

Budget Proposal

2019/20

Key Messages

Audit Scotland is committed to delivering value for money. The budget proposal for 2019/20 continues to focus on maintaining the quality of audit work to support the Auditor General for Scotland and the Accounts Commission in providing independent assurance to the people of Scotland that public money is spent properly and provides value for money.

Budget summary

Total Expenditure Budget

2019/20 £25,394k

(2018/19 £24,618k)

Cash terms +3.2%

Real terms +1.5%

Parliamentary funding

2019/20 £7,564k

(2018/19 £7,148k)

Cash terms +5.8%

Real terms +4.2%

Fee income

2019/20 £17,980k

(2018/19 £17,645k)

Cash terms +1.9%

Real terms +0.3%

Audit Scotland's proposed expenditure of £25,394k represents 0.06% of the £40 billion total expenditure on which we provide assurance. Audit fees to audited bodies contribute 70% towards the total costs for Audit Scotland and 30% is funded by the Scottish Parliament.

The Total Resource Requirement in the 2019/20 budget proposal is £7,564k, an increase of £416k from the approved requirement in 2018/19. This is a 4.2% increase in real terms at 2018/19 prices. This increase largely relates to people costs. These are explained in more detail throughout this submission.

These proposals will:

- deliver core work on public audit in Scotland covering over 220 organisations including the Scottish Government, the NHS in Scotland, local councils, police and fire authorities, integrated joint boards and further education colleges. These organisations spend over £40 billion of public money annually
- provide support for the Scottish Parliament, including investment in scrutiny and audit of Scotland's new financial powers
- deliver the rolling programme of performance audits on behalf of the Auditor General and the Accounts Commission
- provide enhanced audit quality review and reporting
- limit 2018/19 audit fee increases to an overall average increase of 1.6% from 2017/18 charges, a real terms increase of 0.1% (more detail on the fee strategy is provided in Appendix 3)
- continue to enhance our capacity for audit work arising from new financial powers
- increase management contingency to 1.2% of total expenditure budget to cover significant uncertainties in expenditure and income
- continue to provide transparent funding arrangements.

Introduction

1. Audit Scotland provides services to the Auditor General for Scotland and the Accounts Commission. We carry out annual external audits of public bodies and programmes of performance and Best Value audits across the Scottish public sector. We audit around 220 public bodies.
2. Audit Scotland's vision is to be a world class audit organisation that improves the use of public money. To achieve this vision, meet relevant professional standards and retain the independence of audit it is important that appropriate resources are available for our work and that we deliver value for money.
3. This paper presents our budget proposal for the 2019/20 financial year with the Funding & Fee Strategy included in Appendix 3. The budget continues the planned investment in auditing new financial powers and audit quality.
4. The budget proposal for 2019/20 includes information on the budgeted costs for each audit sector.
5. We have provided updated projections of resource requirements for two further years to 2021/22.
6. This paper is presented in three parts.
 - Context
 - Resource Requirements 2019/20
 - Cost projections 2020/21 to 2021/22

Appendix 1 - Net Expenditure Statement expenditure trends

Appendix 2 - Sector cost analysis 2019/20

Appendix 3 – Funding and Fee Strategy

Context

2019/20 uncertainties

7. The budget for 2019/20 has been prepared in the context of a number of significant uncertainties:
 - the impact of the UK autumn budget statement on Scottish budgets
 - public sector pay policy
 - timing of the implementation of the financial aspects of the Scotland Act 2016
 - the impact of the UK leaving the European Union
 - financial assumptions used to estimate International Accounting Standard 19 (IAS 19) defined benefit pension costs.

Audit work 2019/20

8. Core public audit work in Scotland covers over 220 organisations that spend around £40 billion of public money annually. Our work programme will continue to focus on supporting parliament in scrutinising the use of public money and we will deliver national performance audits in line with our five-year rolling programme. Details of our core work programme are described on page 9. We will continue to support the Accounts Commission to deliver its comprehensive programme of best value assurance, financial and performance audit across local government.
9. In addition to the core work programme, legislative change has created new audits and additional audit requirements including:
 - Social Security Scotland began operating as an executive agency on 1 September 2018 and will be responsible for delivering ten devolved benefits totalling around £3.3 billion of spending annually. The agency will take on operational responsibility for devolved benefits on a phased basis through to the end of the current Parliamentary session in 2021. Audit Scotland is the appointed auditor for the agency and the payments it administers, and we have established a new team to lead on all financial and performance audit work on social security.
 - Scotland's public finances are fundamentally changing, with the Scottish budget becoming increasingly complex and directly linked to economic performance. We plan to build capacity to assess and report on overall fiscal management and financial sustainability to inform and support Parliamentary scrutiny.
 - A share of VAT is scheduled to be assigned to the Scottish budget from April 2019. During 2019/20 we will work with the National Audit Office (NAO) to develop arrangements to provide additional assurance to the Scottish Parliament on VAT assignment.
 - Our work with the NAO on Scottish income tax is expected to increase in 2019/20. This will allow us to provide additional assurance to the Scottish Parliament on HMRC's administration of different tax bands and rates for Scottish taxpayers.

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- The UK is expected to leave the European Union on 29 March 2019. During 2018/19 we have been working to understand the potential implications and risks of EU withdrawal for the public sector and how public bodies are responding to this. Work in 2019/20 will increase as the outcome of withdrawal negotiations becomes clearer.
10. High quality audit work remains a priority for Audit Scotland. We continue to invest in a programme of independent external review to assure the Auditor General and the Accounts Commission of the quality of audit. This investment also allows us to promote continuous improvement in audit quality and provide professional and technical leadership.

Resource Requirements 2019/20

11. The total Resource Requirement for 2019/20 requested for approval by the SCPA is £7,564k. This represents an overall cash increase of £416k on the approved 2018/19 budget. This is a 4.2% increase in real terms at 2018/19 prices.
12. The following table summarises the total Resource Requirements included in the 2019/20 budget proposal and provides a comparison with the original and approved 2018/19 budget. More detailed information on expenditure categories is provided in Appendix 1.

Table 1 – Summary of resource requirements for 2019/20

Resource requirements				Movement		
	Original 2018/19	Approved 2018/19	Proposed 2019/20	Actual	Actual	Real Prices
	£000	£000	£000	£000	%	%
Expenditure						
People costs	15,900	15,919	16,819	900	5.7%	4.0%
Other administrative costs	8,456	8,699	8,575	-124	-1.4%	-3.0%
Gross administrative costs	24,356	24,618	25,394	776	3.2%	1.5%
Income						
Income from charges to audited bodies	17,383	17,645	17,980	335	1.9%	0.3%
Bank interest and miscellaneous income	0	0	0	0	0.0%	0.0%
Total income	17,383	17,645	17,980	335	1.9%	0.3%
Net Operating Cost	6,973	6,973	7,414	441	6.3%	4.6%
Capital	175	175	150	-25	-14.3%	-15.6%
TOTAL RESOURCE REQUIREMENT	7,148	7,148	7,564	416	5.8%	4.2%

Resource analysis

13. Our Total Resource Requirement proposals for 2019/20 are £416k more than provided in the 2018/19 budget, a real terms (2018/19 prices) increase of 4.2%.

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14. The 2019/20 budget proposal increases people costs by £900k; other administrative costs decrease by £124k and income increases by £335k from the approved 2018/19 budget. Full details of the budget movements are set out below.
 15. Legislation does not allow us to hold reserves and we are required to break even each financial year, which limits the flexibility to meet unexpected budget pressures. A key factor in budget preparation is the timing of budget statements from the UK and Scottish Governments and the potential impact these announcements will have on the budget assumptions used in preparing our proposal.

Principal budget assumptions - 2019/20 to 2021/22

16. The principal assumptions underlying the budget proposal for 2019/20 and our cost projections for the two following years are set out below.

2018/19 Budget

17. During 2018/19 the total resource requirement remained at the original budget estimate of £7,148k. However, following the submission and approval of our 2018/19 budget proposal we reviewed and updated our budget following the assumptions announced in the Scottish Government budget statement. We identified adjustments that required the application of increases in base expenditure and income budgets of £262k, leading to a revised total expenditure budget of £24,618k and a revised total fee income budget of £17,645k. These budget adjustments were approved by Audit Scotland Board on 28 March 2018 and were managed within existing resources.
18. In line with usual practice, we have provided a separate proposal for Spring Budget Revision 2018/19, which seeks an adjustment to meet non-cash pension cost adjustments. This will be dealt with through the Annually Managed Expenditure (AME) process agreed between the Scottish Government and HM Treasury. The estimate for 2018/19 is £2.9m, based on information provided by the pension scheme actuary.

New Financial Powers and Constitutional change

19. As indicated to the Commission in our Budget Proposal 2018/19, we have planned a phased increase in resources to respond to the Parliament's new financial powers. The 2019/20 budget includes an increase of £285k to fund people costs (estimated at 4.5 w.t.e. staff). As financial powers transfer on a phased basis the full projected funding requirement (subject to implementation uncertainty) remains at £1,273k by 2020/21, equivalent to 20 w.t.e. staff.
20. We are continuing to work on the implications of the UK leaving the European Union and we expect this activity to increase in 2019/20 once we know the outcome of the withdrawal negotiations. This budget assumes continuity in the bodies and accounts we will audit in 2019/20 and in our responsibilities.

Work programme 2019/20 to 2021/22

21. In July 2018 we published a Corporate Plan for 2018 - 2021, describing our strategy and work plans for the three years from 2018. The plan can be found on the Audit Scotland website <http://www.audit-scotland.gov.uk/report/corporate-plan-2018-21>.
22. Our work programme for 2019/20 has a strong emphasis on supporting Parliament to implement Scotland's new financial powers and the recommendations of the Budget Process Review Group (BPRG).
23. We have a five-year rolling programme of national performance audits which is determined by the Auditor General for Scotland and the Accounts Commission for Scotland. The plan is risk based and refreshed following consultation with stakeholders.
24. The programme is designed to reflect changes in the way public services are delivered and covers areas of major investment, the effectiveness of policy implementation and how public agencies work together.
25. The programme for 2019/20 includes audits on:
 - Scotland's new financial powers, including audit work on the implementation and operation of Scotland's new Social Security arrangements
 - Health and social care integration
 - Improving educational outcomes
 - Innovative financing, such as City Deals and the use of Non-Profit Distributing (NPD) funding models
 - The effectiveness of skills planning and investment in supporting economic growth
 - Higher education finances
 - Workforce planning
 - The use of digital technology to improve public services
 - The impact of the UK's decision to leave the EU on Scotland's public finances and public services.
26. The programme includes overview reports on the performance of the NHS, local government and colleges, to assess how effectively those sectors perform and how well they are responding to strategic challenges such as reducing resources, recruitment difficulties and demographic change.
27. The programme also includes provision for statutory reports to be brought to the Parliament by the Auditor General for Scotland on significant issues arising from the annual financial audit process, or to the Accounts Commission for Scotland from the Controller of Audit.

Pay and Pensions

28. Our current pay deal ends on 31 March 2019. Audit Scotland negotiates pay awards on an annual basis and actual awards will be determined as part of this process. For the 2019/20

budget we have assumed that the new arrangements will add 3% per annum to our pay bill (2% for increases in pay scales and up to 1% for pay progression).

29. For planning purposes only we have assumed that in 2019/20 and 2020/21 pay levels will continue to increase by 2% per annum based on the assumption in the Scottish Government Medium Term Financial Outlook.
30. The majority of Audit Scotland's staff are members of the Local Government Pension Scheme and employer contributions have increased by 0.5% in line with the scheme actuary recommendations reported in the 2017 actuarial valuation.
31. Our budget proposal does not include resource to meet non-cash accounting adjustments required under International Accounting Standard 19 (IAS 19). As in previous years, we will seek an adjustment as part of the Spring Budget Revision to meet non-cash pension cost adjustments. The estimate for 2018/19 is £2.9m based on information provided by the pension scheme actuary. The 2019/20 budget proposal has been prepared on the assumption that non-cash pension costs adjustments will continue to be funded through the Spring Budget Revision process.

Appointed auditors (firms)

32. Payments to appointed auditors (firms) for 2018/19 audits will be in accordance with the remuneration increases applied to our own staff at April 2018. For 2019/20 and 2020/21 audits it is assumed that auditor remuneration will increase by 2% per annum.

Management contingency

33. Given the current level of uncertainty we have increased the management contingency by £150k to £300k, which is 1.2% of the total expenditure budget. This will be used to meet reasonable adverse movements including any relating to the uncertainties listed on page 5 of this proposal.
34. If there are significant changes to the budget assumptions on which this proposal is based, we will do our best to manage within the overall budget, but it may be necessary to seek in-year discussions with the SCPA.

Quality

35. The new [Audit Quality Framework](#) published in 2017, provides assurance that work is to be of the highest standard, meeting international audit standards and the requirements of the Auditor General and the Accounts Commission as set out in the Code of Audit Practice. Our 2019/20 budget proposal and projections for 2020/21 and 2021/22 continue to invest £250k to support enhanced audit quality inspection and reporting. The [Audit Quality Annual Report 2017/18](#) sets out the results from last year.

Property

36. Our budget proposals for 2019/20 and our projections for 2020/21 and 2021/22 assume continued occupation of our three offices in Edinburgh, Glasgow and Inverness which are occupied on long-term leases. Property costs in 2019/20 are planned to be £31k (3.3%) less than the 2018/19 budget due to savings in business rates and utilities.

Training and organisational development

37. We will continue to develop our business to improve the way we work and to ensure we deliver efficiencies while maintaining the quality of our work. Our Learning & Development strategy guides our budget allocation and is updated annually to support our corporate plan. We remain committed to our graduate trainee, modern apprentice and student placement programmes which support our workforce planning and long-term talent development.

GDP deflators

38. We have assumed a GDP deflator of 1.6% for 2019/20. For 2020/21 and 2021/22 the deflators are 1.7% for each financial year. This is consistent with the September 2018 rates published by HM Treasury. These are used to remove the effect of price changes (inflation) when comparing expenditure over time.

Net Expenditure

39. An analysis of 2019/20 net expenditure by category is attached in Appendix 1 which also provides information on actual net expenditure levels in 2016/17 and 2017/18, the original budget for 2018/19 and the approved budget for 2018/19.
40. Net expenditure increases in cash terms by £441k from the 2018/19 budget, a real terms increase of 4.6%.
41. Excluding the budget for new financial powers, management contingency and the National Fraud Initiative, the cash increase is £206k, a real terms increase of 1.3%.
42. The table below provides an analysis of the movement from the net approved expenditure in the 2018/19 budget to the proposed 2019/20 net expenditure resource requirement.

	£k	£k
2018/19 Net Approved Expenditure		6,973
Analysis of budget change		
New Financial Powers	+285	
April 2019 pay growth	+528	
Pension contributions increase	+87	
Increase in People Costs		+900
National Fraud Initiative	-200	
Management contingency	+150	
Other administration budget savings ¹	-138	
Approved Auditors	+64	
Other administrative costs decrease		-124
Income increase		-335
2019/20 Net Expenditure Resource Requirement		7,414

¹ Main budget savings relate to business rates, travel & subsistence and depreciation

People Costs

- 43. People costs represent 66% of our expenditure budget proposals and our 2019/20 budget requirement is £900k higher in cash terms than the approved 2018/19 budget. In real terms this is an increase of £635k (4.0%).
- 44. The main drivers of the increase are annual pay growth, employer pension contributions and staffing for new financial powers.
- 45. The proposed budget increases the established staffing requirement by 4.5 w.t.e. from the 2018/19 budget, providing a total staffing of 282.5 w.t.e. in 2019/20. This increase is attributable to new financial powers resourcing requirements.

Other administrative costs

- 46. Other administrative costs are £124k lower in the proposed 2019/20 budget compared to the approved 2018/19 budget. The main changes are an increase of £150k in the management contingency and a reduction of £200k for the biennial National Fraud Initiative. The balance of £74k from 2018/19 is attributable to various identified budget reductions and increases.

Income

- 47. Audit Scotland is funded by fees and the Scottish Consolidated Fund, approved by Parliament. Money voted by Parliament funds the annual audits that under legislation we cannot charge for, together with performance audit work within the Auditor General's remit.
- 48. Our funding and fee arrangements are set out in our Funding and Fee Strategy at Appendix 3.
- 49. As highlighted on page 8, we revised our approved SCPA budget for 2018/19 to recognise in-year agreed base fee increases from £17,383k to a revised figure of £17,645k. Taking cognisance of this budget adjustment the actual increase to the proposed fees budget for 2019/20 is 1.9%, an overall increase in real terms of 0.3%.

50. Income from charges to audited bodies by financial year is provided below:

Table 2 – Income from charges to audited bodies

	Actual	Actual	Original	Revised	Proposed
	2016/17	2017/18	Budget	Fee	Budget
	£000	£000	£000	Budget	£000
			2018/19	2018/19	2019/20
Local authorities	11,531	11,565	11,153	11,372	11,636
NHS bodies	3,584	2,999	2,862	2,862	2,866
Further education colleges	540	515	492	522	540
Scottish Government depts. and sponsored bodies	2,827	2,811	2,876	2,889	2,938
Total income from charges to audited bodies	18,482	17,890	17,383	17,645	17,980
% cash increase in fees from approved 2018/19 budget					1.9%

51. For 2018/19 audits the proposed average fee increase is 1.6%, a real terms increase of 0.1% on 2017/18 fees.

52. Appendix 2 provides an analysis of the 2019/20 budget by sector and funding source.

Capital

53. The proposed capital budget for 2019/20 is £150k, a reduction of £25k on 2018/19. The investment will continue to support our rolling information technology programme. Details of the 2019/20 capital requirements are provided below:

	£000
IT Hardware	75
Software	75
TOTAL	150

Cost savings and efficiencies

54. Our gross expenditure, excluding IAS 19 pension costs, has reduced by 7.5% in real terms from 2012/13. We have delivered a £5.6 million cumulative reduction in expenditure in real terms over the 5-year period 2013/14 to 2017/18.
55. We have delivered significant savings and efficiencies in respect of audit firm contract costs, property rationalisation, travel & subsistence, energy efficiency and business re-structuring.
56. These savings have enabled us to reduce the fees charged to audited bodies at a time when they have been required to make substantial savings to meet increased service demand.
57. In this budget proposal we continue to deliver those longer-term reductions in respect of payments to audit firms, capital investment, property costs and other administration costs.
58. In addition to these tangible savings we continue to identify opportunities to deliver efficiencies where we can meet additional demands from within our existing resources.

Cost projections 2020/21 to 2021/22

59. In addition to our budget proposal for 2019/20, we have prepared projections for the following two years.

Principal assumptions

60. The principal assumptions for our 2019/20 budget proposals and projections for 2020/21 and 2021/22 are set out on pages 8 to 11 of this submission.

Projections

61. The table below highlights Audit Scotland's budget projections for the period 2019/20 to 2021/22.

Table 3 – Budget Projections for 2019/20 to 2021/22

	Original	Approved	Proposed	Projection	
	Budget	Budget	Budget	2020/21	2021/22
	2018/19	2018/19	2019/20	2020/21	2021/22
	£000	£000	£000	£000	£000
Expenditure					
People costs	15,900	15,919	16,819	17,633	18,346
Other administrative costs	8,456	8,699	8,575	8,866	8,704
Gross administrative costs	24,356	24,618	25,394	26,499	27,050
Corporation Tax payable	0	0	0	0	0
Total Income	(17,383)	(17,645)	(17,980)	(18,322)	(18,670)
Net Expenditure Requirement	6,973	6,973	7,414	8,177	8,380
Capital	175	175	150	150	150
Total Resource Requirement	7,148	7,148	7,564	8,327	8,530
Annual GDP deflators			-1.6%	-1.7%	-1.7%
Net cost at 2018/19 prices			7,445	8,059	8,117
Staff Projections (w.t.e.)	278	278	282.5	286.5	290

62. People costs are rising in cash terms in all years of the projection. Explanations of the movements in 2019/20 have been provided on page 13. The increased costs in the following years are due to pay growth assumptions and increased resources for new financial powers work.

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63. Other administrative costs increase in 2020/21 and then decrease in 2021/22 mainly from the National Fraud Initiative costs which occur every two years.

SCPA approved funding

64. In 2019/20 our budget proposals require a cash increase of £416k in total funding from that approved for 2018/19. In real price terms (2018/19 prices) this represents a 4.2% increase.
65. Revenue support from the Scottish Consolidated Fund provides funding for:
- non-chargeable Central Government audits
 - performance audits
 - the Auditor General
 - the Accounts Commission
 - a proportion of Audit Scotland senior management
 - management contingency
 - auditing related to the new financial powers, fiscal framework and social security
 - assuring the quality of public audit in Scotland.

Appendix 1 - Net Expenditure Statement expenditure trends

	Actual		Original 2018-19 Budget £k	Approved 2018-19 Budget £k	Proposed 2019-20 Budget £k
	2016~17 £k	2017~18 £k			
People Costs					
Salaries and temporary staff	11,930	11,861	12,172	12,128	12,821
Employers on costs	3,305	3,421	3,439	3,496	3,699
Pension adjustments	894	1,858	125	125	125
	16,129	17,140	15,736	15,749	16,645
Accounts Commission members	157	153	164	170	174
Total people costs	16,286	17,293	15,900	15,919	16,819
Fees and expenses paid to external firms	4,987	4,355	3,991	4,125	4,189
Other operating expenditure					
Rent & Rates	550	519	525	525	511
Other accommodation Costs	346	420	410	410	393
Travel & Subsistence	853	855	894	894	852
Legal & Professional Fees	615	474	765	921	879
Stationery & printing	141	121	148	148	131
Training & organisational development	484	429	528	483	481
Staff recruitment	109	128	105	105	130
Communications (telephone, postage)	37	26	46	44	38
Insurance	72	80	79	79	79
Information technology	413	414	456	458	444
Internal Audit	29	28	30	30	30
External Audit - financial statements	27	27	30	30	30
Other	72	35	65	63	65
Depreciation	354	371	384	384	323
Total other operating expenditure	4,102	3,927	4,465	4,574	4,386
TOTAL OPERATING EXPENDITURE	25,375	25,575	24,356	24,618	25,394
Corporation Tax payable	7	1	0	0	0
Income					
Fees and charges payable	18,482	17,890	17,383	17,645	17,980
Bank Interest	36	7	0	0	0
Miscellaneous income	140	58	0	0	0
Other finance income - pensions related	-626	-893	0	0	0
TOTAL	18,032	17,062	17,383	17,645	17,980
NET EXPENDITURE AFTER TAX	7,350	8,514	6,973	6,973	7,414

Appendix 2 - Sector cost analysis 2019/20

Expenditure budget	Fees					SCPA Parliament £k	TOTAL £k
	Local Authorities £k	NHS Bodies £k	Further Education £k	Central Government £k	Total Fees £k		
Auditor General for Scotland	0	0	0	0	0	236	236
Accounts Commission	0	0	0	0	0	184	184
Governance	114	24	1	33	172	442	614
Audit Quality and Appointments, Professional Support incl. NFI	333	109	21	104	567	78	645
External Audit firms	2,102	878	432	512	3,924	264	4,188
Audit Services	4,452	1,372	61	1,633	7,518	2,254	9,772
Performance and Best Value audit	2,060	0	0	0	2,060	1,827	3,887
Corporate Services and overheads	2,575	483	25	656	3,739	2,129	5,868
Total budgeted expenditure	11,636	2,866	540	2,938	17,980	7,414	25,394
Fee income	11,636	2,866	540	2,938	17,980	0	17,980
Support from Parliament	0	0	0	0	0	7,414	7,414
Total Income	11,636	2,866	540	2,938	17,980	7,414	25,394
Surplus (Deficit)	0	0	0	0	0	0	0
% Surplus / (Deficit)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Appendix 3 – Funding and Fee Strategy

Objectives of the funding and fee setting arrangements

1. The overall aim of the funding & fee setting arrangements is to support Audit Scotland to provide high quality independent public audit in Scotland whilst keeping audit fees charges to the minimum necessary. The objectives for the arrangements are that they:
 - comply with statute
 - maintain the independence of auditors
 - reflect the way in which public services are organised and audited
 - are transparent and easy to understand
 - are simple to operate
 - are sustainable
 - are not volatile from year to year without reason.
2. Audit Scotland is required to aim to break even on audit work that is charged for, taking one year with another, either for each audit or for classes of audits. We have determined each sector as being a class of audits.
3. Audit Scotland considers that audit fees should be set with the objective of recovering the full cost of audit work in each sector.
4. Audit appointments are made by the Auditor General or the Accounts Commission rather than by audited bodies themselves thereby enhancing the independence of external audit. The identity or location of the appointed auditor could therefore affect the total cost of undertaking the audit. Audit Scotland considers that an audited body should, as far as possible, pay the same audit fee irrespective of the location or identity of the audit provider. We therefore pool some costs such as travel and subsistence and savings from the audit procurement exercise and apportion them between audited bodies within the same sector in proportion to the levels of direct auditor remuneration.

Parliamentary funding of audit work

5. Parliamentary funding pays for all financial audits of central government bodies that we cannot charge for and performance audit work in central government, NHS, further education and Scottish Water. It also pays for the costs of supporting Parliament and its committees, the national fraud initiative and the costs of the Auditor General, Accounts Commission and Audit Scotland Board.

Audit work subject to fees

6. Local government has its own democratic structure and the Accounts Commission appoints auditors and oversees performance and best value audit arrangements. Local government

funding includes an amount for scrutiny costs such as best value audit and therefore local government bodies pay for all audit work across the sector.

7. The fee setting arrangements therefore cover all local government audit work, including integrated joint boards, and the costs of annual audit work in the NHS, central government, Scottish Water and further education colleges. The same principles are used to calculate notional fees for the central government audits that we cannot charge for.

Fee setting process and governance

8. Fee setting is one part of the annual budget process. During June to August draft cost budgets are prepared for the following financial year. The implications of these for the levels of charges and Parliamentary funding are considered, including new audit burdens, cost pressures, efficiency targets, outturn from the previous financial year and any potential End Year Flexibility available.
9. Budget proposals, including levels of charges, are presented to the Audit Scotland Board for discussion and approval, before being submitted to the SCPA for their consideration as part of the Budget Bill process.
10. Because charges are set for audit years that run from approximately November to October, the fee setting process related to each financial year covers two audit years. Therefore, in September 2018, Audit Scotland confirmed the levels of charges for the 2018/19 audits which were provisionally set as part of the 2018/19 financial year budget in December 2017. We also indicate our plans for charges over the next two audit years.

Calculating audit fees

11. Audited bodies will receive the following breakdown of the total audit fee from 2018/19 audits and prior year fees:
 - Auditor remuneration
 - Pooled costs
 - Performance audit and best value (where relevant)
 - Audit Scotland costs

Auditor remuneration

12. The auditor remuneration element is based on our assessment of the audit input likely to be required to deliver an audit that complies with the Code of Audit Practice for a body of that size facing the normal risks for its part of the public sector. The fee assumes that the body is well governed, has effective internal controls and prepares complete draft accounts in accordance with the agreed timetable and takes account of actual recent costs of carrying out the audit.
13. Auditors and audited bodies can agree remuneration up to 10 per cent above the level set either where local circumstances mean that the implicit assumptions are not being met or

where significant local issues require additional work to be undertaken, for example a new and complex accounting issue or a history of accounting errors. In exceptional circumstances fees can be agreed above the 10% limit with the prior agreement of Audit Scotland.

14. If the auditor and audited body agree that a permanent reduction in remuneration is appropriate, Audit Scotland will consider the proposal taking account of any potential impact on audit quality.

Pooled items

15. To achieve the aim that as far as possible an audited body should pay the same fee irrespective of identity or location of the auditor we pool certain costs which would otherwise lead to different fees being charged depending on the identity or location of the appointed auditor. These pooled costs are currently apportioned across the audited bodies in each sector in proportion to the expected level of auditor remuneration. The pooled costs are:
 - travel and subsistence costs
 - procurement savings
 - any difference between the costs of Audit Scotland teams and the auditor remuneration for their audits
 - recoverable input VAT (local government only).

Performance audit and best value audit costs (local government only)

16. Local government bodies pay for the cost of all audit work carried out in the sector including national performance audits, best value audits and housing benefit audits. All councils carry out a similar range of services and therefore all can benefit from the recommendations for improvement and good practices identified in best value reports at other councils.
17. For performance audit work, including the costs of responding to correspondence from elected representatives and members of the public about issues in local government bodies, the budgeted costs are apportioned between significant local government bodies (councils, Integration Joint Boards and Strathclyde Passenger Transport) in proportion to the level of auditor remuneration.
18. For best value audit and housing benefit audit the amount of money received by councils towards the cost of this work is apportioned between the 32 councils only on the basis of relative populations in June 2015, being a proxy for the distribution of the funding through the local government settlement. We fully recognise that this approach to charging for best value does not reflect the actual costs incurred in relation to each council but believe that it is appropriate when considering the way in which councils were funded for it.

Audit support costs

19. Audit Scotland incurs costs in making audit appointments, reviewing, reporting and providing assurance on audit quality, providing technical guidance and professional support to all

appointed auditors and contributing to the development of auditing and accounting guidance within Scotland and across the UK. These costs are apportioned across all audits relative to the level of auditor remuneration.

Audit fees for 2018/19 audits

Fee levels

20. An overall increase in average fees of 1.6% for 2018/19 audits leads to a real terms increase of 0.1% on 2017/18 charges.
21. As shown in Table 1 there is variation around this average between sectors. These differences arise from the agreed application of cost apportionment methods across all sectors set in the funding and fees review carried out in 2016.

Table 1

	Average change on 2017/18 charges	Real terms
Local government	+2.0%	+0.5%
NHS	0.0%	-1.5%
Central government - chargeable audits	+1.9%	+0.5%
Further education	+2.0%	+0.5%
Overall average	+1.6%	+0.1%

Fee movements

22. The fee movements shown in Table 1 are based on achieving a break-even position for the 2019/20 financial year in all sectors.
23. Within sectors there will be a range of decreases and increases which reflect the actual costs of undertaking each audit and the consequences of implementing simpler and more transparent apportionment of pooled costs across and within sectors.
 - Local government - council increases will range from 1.7% to 2.0% and other local government bodies will see fees increase by an average of 3.0%.
 - NHS – except for two bodies that require an increase to reflect audit resource costs the remaining mainland, island and special health boards will see no change in fees.
 - Central government chargeable bodies will generally see average increases of 1.9%.
 - Further education - college fees will increase on average 2.0%.

Future years

24. For 2019/20 and 2020/21 audits we aim to keep increases across all sectors at levels no higher than the average increase applied to the 2018/19 audits.

Hourly rates

25. Hourly rates are calculated for each grade of staff. The rates are based on the average direct costs of the role (such as salaries, national insurance and pension contributions) and indirect costs (such as property costs, and corporate support costs including IT, finance and human resources).

26. For the 2018/19 financial year the hourly rates used to cost audit work are:

	2017/18	2018/19
Trainees	£48	£44
Business support specialist	£22	£20
Audit/support officer	£38	£39
Auditor	£43	£43
Senior auditor	£59	£63
Manager	£70	£76
Senior manager	£88	£93
Directors and Assistant Directors	£148	£155

27. The rates for the 2019/20 financial year will be calculated once the budget has been finalised.