td>
</tr>
<tr>
<td><strong>TOTAL RESOURCE REQUIREMENT</strong></td>
<td><strong>7,250</strong></td>
<td><strong>7,108</strong></td>
</tr>
</tbody>
</table>
The Total Resource Requirement represents an increase of 2.0% over last year.

The Capital Expenditure proposal represents an increase of 2% and is principally for Audit Scotland’s rolling Information Technology replacement and upgrading programme.

Principal Assumptions

The principal assumptions underlying the budget proposal are:

- Provision has been made for pay increases including increments. Audit Scotland’s pay increases are based on local government arrangements. The basic increase from April 2008 has been assumed to be 2.5%
- Employer’s pension contributions remain at 13% plus £200,000 for 2006-2009 as recommended by the last actuarial valuation
- Increases to payments to approved auditors (firms) will be 2.5% in November 2007 and a further 2.5% in November 2008. There will need to be an additional increase from November 2008 to reflect the introduction of International Financial Reporting Standards. Work to finalise the extent of the changes and their likely impact is only just beginning at a UK level.
- The introduction of International Financial Reporting Standards for the preparation of accounts for 2008/09 will also apply to Audit Scotland. The proposed budget does not take account of any impact on the resources required as we understand that it is the intention of HM Treasury and of the Scottish Government’s central finance team that any change in resources required as a result of the introduction of the new standards will be dealt with through a Budget Revision during 2008/09 rather than in preparing initial budgets. This is because until the details of the accounting policies required have been finalised (not expected before mid December 2007) it is not possible for budget preparers to estimate their impact. At this early stage we anticipate that the most significant impact on Audit Scotland will be a requirement to accrue the cost of untaken holidays which is likely to result in a one off additional resource requirement in excess of £0.5million.

Expenditure

An analysis of gross expenditure by type is attached as Appendix 1 together with a breakdown between Direct and Indirect costs. The expenditure budget is arrived at after reviewing actual costs for each of the last two years and the current year budget and taking account of any planned developments.

In considering Appendix 1 members should note that the 2007/08 figures are those presented to the Commission in September 2006 and which underpin the resulting Budget Act approved resource requirement. It was after these were considered by the Commission that agreement was reached with HM Revenue and Customs about Audit Scotland’s VAT status which explains why the Approved auditors’ amount has decreased from 2007/08.
The number of core audit staff is expected to fall by 3 posts although this will be offset by the recruitment of 2 new staff to undertake local government benefits audit work being transferred from the DWP to the Accounts Commission/Audit Scotland from 1 April 2008 taking the total establishment to 293 full time equivalents. We also intend to recruit 4 staff on fixed term appointments of between 18 months and 3 years to assist in developing the business. These posts will be funded from money carried forward under End Year Flexibility – see separate paper on Audit Scotland’s proposals for the Autumn Budget Revision

Efficient Government

The Efficient Government agenda affects all of the organisations that we audit. Audit Scotland is committed to assisting the public sector to achieve efficiencies and is also fully committed to generating its own efficiencies which can be redirected towards better services or returned to audited bodies.

In preparing the 2007/08 budget we were able to identify annual cash releasing savings of £160,000 by reducing the number of senior management. These savings continue in 2008/09. In addition we have identified the following further cash releasing savings targets in preparing the 2008/09 budget:

| Reductions in insurance premiums following an internal review and re-tendering | £000 |
| Reductions in print costs following re-tendering | 27 |
| Reductions in various central budgets from 2007/08 | 183 |
| Total | 260 |

Efficiencies put into place in earlier years will also continue – for example we will continue to only produce local government performance indicators in electronic format, replacement computers will continue to have their useful lives assessed at four years rather than three, and environmental initiatives to continuously reduce consumption of paper and energy will be pursued.

Income from charges to audited bodies

Audit Scotland is required to broadly break even taking one year with another for that audit work which is charged to audited bodies. All local government audit work is charged for, as are the annual audits of other bodies except those which Audit Scotland is prohibited from charging for ie Scottish Government, Executive Agencies and the Scottish Parliamentary Corporate Body. Money voted by Parliament covers the cost of the annual audits that we do not charge for together with most of the performance audit work within the Auditor General’s remit.

The budget proposal is based on increases in charges to audited bodies of 2% for the 2007/08 audits and 2.5% for 2008/09 audits. The increase which we now intend to implement for 2007/08 audits is 1% lower than that previously notified to those bodies.
Income from charges to audited bodies is analysed below:

<table>
<thead>
<tr>
<th></th>
<th>2008/09 £000</th>
<th>2007/08 £000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local government</td>
<td>12,551</td>
<td>12,631</td>
</tr>
<tr>
<td>Health</td>
<td>4,253</td>
<td>4,368</td>
</tr>
<tr>
<td>Central government</td>
<td>1,901</td>
<td>1,770</td>
</tr>
<tr>
<td>Further education</td>
<td>535</td>
<td>525</td>
</tr>
<tr>
<td><strong>Total income from charges</strong></td>
<td><strong>19,240</strong></td>
<td><strong>19,294</strong></td>
</tr>
</tbody>
</table>

The local government amount for 2007/08 is stated before agreement was reached on VAT which has resulted in a reduction in fee income of around £420,000 per year.

Audit Scotland
28 September 2007
Subjective breakdown of running costs:

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£(000)</td>
<td>£(000)</td>
<td>£(000)</td>
<td>£(000)</td>
</tr>
<tr>
<td>Employees:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Salaries and temporary staff</td>
<td>11,531</td>
<td>10,950</td>
<td>10,169</td>
<td>9,527</td>
</tr>
<tr>
<td>Employer's oncosts</td>
<td>2,855</td>
<td>2,750</td>
<td>2,518</td>
<td>2,393</td>
</tr>
<tr>
<td>Total employee costs</td>
<td>14,386</td>
<td>13,700</td>
<td>12,687</td>
<td>11,919</td>
</tr>
<tr>
<td>Approved auditors</td>
<td>5,724</td>
<td>6,089</td>
<td>5,724</td>
<td>6,089</td>
</tr>
<tr>
<td>Performance audit and other consultancy</td>
<td>1,073</td>
<td>1,162</td>
<td>908</td>
<td>952</td>
</tr>
<tr>
<td>Training and development</td>
<td>479</td>
<td>510</td>
<td>422</td>
<td>444</td>
</tr>
<tr>
<td>Travel and subsistence</td>
<td>880</td>
<td>833</td>
<td>880</td>
<td>833</td>
</tr>
<tr>
<td>Recruitment &amp; Other Staff Costs</td>
<td>237</td>
<td>265</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Professional Subscriptions</td>
<td>44</td>
<td>40</td>
<td>39</td>
<td>35</td>
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<tr>
<td>Premises</td>
<td>1,384</td>
<td>1,419</td>
<td>0</td>
<td>1,384</td>
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<tr>
<td>Office expenses</td>
<td>492</td>
<td>512</td>
<td>0</td>
<td>492</td>
</tr>
<tr>
<td>IT</td>
<td>408</td>
<td>451</td>
<td>0</td>
<td>408</td>
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<tr>
<td>Publications and media</td>
<td>254</td>
<td>273</td>
<td>0</td>
<td>254</td>
</tr>
<tr>
<td>Depreciation</td>
<td>585</td>
<td>610</td>
<td>0</td>
<td>585</td>
</tr>
<tr>
<td>Cost of capital</td>
<td>75</td>
<td>73</td>
<td>0</td>
<td>75</td>
</tr>
<tr>
<td><strong>Total Audit Scotland expenditure</strong></td>
<td><strong>26,021</strong></td>
<td><strong>25,937</strong></td>
<td><strong>20,660</strong></td>
<td><strong>20,272</strong></td>
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<tr>
<td>Accounts Commission costs</td>
<td>152</td>
<td>157</td>
<td>0</td>
<td>152</td>
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<tr>
<td>Sundry income</td>
<td>(216)</td>
<td>(215)</td>
<td>-66</td>
<td>-100</td>
</tr>
<tr>
<td><strong>Total Net Expenditure</strong></td>
<td>25,957</td>
<td>25,879</td>
<td>20,594</td>
<td>20,172</td>
</tr>
</tbody>
</table>
Notes to Appendix 2

Basis of allocating direct and indirect costs

As a result of discussion with the previous Commission about the presentation of information on direct and indirect costs we have reviewed the presentation of this information and concluded that it would be more useful if the analysis of direct and indirect costs was shown on the basis of the subjective breakdown of costs.

Direct and Indirect costs can be apportioned in many different ways depending on the nature of the business and the purpose for which the analysis is required. The essential requirement is to enable comparison between years.

The analysis in the table is based on apportioning costs based on the nature of the cost or on the type of work being undertaken.

Staff costs, training and development and professional subscriptions are apportioned on the basis of headcount. Those staff working in the Audit Services Group (planning, delivering and reporting annual audits of audited bodies), Public Reporting Group (planning, delivering and reporting national performance audit studies and best value audits) and Audit Strategy Group (supporting auditors with professional guidance) are regarded as direct costs. Those staff working in the Corporate Services Group (HR, Finance, Information Systems, Communications and Office Services) are treated as indirect costs.

Other categories of costs are allocated as direct or indirect based on their type or, in the case of performance and other consultancy, allocated according to the purpose of the expense eg consultancy to support national studies is treated as a direct cost whereas corporate legal fees are treated as indirect.

In previous years the analysis was presented between the different parts of Audit Scotland and analysed certain costs such as premises, IT and depreciation according to the type of activity being supported.
Autumn Budget Revision
2007/08
Audit Scotland
Autumn Budget Revision 2007-08

Introduction

Audit Scotland’s budget and Parliamentary funding is subject to scrutiny by the Scottish Commission for Public Audit as are any revisions to that Parliamentary funding.

This paper represents Audit Scotland’s proposals for the 2007/08 Autumn Budget Revision.

Background

Bodies funded by Parliamentary Vote only have authority to spend the resources voted to them in one financial year. Any unspent resources are lost unless Parliament votes for them to be carried forward to the next financial year. This mechanism is known as End Year Flexibility (EYF) and is approved by Parliament each year as part of the Autumn Budget Revision process.

The ability to use EYF is very important to the sound management of Audit Scotland for two main reasons:

- the high proportion of our income which comes from fees and charges, and
- the timing of our primary business cycle, which is broadly November to October.

The use of EYF enables Audit Scotland to:

- manage our income, taking one year with another, to minimise volatility
- notify any changes in audit charges to audited bodies in good time.

Overall proposal

The only proposed revision is for Audit Scotland to take up End Year Flexibility (EYF) arising from 2006/07. The overall proposal is:

<table>
<thead>
<tr>
<th></th>
<th>Revenue</th>
<th>Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>£000</td>
<td>£000</td>
</tr>
<tr>
<td>EYF</td>
<td>1,541</td>
<td>1,043</td>
</tr>
<tr>
<td>Total revision</td>
<td>1,541</td>
<td>1,043</td>
</tr>
<tr>
<td>Original 2007/08 budget</td>
<td>6,585</td>
<td>523</td>
</tr>
<tr>
<td>Revised total funding</td>
<td>8,126</td>
<td>1,566</td>
</tr>
</tbody>
</table>

Revenue EYF

The total amount of revenue EYF available to Audit Scotland as at 31 March 2007 was £2.416 million. However, as explained below, £875,000 of this relates to favourable pensions accounting year end adjustments which Audit Scotland does not consider needs be carried forward. Our proposal is therefore that £1.541 million of revenue EYF should be carried forward.
Our proposals for the use of EYF cover:

- pension accounting
- fees and charges
- developing the business
- funding lease obligations.

Pension Accounting

The impact of the Financial Reporting Standard for pensions (FRS17) this year accounts for £875,000 of the revenue balance at March 2007. This positive impact reflects the rising asset values and changes to the local government pension scheme rules which took place during the year.

The impact of FRS17 requirements is more significant for Audit Scotland than for most bodies receiving Parliamentary funding. Most of Audit Scotland’s staff are members of the local government pension scheme which is a funded scheme. The vast majority of central government bodies including the Scottish Government and its Executive Agencies are members of the Principal Civil Service Pension Scheme which is an unfunded scheme for which similar accounting adjustments are not required.

The year end accounting adjustments required by FRS17 contribute to the volatility of certain parts of Audit Scotland’s accounts and on this occasion are favourable movements. As this amount does not reflect an amount that was either earned or not spent in 2006/07, but which would be required in 2007/08, we do not propose to request that this element be carried forward as part of EYF. We would however note that it is quite possible that in some future years these adjustments will be adverse and accordingly we may need to request additional resources should that situation arise through the Autumn Budget Revision. Information to date suggests that the FRS17 adjustment for 2007/08 is also likely to be favourable.

Fees and Charges

Our fee strategy requires £480,000 of revenue funding to be carried forward at 31 March 2007. In accordance with our charging strategy, we aim to notify audited bodies well in advance of each audit year of the charges that they will incur and to provide an indication of the likely increases for the following year. In order to minimise the volatility of increases Audit Scotland plans to use EYF over an 18 month to 2 year period and most of this amount reflects an element of the EYF from 2005/06 that was planned to be used during 2007/08.

Developing the Business

Audit Scotland is always seeking to improve the way that it conducts its business and also needs to respond to external changes in its environment. Whilst there is a degree of resource from within the main annual budget able to be allocated to this work, external changes in particular tend to occur unevenly. The current year is an example of this as we are currently responding to a number of drivers for change including:
Audit Scotland
Autumn Budget Revision 2007-08

- Introduction of International Financial Reporting Standards to central government from 2008/09 and the impact on local government through Whole of Government Accounts which will require further professional training for our teams
- Supporting and then responding to the Crerar Review of Scrutiny bodies
- Taking forward the recommendations from the external interim review of Best Value audit in local government and developing the approach for the second round of audits
- Developing our approach to Best Value audit in the rest of the public sector.

To help us to meet these challenges we intend to appoint 4 additional members of staff on fixed term contracts of between 18 month and 3 years and to use the EYF funding from the 2007/08 Autumn Budget Revision to fully cover this cost.

Landlord Works on Offices

In addition to the refurbishment of the areas that Audit Scotland occupies within 18 George Street, the landlord has recently proposed significant work on the common areas including major maintenance of the lifts. The cost of this work, initially estimated at around £200,000 will be recharged to tenants through the service charge towards the end of 2007/08 or early in 2008/09. We intend to apply EYF to meet this cost.

Capital EYF

The capital amount available is £1,043,000. The majority of this relates to funding for the refurbishment of offices at 18 George Street, Edinburgh. The work on these offices commenced in autumn 2006 and was finished in summer 2007. £475,000 had been spent on the refurbishment between 31 March 2007 up to 31 August 2007 and the final total when all bills are settled is expected to be £620,000.

The remaining EYF will be used to support a number of equipment replacement projects including printers and copiers and videoconferencing.
Dear Convener

Follow up to meeting of 19 September 2007

Thank you for your letter of 26 September requesting further information on some of the issues discussed at the meeting of the Commission on 19 September.

The attached note provides our response to the issues raised. In doing so we have tried to provide more information on the way in which our budgets are prepared which we hope will provide useful context for the more specific answers.

Yours sincerely

Robert W Black
Auditor General for Scotland
Note in response to follow up request for further information arising from the meeting of the Scottish Commission for Public Audit on 19th September

Structure of the note
The aim of this note is to provide further information about certain aspects of Audit Scotland’s budget processes as requested in the Convener’s letter of 26th September 2007. In order to respond to the points raised we thought it would be helpful to set out an overview of the budget process in order to provide a clear foundation for the responses to the individual points.

Budget cycle
The main budgeting process takes place in the late summer in order to provide the SCPA with a formal submission by 30th September for the following financial year. At that point Audit Scotland has available the audited accounts for the previous financial year and consequently knows the potential amount of End Year Flexibility (EYF) available. It also has an idea how the current year is progressing and prepares expenditure estimates for the following year.

Given the different audit and financial year cycles the aims of the budgeting exercise are to:
- Prepare the formal submission to the SCPA for the next financial year
- Prepare the formal submission to the SCPA for use of EYF arising from the previous year
- Agree the adjustments in fees to apply from November of the current year and to indicate the likely adjustments from November of the following year

Budget process
The internal budget process begins with expenditure estimates being prepared for each cost centre. This is done by providing each cost centre with details of their actual expenditure for each of the previous two financial years and the budget for the current year. The budget holders then complete the estimates for the following year taking account of current and projected audit activity. These are then subject to review by the finance team and by senior management.

The expenditure estimates are then modelled against different levels of fee increase to establish the level of increase needed to match expenditure. This is done for each part of the public sector eg local government audit, NHS audit etc to take account of any changes in the number of bodies to be audited or the scope of the audit.

As noted above, at this point Audit Scotland knows the amount of EYF potentially available from the previous year and, subject to any remaining commitments of EYF coming forward from EYF in previous years, can consider taking this into account in balancing the budget and in setting levels of fee increase. In summer 2006 Audit Scotland had uncommitted EYF arising at 31 March 2006 available to help reduce fee increases of £400,000. This could have been entirely applied to keep the fee increase from 1 November 2006 down but his would have meant a far larger increase in fees from 1 November 2007 (see the example under “Fee strategy” below for more detail).

The various options available to Audit Scotland in terms of the level of expenditure, the level of fee increase and the potential use of EYF are then combined to produce
a report for scrutiny by the Management Team. A report is then given to the Audit Scotland Board where the proposals are subject to further scrutiny. The scrutiny process takes into account the overall objective of keeping fee increases as low as possible. It also considers the volatility of increases as in discussions over the last few years audited bodies have expressed a preference for stability in the level of increases. Following consideration by these groups the formal submission is made to the SCPA by the end of September. The proposed increases in local government fees are also submitted to the Accounts Commission for consideration and approval.

**Capital end year flexibility**
The total capital EYF available at 31 March 2007 is £1.043 million. Audit Scotland leases the 2nd to 6th (top) floors of 18 George Street. A refurbishment programme was partially complete at 31 March 2007 and we expected the work to be finished by summer. By the end of August 2007 Audit Scotland had spent £475,000 (the amount included in the note for the meeting on 19th September) and we expect the full cost to be met in 2007/08 after release of retentions and settlement of final accounts to be £620,000.

The lease is a typical institutional lease and confers all responsibility for repairs and maintenance directly to the tenants. It also allows the landlords, if they consider it desirable, to upgrade and improve any common areas at the tenants cost.

Our landlord has proposed a refurbishment of the common areas and a replacement of the two lifts serving the building requiring an estimated contribution from Audit Scotland of £255k (inclusive of VAT). The lift element of the project accounts for 40% of the project cost with the balance attributable to redecoration, improved fire alarm and security features, new lighting and a new Disability Discrimination Act complaint entrance door.

The lifts in the building have proved problematic over the past few years with regular break downs which can cause unacceptable stress to staff if they are in the lifts at the time. The lifts are now past their expected operational life and repair costs have been high over the past year. The landlord now feels that they require full modernisation or replacement. Audit Scotland has previously requested that the landlord improve the service in this area. Whilst we fully agree that much of this work needs to be carried out we are in the process of discussing the full extent and cost of the work with the landlord to establish the extent to which it can be regarded as reasonable upgrades.

Other points raised in the letter:

**Fee strategy**
Reference to the fees strategy was to the general principles that are taken into account in proposing fee adjustments levels to the Auditor General and the Accounts Commission. These are not set out in any specific document but are included in the commentary on the options available that are discussed with the Auditor General and the Accounts Commission each year. As noted above informal discussions with audited bodies and the Accounts Commission have found a consistent preference for smooth increases in audit charges. An illustration may help. An audit has had a fee of £100,000. If Audit Scotland proposed a fee increase of 3% per annum for each of the next two years the fees would be £103,000 and £106,090. If EYF were available it might be possible to reduce the increase in year one to zero but in year two Audit Scotland would still need to receive a fee of £106,090 and would therefore have to apply an increase for year two of 6.09%. Those budget holders in audited bodies that bear the audit fee find it easier to manage progressive increases in fees rather than an initial freeze followed by a higher increase.
Billing cycles
There are two separate concepts that Audit Scotland is managing, income recognition and cash flow.

Income recognition refers to the way in which fee income is recognised in our accounts and is broadly based on the percentage of the audit completed by any given date. For example if an audit with a fee of £100,000 is 30% complete by 31 March then we will recognise income of £30,000 in our accounts for that year.

Cash flow refers to the timing of the receipt of cash from the audited body which in turn will depend on the frequency of billing. To build on the above example if Audit Scotland has not billed any of the audit work by 31 March then its balance sheet will show a debtor of £30,000 in respect of the income earned from the work done and there will be no cash balance. However if Audit Scotland correctly estimated that the audit would be 30% complete by 31 March, billed the body in say February and received payment during March then the balance sheet would show no debtors and a cash balance of £30,000. As a final example if Audit Scotland billed in advance 50% of the value of the audit and received the cash before 31 March then its balance sheet would show no debtors, cash of £50,000 and a creditor of £20,000 to reflect the fact that more cash had been collected than had been earned as income at that point in time.

In practice Audit Scotland bills audited bodies two or three times a year and the balance sheet will show a mixture of debtors for work not yet billed or billed but not paid, cash received and creditors to reflect any cash received in excess of the income earned by the balance sheet date.

The billing points as notified in advance to audited bodies for the 2006/07 audits are shown below:

<table>
<thead>
<tr>
<th></th>
<th>Year end</th>
<th>First instalment</th>
<th>Second instalment</th>
<th>Third instalment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local government</td>
<td>31/3</td>
<td>December</td>
<td>March/April</td>
<td>August</td>
</tr>
<tr>
<td>Health</td>
<td>31/3</td>
<td>December</td>
<td>March/April</td>
<td>August</td>
</tr>
<tr>
<td>Central government</td>
<td>31/3</td>
<td>January</td>
<td>March/April</td>
<td>August</td>
</tr>
<tr>
<td>Further education</td>
<td>31/7</td>
<td>August</td>
<td>January</td>
<td>N/A</td>
</tr>
</tbody>
</table>

The above billings are made on the basis of the fees agreed with the audited body at the start of the audit. Any further fees for additional work arising are billed after the completion of the audits.

The timing of billings takes into account the approximate expected timing of the audit work, the cash requirement of Audit Scotland to pay salaries and other costs and the work involved for both Audit Scotland and audited bodies in processing transactions. Given that all our fees come from public bodies we believe that reducing the costs of administration for the public sector as a whole is more important than the precise matching of the timing of cash receipts and payments within Audit Scotland.

Audit Scotland
October 2007
Thank you for your letter of 1 October 2007 requesting information on the governance arrangements for Audit Scotland’s international activity. I am happy to provide this to assist the Commission in its understanding of our work.

Audit Scotland international work

I have attached a copy of our International Strategy, approved by the Audit Scotland Board. This sets out the basis of our involvement in international auditing work and what we hope to achieve from it. It also details all international activity undertaken by Audit Scotland colleagues since 2000, and visits and delegations to Audit Scotland since 2004.

In summary, a limited involvement in international auditing work provides opportunities for professional and personal development and cross-cultural learning and exchange. There is considerable interest from Europe and elsewhere in the modern accountability and auditing regime that we have established in Scotland. Audit Scotland’s involvement focuses on

- Providing expert support as part of institution building projects, such as twinning arrangements and peer reviews
- Providing technical support or training on financial and performance audit techniques and public accountability models
- Developing networks, exchange visits and secondment opportunities with international audit institutions
- Hosting visits to Audit Scotland.

We have decided that our main involvement in international activity should be as a partner of either the National Audit Office of the UK government or the National Audit Office of Sweden. Both of these organisations make a very significant contribution to international work and have expressed particular interest in the skills that Audit Scotland can offer (for example, in the field of local government audit) to supplement their own expertise. As the lead partner, the UK NAO or the Swedish NAO will agree the fees for international engagements with the host country, and our costs would be recovered through them.

We have a budget of £10,000 in 2008/09 for hosting visits from overseas and supporting exchanges and secondments. We do not expect to exceed this amount and any additional spend would be subject to approval by Audit Scotland’s Management Team and, if necessary, the Board.
Angela Constance MSP

31 October 2007

As you will see from the Appendices to the Strategy document, interest in Audit Scotland’s work is now coming from a wide range of countries from Europe, Africa and Asia. Our involvement internationally has been primarily with EU states.

**Auditor General for Scotland international expenses and travel**

My expenses are reviewed annually by a non-executive member of the Audit Scotland Board who reports on his review to the Board. I advise the Audit Scotland Board in advance of any occasional speaking engagements outside of the UK and report back on these.

In the past two years, I have made no trips outside Europe. In the past two years I have made two trips within Europe to take up invitations to speak – once to Seville, and once to Toulouse. On both occasions, the organising bodies paid my costs, and I travelled on my own.

I have also accompanied the Scottish Parliament’s Audit Committee on a trip to Denmark, when my involvement was with the support of the Parliament.

In 2004, I spoke at a conference in Barcelona. My costs were paid for by the organisers. My wife accompanied me on this trip, and I met all her costs myself. I have a policy always to pay the costs of my wife’s travel and/or accommodation myself and never to recover these costs from Audit Scotland.

I have just completed a speaking engagement in Switzerland as part of the 6th EURORAI Congress. The conference organisers are meeting most of my costs. My wife accompanied me and I have met all of her costs, in line with my normal practice.

If you require any further information, please do not hesitate to get in touch.

Robert W Black
Auditor General for Scotland

CC Mark Brough Esq
Secretary to the Commission
AUDIT SCOTLAND'S INTERNATIONAL WORK

1. Executive Summary
This paper sets out the strategy for Audit Scotland’s international activity. Audit Scotland recognises the benefits of being involved in international work and is committed to supporting its development, within clearly defined limits which are described in the strategy.

1.1 Types of work
Audit Scotland will focus on four types of international activity:

- Providing expert support on institution building projects, such as twinning arrangements or peer reviews
- Providing technical support or training on financial and performance audit techniques and public accountability models
- Developing networks, exchange visits and secondment opportunities with international audit institutions
- Hosting visits to Audit Scotland.

1.2 Target markets
The work will concentrate mainly within and around the European Union; accession countries, those in the Balkans and the Baltic states and those on the periphery of the EU. In addition, we will carefully consider opportunities in Africa, particularly Malawi, although these bring higher risks.

1.3 Preferred partners
Our work abroad will mainly involve working in partnership with more experienced audit institutions. In particular, we will build on existing relationships with the NAO in the UK and the Swedish NAO. There will normally be an agreed fee basis for services provided by Audit Scotland, with the expectation that costs should be fully recovered.
1.4 Extent of involvement

In the financial year 2008/09 our target is to restrict our involvement to around 40 weeks of international work abroad. The activity will be spread across a number of people and will be carried out in short periods of time.

2. The international market in public audit and related services

2.1 Nature of work

International audit work is broadly defined as providing professional, technical or other audit and related services to a range of public sector organisations around the world. The majority of international audit work tends to be related to financial audit, although there does appear to be a growing demand for performance audit expertise. Specific activities include:

- institution building and related support to developing audit offices and other public sector organisations, such as participation in twinning projects and peer reviews;
- ad-hoc services of a specific nature, such as the provision of training or advising on public accountability models;
- participating in a variety of network groups associated with the wider development and implementation of governance, auditing and accounting standards within the international public sector;
- organising staff exchange visits and secondments with other audit offices and international organisations etc.
- hosting delegations from international audit organizations and other institutions
- hosting international conferences, seminars and workshops, and providing speakers to similar events abroad
- professional services such as external audit (e.g. within the UN family of organizations).

The bulk of demand currently comes from Africa and EU accession-type countries, but there is also increasing demand from former USSR satellite states, and from far-east countries such as China.

2.2 Duration of activities

The duration of individual activities can vary significantly, depending on the nature of the activity and the level of responsibility assumed by the provider. Some activities will last only
a few days (conferences, seminars etc), whilst others could last up to two years (eg twinning projects); and some involve the lead partner organizations (but not Audit Scotland) in having full time posts abroad, such as external audit appointments.

2.3 Staff skills
The nature of international work usually requires highly experienced staff with strong technical and communication skills. It can be extremely demanding, often requiring long hours and traveling at week-ends and in the evenings. Staff therefore need to understand what their participation means in terms of personal commitment. However, international work also offers great job satisfaction and career development opportunities, which have significant benefits for both staff and Audit Scotland.

3. Our strategy

3.1 Types of work
The nature of the services provided will vary, although the majority of opportunities are likely to be related to financial audit. We will concentrate on providing support to large scale projects, either as a junior partner or providing short term experts.

The specific types of direct work that are best suited to our circumstances include:

- Collaborative working with other audit organisations in institution building projects, either as a junior partner or simply providing specified support on particular aspects of the project. This is likely to be the main source of work, particularly in this early phase of our development. Recent examples include twinning projects managed by the NAO in Lithuania, Jordan and Northern Cyprus.
- The provision of technical support or training on financial and performance audit techniques and public accountability models, either alone or in partnership with another organisation
- Short-term exchanges and secondments with other audit institutions, for example, the NAO, Sweden, Denmark and Holland.
- Hosting visits to Audit Scotland.

A key element of our activity involves networking with other international audit institutions, designed to increase Audit Scotland’s profile internationally.

For example, developing effective networking might involve:

- Participation in regional / international conferences and seminars, including providing
speakers

- Exchange visits to / from other audit organisations, especially those in target areas
- Increased participation and profile within EURORAI
- Developing contacts with key EU bodies, especially the Court of Auditors
- Participation in EU standard setting forums and discussion groups.

3.2 Target markets
The market demand for this type of work generally originates from one of two sources:

- large scale projects are usually advertised on a bidding basis by the funding body, the main external ones being EU and World Bank, but it can also be the recipient country itself;
- networking contacts whereby respected providers are approached direct with a request for assistance (the UK NAO and Swedish NAO obtain a lot of work this way).

While we would not want to dismiss any particular location outright, we recognise that some offer better odds of success than others, and some locations are higher risk and will require careful consideration.

At this stage in our development, EU and EU related projects offer the opportunity to gain more experience, have a greater likelihood of successful completion, and will allow us to build our reputation in a relatively low risk environment. They are also likely to gain more support within Scotland and the UK due to our membership of the EU as it sits comfortably with wider policies and objectives. Another advantage is that travel arrangements and language is not generally a problem.

The key markets we should therefore prioritise are;

- EU accession and applicant countries, especially the smaller countries such as the Baltic and Balkan States, which have much in common with Scotland in terms of size and population and where our modern legislative structure is of particular relevance
- Direct EU funded projects, which cover both member states and countries peripheral to the EU.

Africa also offers significant potential, but the risks are higher due to inherent difficulties, particularly the lack of established infrastructure and political instability. However, in terms of need and wider political priority, the African countries rank highly and attract considerable external funding. Despite the risks, we should consider Africa as a potential target market,
particularly Malawi given the established connections with Scotland.

3.3 Key partners
In terms of priority, the main partners we should develop formal ties with are;

- The UK NAO; and
- The Swedish NAO.

The UK NAO is the largest player in this field, with Sweden also a significant presence. Both organisations are experienced in running large scale projects of various types and complexity. Both are finding it difficult to find resources to meet current and future commitments, and have already expressed serious interest in developing more formal relations with Audit Scotland to provide support. Both organisations have expressed a particular interest in our local government expertise, as they do not themselves audit local authorities.

Partnership working will involve:

- A formal agreement specifying the nature of the relationship and the admin and other arrangements underlying it
- An agreed fee basis for services provided by Audit Scotland, which will normally provide for full recovery of our costs
- Reciprocal staff exchanges / secondments to facilitate mutual understanding and closer co-operation
- Shared training opportunities, where relevant
- Exchange of information where relevant and appropriate.

4. Extent of involvement and health and safety

4.1 Extent of involvement
In most cases, the envisaged role of Audit Scotland staff is to support lead audit institutions on larger scale projects. In these circumstances our commitment to a project will be restricted to a specified resource, from a few days to several weeks, spread over the duration of the project. There may be a few small scale projects that we can undertake on our own, where the duration is limited to around three or four weeks (e.g. training courses).

Initially, we should concentrate on small scale, well defined projects that can be comfortably accommodated within existing workloads. This will most likely be achieved through
collaborative working with the UK NAO and Swedish NAO, although other opportunities should be considered as they arise.

In 2008/09 our target is to limit our involvement to around 40 weeks of international work spread across a pool of people.

4.2 Health and safety considerations
Audit Scotland has a clear responsibility to ensure the welfare of its employees at all times, including when they are working abroad. Our partner audit organisations such as the NAO, are very experienced in international activity and have established mechanisms in place to deal with issues should they arise when abroad. We will be advised by our partners as to what precautions we should take which will vary depending on the destination.

However, as a minimum we ensure that colleagues:

- are appropriately briefed and trained prior to working on overseas assignments. In most cases this will be provided by the lead audit organisation, and we will ensure that it meets the expectations of Audit Scotland as an employer
- know what to do in an emergency situation and that we are able to make contact with them at all times. Often overseas work will involve regular contact with the Foreign and Commonwealth Office.

Our employers insurance, renewed in July 2007, provides comprehensive cover for international travel and working abroad has no implications for death in service benefits.

5. Conclusion

Audit Scotland’s international activity presents good career development opportunities, both for those working abroad and for people involved in hosting visits. It can also build Audit Scotland’s profile and reputation in Europe and elsewhere. There is a great opportunity to share our experience and expertise with colleagues internationally and also for us to learn from other countries.
### VISITS AND DELEGATIONS TO AUDIT SCOTLAND - SUMMARY

<table>
<thead>
<tr>
<th>Year</th>
<th>Country</th>
<th>Body</th>
<th>Duration (Days)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>Norway</td>
<td>NKRF</td>
<td>1</td>
</tr>
<tr>
<td>2004</td>
<td>Russia</td>
<td>Russian Federation</td>
<td>2</td>
</tr>
<tr>
<td>2005</td>
<td>Denmark</td>
<td>Danish Audit Office</td>
<td>1</td>
</tr>
<tr>
<td>2005</td>
<td>Russia</td>
<td>Moscow Chamber of Audit</td>
<td>1</td>
</tr>
<tr>
<td>2005</td>
<td>Korea</td>
<td>Korean Board of Audit</td>
<td>1</td>
</tr>
<tr>
<td>2005</td>
<td>Estonia</td>
<td>Estonia NAO</td>
<td>2</td>
</tr>
<tr>
<td>2006</td>
<td>USA</td>
<td>Kansas Audit Office</td>
<td>2</td>
</tr>
<tr>
<td>2006</td>
<td>Sweden</td>
<td>Swedish NAO</td>
<td>2</td>
</tr>
<tr>
<td>2006</td>
<td>Mongolia</td>
<td>Mongolian NAO</td>
<td>1</td>
</tr>
<tr>
<td>2006</td>
<td>Japan</td>
<td>Japanese NAO</td>
<td>1</td>
</tr>
<tr>
<td>2006</td>
<td>Tanzania</td>
<td>Parliamentary delegation</td>
<td>1</td>
</tr>
<tr>
<td>2007</td>
<td>Malawi</td>
<td>Parliamentary delegation</td>
<td>1</td>
</tr>
<tr>
<td>2007</td>
<td>Russia</td>
<td>Russian Federal and Regional Archivists</td>
<td>1</td>
</tr>
<tr>
<td>2007</td>
<td>Pakistan</td>
<td>Pakistan NAO</td>
<td>1</td>
</tr>
<tr>
<td>2007</td>
<td>Uganda</td>
<td>Ugandan NAO and other public sector bodies</td>
<td>2</td>
</tr>
<tr>
<td>2007</td>
<td>Romania</td>
<td>Government Internal Audit (via FCO)</td>
<td>3</td>
</tr>
</tbody>
</table>
### Appendix 1 - Attachment 2

#### AUDIT SCOTLAND - SUMMARY OF OVERSEAS WORK

<table>
<thead>
<tr>
<th>Year</th>
<th>AS Staff</th>
<th>Contract body</th>
<th>Country</th>
<th>Activity</th>
<th>Duration</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>A W Anderson</td>
<td>NAO</td>
<td>Italy</td>
<td>External audit of UN body - UNICRI</td>
<td>2 weeks</td>
</tr>
<tr>
<td>2001</td>
<td>A W Anderson</td>
<td>NAO</td>
<td>Italy</td>
<td>External audit of UN body - UNICRI</td>
<td>2 weeks</td>
</tr>
<tr>
<td>2003</td>
<td>A W Anderson</td>
<td>NAO</td>
<td>Lithuania</td>
<td>EU: First Twinning Project; providing technical support and training to pilot audits</td>
<td>3 weeks</td>
</tr>
<tr>
<td>2004-05</td>
<td>A W Anderson</td>
<td>NAO</td>
<td>Lithuania</td>
<td>EU: Second Twinning Project; technical support and training to pilot audits</td>
<td>3 weeks</td>
</tr>
<tr>
<td>2004</td>
<td>M Bowman</td>
<td>NAO</td>
<td>Romania</td>
<td>Technical support on EAGGF audit</td>
<td>5 weeks</td>
</tr>
<tr>
<td>2005</td>
<td>A W Anderson</td>
<td>SIGMA</td>
<td>Malta</td>
<td>Participation as facilitator and presenter in EU training workshop for SAI’s</td>
<td>1 week</td>
</tr>
<tr>
<td>2005</td>
<td>A W Anderson</td>
<td>SIGMA</td>
<td>Estonia</td>
<td>Peer review of Estonian NAO – responsibility for financial audit</td>
<td>1 week</td>
</tr>
<tr>
<td>2005-06</td>
<td>A W Anderson</td>
<td>SIGMA</td>
<td>Lithuania</td>
<td>Peer review of Lithuanian NAO – responsibility for financial audit</td>
<td>7 weeks</td>
</tr>
<tr>
<td>2005-06</td>
<td>J Rundell</td>
<td>SIGMA</td>
<td>Bulgaria</td>
<td>Peer review of Bulgarian NAO – responsibility for financial audit</td>
<td>7 weeks</td>
</tr>
<tr>
<td>2006</td>
<td>A W Anderson</td>
<td>SIGMA</td>
<td>Estonia</td>
<td>Technical support to Estonian NAO on audit of WGA account</td>
<td>1 week</td>
</tr>
<tr>
<td>2006</td>
<td>A Cullen</td>
<td>NAO</td>
<td>Cyprus</td>
<td>Technical support and training on performance audit</td>
<td>5 weeks</td>
</tr>
<tr>
<td>2006</td>
<td>M Ferris</td>
<td>NAO</td>
<td>Uganda</td>
<td>Technical support on financial audit of municipalities</td>
<td>2 weeks</td>
</tr>
<tr>
<td>2007</td>
<td>Barbara Hurst</td>
<td></td>
<td>Bangladesh</td>
<td>Speaker at conference / workshop</td>
<td>1 week</td>
</tr>
<tr>
<td>2007</td>
<td>A W Anderson</td>
<td>NAO</td>
<td>Jordan</td>
<td>EU: Twinning Project; provision of training on financial audit</td>
<td>4 weeks</td>
</tr>
<tr>
<td>2007-08</td>
<td>A W Anderson</td>
<td>NAO</td>
<td>Jordan</td>
<td>EU: Twinning Project; technical support to pilot audits</td>
<td>5 weeks</td>
</tr>
<tr>
<td>2007-08</td>
<td>AN Other</td>
<td>NAO</td>
<td>Jordan</td>
<td>EU: Twinning Project; technical support to pilot audits</td>
<td>5 weeks</td>
</tr>
<tr>
<td>2007-08</td>
<td>AN Other</td>
<td>Swedish NAO</td>
<td>Bosnia/ Moldova</td>
<td>Technical support on quality control</td>
<td>6 weeks</td>
</tr>
</tbody>
</table>