

Public audit in Scotland

A strategic statement by the Auditor General

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Auditor General for Scotland

The Auditor General for Scotland is the Parliament's watchdog for ensuring propriety and value for money in the spending of public funds.

He is responsible for investigating whether public spending bodies achieve the best possible value for money and adhere to the highest standards of financial management.

He is independent and not subject to the control of any member of the Scottish Executive or the Parliament.

The Auditor General is responsible for securing the audit of the Scottish Executive and most other public sector bodies except local authorities and fire and police boards.

The following bodies fall within the remit of the Auditor General:

- departments of the Scottish Executive eg the Department of Health
- executive agencies eg the Prison Service, Historic Scotland
- NHS boards and trusts
- further education colleges
- water authorities
- NDPBs and others eg Scottish Enterprise.

Audit Scotland

Audit Scotland is a statutory body set up in April 2000, under the Public Finance and Accountability (Scotland) Act 2000. It provides services to both the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Executive and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

Introduction

As Auditor General I am responsible for securing and reporting the audit of the accounts of a wide range of public bodies in Scotland and also for undertaking examinations into the economy, efficiency and effectiveness with which resources are used (commonly referred to as value for money studies). The Accounts Commission for Scotland has similar responsibilities for local authorities. Neither the Auditor General nor the Accounts Commission directly employ staff. Audit Scotland employs staff who provide services to both the Auditor General and the Accounts Commission.

It is important to have a strategy for public audit in Scotland. This strategic statement has two purposes. It gives me an opportunity to outline my suggestions for the direction and priorities for public audit over the next three years. Secondly, this statement provides a framework within which Audit Scotland, as the service provider, can formulate its corporate plan. Audit Scotland must also take into account the published strategy of the Accounts Commission.

The role of public audit

With the creation of the Scottish Parliament, public audit has taken on a new significance in Scotland, because it has an important role in supporting effective democratic scrutiny. Public audit can provide independent assurance on standards of financial stewardship and governance in public bodies. Audit can also provide objective evidence on the performance of these bodies and the audit process can help to identify scope for improvements in both the management and delivery of public services.

Citizens as taxpayers have a right to know whether public bodies are spending public money properly, wisely and well. I am committed to a public audit regime which is objective, rigorous, transparent, open and fair, in order that reports by auditors allow citizens to take an informed view of the management of public money.

It is the responsibility of the management of public bodies to use public funds properly, wisely and well and it is the duty of auditors to report in public if they find that stewardship of public funds has been inadequate. However, I expect auditors, whenever possible, to work with managers in developing an approach to scrutiny which promotes and supports improvements in performance rather than concentrating upon past failures.

In assessing the performance of public bodies, a key issue is the quality and standard of services received by the public. The work of audit should take into account the experience of the users of services.

These expectations are captured in the proposed Mission Statement of Audit Scotland.

Audit Scotland Mission Statement

Audit Scotland will provide high-quality services to the Auditor General and the Accounts Commission. We will support effective democratic scrutiny by providing independent, objective assurance on governance, financial stewardship and performance. We will also support continuous improvement in public services and give priority to the interests of the people of Scotland.

I and the Accounts Commission believe that public audit must be based on three principles:

- the independence of public sector auditors from the organisations being audited
- the wide scope of public audit, covering not only the audit of financial statements, but also regularity, probity, value for money and governance
- the ability of public auditors to make the results of their audits available to elected representatives and to the public.

The wide application of these principles is particularly important in relation to the devolved budget of the Scottish Parliament. Of the £19.8 billion in the Scottish budget for 2001/02, less than 20% is spent directly by the Scottish Executive. About 33% (£6.5 billion) is spent by local government and 31% (£6.1 billion) by NHS bodies. The six largest NDPBs spend about 10% (£1.96 billion) and Executive Agencies spend just under 5% (£0.92 billion). The rest is spent on NHS and teachers' pensions, EU support schemes and the Parliament's own requirements. Most spending is therefore incurred by public bodies which are at arm's length from both the Scottish Executive and the Parliament. Robust and effective audit reporting will assist the Parliament in holding to account about 200 public bodies which spend most of the Parliament's budget. In each of these bodies, there is an external auditor appointed by me (or by the Accounts Commission) who can be an independent local resource for conducting examinations and reporting on the performance of arms-length organisations. Public audit can therefore provide assurance to the Scottish Executive and the Parliament that local management have suitable performance targets and action plans in place, and audit can report on changes in performance in future years.

Some important bodies spending significant sums of public money, for example universities and local enterprise companies, are not covered by the new audit arrangements. In my opinion, it would be appropriate for the Auditor General to be given rights of access to bodies such as these, in order that examinations may be undertaken of the economy, efficiency and effectiveness with which they use resources.

Themes for Audit Scotland's corporate plan

The Scottish Parliament and the Scottish Executive are bringing about significant changes in public services, with challenging and wide-ranging policy commitments. Key developments include:

- more wide-ranging and detailed scrutiny of public spending
- the comprehensive spending review, with additional resources concentrated mainly in education and health
- the introduction of three year planning and budgeting, and resource accounting and budgeting
- new ways of bringing private money into the public sector including the private finance initiative, public private partnerships, large scale transfers of council housing to new landlords, and a range of other partnership projects
- the modernising government agenda with an emphasis on:
 - finding solutions that work
 - increased flexibility to meet the needs of individuals
 - clearer measurement of and accountability for performance
 - e-government.

In this context, ten themes can be identified for consideration and action by Audit Scotland:

- supporting democratic scrutiny
- focusing on governance and financial stewardship
- challenging and supporting public bodies to achieve continuous improvement in their services
- responding to new forms of accountability
- taking a citizen perspective
- using information effectively to monitor and assess performance
- working with auditors to develop a relationship which is both innovative and responsive, while continuing to improve quality and efficiency
- strengthening partnerships with regulators, inspectors and funding bodies
- working with other audit agencies
- establishing Audit Scotland as an effective, well managed organisation which meets the standards expected of other public bodies.

Supporting democratic scrutiny

The creation of the Scottish Parliament has greatly strengthened the arrangements for holding Ministers, civil servants and the managers of public bodies to account for the use of public funds. Audit provides information which the Parliament needs to reach judgements on regularity, probity and value for money.

The Scottish Parliament and the Executive have demonstrated, in practical ways, a commitment to modern ways of working. An important attribute of the Parliament is the prominent role played by committees. Reports by the Auditor General are considered by the Audit Committee, which usually decides, in relation to significant

issues, to take evidence from accountable officers and sometimes other witnesses, before making a report of its findings and conclusions to the Parliament. The Audit Committee has recognised that the process of holding to account can take different forms. In particular, the Audit Committee has agreed that there is a requirement for three types of reports from the Auditor General:

- reports on particular issues of concern to the Parliament where there is evidence of poor management
- overview reports of financial performance and stewardship which look at sectors as a whole (eg the health service and further education). These reports will highlight any risk areas affecting the sector which have been identified in reports of local auditors, and they may mention significant problems arising in individual bodies. They may also comment on sector-wide performance matters arising from performance audit studies. Overview reports will highlight issues requiring particular attention from managers and external auditors in ensuing years
- performance reports. These can be “baseline reports” which are a snapshot of recent performance sometimes with guidance on “what works best”, or they can be full performance reports which examine whether performance is improving over time, with names attached to public bodies which demonstrate continuing shortfalls in performance.

The Audit Committee is rightly seen by the Parliament as the main committee for considering my reports and offering suggestions on the composition of the forward work programme of Audit Scotland. Occasionally one of my reports will be of interest to a subject committee of the Parliament, either because the report addresses an issue of concern to that committee, or because the committee has particular knowledge of the issue. In such cases, it could be appropriate to have a report considered by the relevant subject committee as well as the Audit Committee.

Focusing on governance and financial stewardship

Responsibility for stewardship of public funds rests with the management of public bodies receiving the money. It is the duty of management to put in place sound internal controls and corporate governance regimes. Strong and effective external audit provides independent assurance, through public reporting, on the adequacy of internal controls and corporate governance in public bodies.

There is a growing emphasis on corporate governance, risk management and performance across the public sector. Everyone, including Scottish Ministers, elected representatives, accountable officers and taxpayers, has an interest in ensuring that public bodies are well managed, with good standards of governance, sound financial stewardship and transparent decision making. Public bodies which have these attributes carry fewer risks of things going wrong than poorly run organisations. And the burden of audit and inspection can best be contained in organisations that are demonstrably well run.

Financial audit and assurance is at the heart of public audit. The external auditor must audit and give an opinion on the financial statements. In addition, the auditor is responsible for reviewing and reporting on the audited body's corporate governance arrangements as they relate to:

- systems of internal controls, including the management of risk
- the regularity of financial transactions
- the audited body's arrangements to prevent and detect fraud or error
- standards of conduct, and arrangements to prevent and detect corruption
- the audited body's internal and external reporting arrangements
- the financial position of the audited body.

Financial audit and assurance, although wider in its scope than the external audit of private companies, cannot be expected to detect all failings in public bodies. For example, it is not the role of the external auditor of a public body to detect fraud. It is management's responsibility to have anti-fraud systems in place and it is the auditor's role to review these systems. There is a trend for more demands to be placed upon auditors and I, together with the Accounts Commission, must balance the benefits of asking auditors to do more against the costs of additional workloads.

However, it is important that we get the most from the resources of public audit. The external auditors will be expected to work and report against the standards in a new Code of Audit Practice which will be applied uniformly to all public bodies. This Code summarises the wide scope of public audit to include reporting on governance, financial management, regularity, probity, value for money and performance. It requires auditors to recognise that there are different stakeholder interests, requiring a range of reports that are relevant and useful to local management and also reports that meet the needs of the Auditor General and the Accounts Commission. This, in turn, involves an expectation that external auditors will communicate effectively on the issues that are really important to management, for example on risk assessments, governance standards and performance issues.

As a consequence of auditors reporting against the standards in the Code, a higher profile may be given to the variety of governance and accountability arrangements that exist in the public sector. The application of consistent and rigorous public audit standards may promote more consistent governance and accountability arrangements. This could be a further benefit of the public audit model.

Since April 2001, resource accounting and budgeting (RAB) has been applied to the Scottish Executive (and to all UK central government departments). RAB distinguishes assets from liabilities and allows the full economic costs of government activities (cash and non-cash) to be accounted for at the appropriate time. Both the UK government and the Scottish Executive are now committed to the development of whole of government accounts. This major project should further improve accountability for the management of public money because it should lead to audited accounts based on consistent accounting

standards and reporting practices across the public sector. This should greatly improve the quality of financial reporting, for example at the level of the Scottish Executive as a whole. Audit Scotland must continue to provide support and advice in the introduction of these new accounting regimes and ensure that adaptations are made to the audit process. Audit Scotland must also continue to play its part in the general development of accounting and auditing standards in the UK.

Promoting continuous improvement

Performance audit covers all the work associated with analysing and reporting on the performance of public bodies and supports improvements. It consists of three types of work:

- value for money studies of particular services or functions
- validated performance information which gives a picture of current performance and of improvements over time
- assessments of the processes which bodies use for performance management and planning.

The main challenge will be to integrate these different elements in order to provide a robust and comprehensive picture of the performance of individual audited bodies. The approach has been most fully developed in local government, as part of the best value policy, and in principle it could be extended to the rest of the public sector.

I mentioned earlier that auditors will be expected to report on the issues which are important for management. To achieve this, Audit Scotland will have to secure new forms of integrated reporting which bring together performance reporting and reporting on financial audit and assurance. Where improvements are needed, management will be expected to prepare action plans in consultation with the external auditor. If an auditor can report that a suitable action plan is in place, then this can provide independent assurance that management is engaged in continuous improvement on the issues that matter.

The goal of sustained improvement in the management and performance of public services can be achieved only if the right incentives are in place for managers to take positive action. I have agreed with the Audit Committee that it will sometimes be appropriate to prepare “baseline reports” which look at the current performance of an organisation or a sector. The report will often contain objective evidence of what works best. Managers will then be given a suitable period, say two years, in which to make improvements. Then a performance audit report will be prepared in which performance changes are tracked and individual bodies are named. At this point, the Audit Committee could take evidence in public from accountable officers and managers. In my opinion this approach to performance audit provides incentives for managers to deliver improvements, without compromising the independence and objectivity of auditors.

The introduction of resource accounting and budgeting for government expenditure is providing a link between resources used and performance achieved, so that Parliament and the taxpayer can

have greater assurance about the way in which public money is spent. Audit can play an important role in providing independent validation of performance measures under this regime. This may include an assurance that targets reflect the objectives set by the Executive for individual public bodies, that the targets are sufficiently challenging, and that performance against the targets is reported accurately.

Responding to new forms of accountability

The public sector is becoming increasingly complex, with a growing range of services requiring the involvement of several different agencies. Better government requires more sophisticated and co-operative approaches to cross-cutting issues, stressing the importance of partnership, co-ordination and joint working. Many initiatives, such as Local Enterprise Forums, are designed to implement this approach.

Where responsibility for a programme is spread over a number of bodies it is important to be clear where the accountabilities lie. As with other public expenditure, it is the responsibility of identified accountable managers to ensure that pooled budgets are spent properly, wisely and well, and it is the responsibility of external audit to report on whether this has happened. Management must ensure that there is a clear governance framework, accountability and reporting arrangements. Auditors must understand this framework, and be satisfied that it is fit for its purpose, in order to fulfil their responsibilities for independent reporting.

Public bodies, including government departments, NDPBs and local authorities, have sometimes set up companies to carry out important tasks. Bodies set up as limited companies are still subject to Government Accounting rules, and accountable managers in the sponsoring public bodies must safeguard public money by ensuring that adequate controls are in place. In Scotland, local authorities have been innovative in their use of companies, trusts and other arms-length bodies. These practices led the Accounts Commission and CoSLA to produce a code of guidance for local authorities on funding external bodies and following the public pound. In my view, it would be appropriate to review all of the guidance (covering all public bodies) in this area to ensure that it is adequate. This should help auditors to ensure that they are fulfilling their responsibilities for reporting on such expenditure.

Taking a citizen perspective

The goal of Modernising Government is to improve public services for citizens. There is an important requirement that innovative approaches to cross-cutting issues should provide better services that appear seamless to the service user. The interests of service users are kept at the forefront of new initiatives. Since Audit Scotland covers most of the public sector in Scotland, it is uniquely placed to support improvements in multi-agency working. This can be achieved through studies that cut across organisational, professional or geographical boundaries, and that view services from the user's perspective.

All organisations must comply with equal opportunities legislation. Sometimes it will be important for performance audit to consider explicitly equal opportunities issues when studies are being planned. Equal opportunities issues will be present more often than is realised, and Audit Scotland should be vigilant in this area.

Using information effectively

The Scottish Parliament's commitment to openness and accountability implies the need for better information on the activities of public bodies. There is also a growing demand for information within public bodies themselves, to help them to assess their performance and identify opportunities for improvement. Public audit has a key role to play in encouraging the development of this information, and in providing assurance that the information is reliable, accurate and fit for the purpose to which it is applied.

Working with auditors

A great strength of public audit in Scotland is that each public body has its own external auditor formally appointed by the Auditor General or (in the case of local government) by the Accounts Commission. Significant exceptions include Scottish universities and local enterprise companies, which are private companies, and of course, non-devolved functions.

The content of national reports in the name of the Auditor General and/or the Accounts Commission often depend upon reports and information provided by the local auditors. One significant benefit is that national reports can draw upon local evidence and real-life experience at the front line of public services.

External auditors are drawn from the staff of Audit Scotland or private firms which are appointed as auditors. The Accounts Commission and I share a commitment to maintaining a "mixed economy" of appointed auditors. There are differences in the skills, resources and experience of staff employed by Audit Scotland and the private firms, which enrich the quality of public audit as a whole. In evaluating the performance of auditors, it is useful to be able to make comparisons between public and private sector providers.

Promoting good working relationships between Audit Scotland and appointed auditors will be central to the efficiency and effectiveness of public audit. It will be very important to develop systems for monitoring and managing the costs and quality of auditors' work, building upon the quality management systems inherited from the Accounts Commission.

Strengthening partnerships with regulators, inspectors and funding bodies

The world of public sector audit is becoming more complex. Auditors, regulators, inspectors and funding bodies need to understand how their different regimes contribute to local improvement. Audit Scotland, because of its wide-ranging responsibilities and its experience of joint working with inspectors, must keep under review its activities and partnerships to ensure that its contribution continues to be relevant and cost-effective.

Audit and inspection regimes need to complement each other. The audit regime is generalist, ever-present and wide-ranging. Inspection regimes vary, but are usually specialist, based on professional or service groupings, measure against professional standards, and are cyclical. The challenge is to develop working arrangements that deliver the best combination of these two regimes.

I and the Accounts Commission are committed to working in partnership with inspectors to improve our working practices and enhance the value of the audit process. Audit Scotland works closely with professional inspectorates such as Her Majesty's Inspectorates of Schools, Fire and Constabulary to collect information and disseminate good practice. This demonstrates that, at its best, partnership working can provide a powerful combination of skills. Audit Scotland's cross-sectoral experience and ability to assess the arrangements for managing resources can be combined with the professional expertise of inspectors. This combination can provide a regime that is efficient as well as effective, spurring change through co-ordinated findings and recommendations. In my opinion, there are opportunities to develop partnership working more fully, especially with the Social Work Services Inspectorate.

I believe that there are opportunities for joint working with public service regulators such as the Clinical Standards Board for Scotland and the new Scottish Commission for the Regulation of Care. Possible benefits include the sharing of skills and techniques to add value to the overall regulatory system, and extending the existing programme of joint studies. Ultimately this should benefit audited bodies, by bringing in more consistent and better co-ordinated regulatory arrangements to help them in the drive for continuous improvement.

There are similar opportunities for joint working with funding organisations such as SFEFC/SHEFC and Scottish Homes. These bodies have a responsibility to ensure that the money which they allocate is spent properly and provides value for money in service delivery. Audit Scotland is developing agreements with these bodies about future relationships and complementary roles.

Working with other audit agencies

It is important to ensure that there is effective dialogue and co-operation with other public audit agencies. The heads of these agencies (the Comptroller and Auditor General for the United Kingdom, the Controller of Audit with the Audit Commission for England and Wales, the Auditor General for Northern Ireland and the Auditor General for Scotland) meet regularly to consider common issues. They also oversee the work of the Public Audit Forum which helps to provide a strategic context for the work of the national audit agencies. The Forum has a wide membership which includes representatives of government departments, audited bodies and private firms involved in audit. In addition, there is ongoing dialogue and co-operation between the staff of Audit Scotland and those in the other public audit agencies in the UK.

At the European level there is growing co-operation and exchange of experience among regional audit agencies, mainly through EURORAI¹, with the overall aim of improving financial controls and helping to make better use of public money throughout Europe. There is considerable interest in Europe and elsewhere in the public audit model which is being developed under the Scottish Parliament.

Establishing Audit Scotland as an effective, well-managed organisation

Audit Scotland is a new organisation, which brought together the former staff of the National Audit Office in Scotland and the Accounts Commission. The responsibilities of Audit Scotland are significantly different from those of the predecessor organisations, and the new organisation is developing new ways of working. It will be essential for Audit Scotland to invest in its staff to meet the challenges and fulfil the expectations of our stakeholders.

Audit Scotland must meet the standards expected of other public bodies, and demonstrate best value in the delivery of public audit. This means a focus on:

- delivering improvements through the 4Cs: challenge, compare, compete, consult
- sound governance, to create a culture of transparency and accountability in the use of public funds
- developing new ways of working through the use of new technology and cross-cutting working.

¹ European Organisation of Regional External Public Finance Audit Institutions

Conclusion

Public audit should play an important role in supporting democratic scrutiny in the Scottish Parliament by providing independent objective information on governance, financial stewardship and performance. Public audit can also support continuous improvement in public services and help to promote the interests of citizens, both as users of these services and as taxpayers. The creation of Audit Scotland as a single public audit body in Scotland (serving both the Auditor General and the Accounts Commission) provides a unique opportunity for a joined-up approach to audit examination and reports.

In the Annex to this strategic statement is a list of suggestions for action by Audit Scotland. I would expect Audit Scotland to be able to demonstrate progress in these areas, through its corporate planning process and future annual reports.



Robert W Black
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Edinburgh
August 2001

Annex: Suggestions for action by Audit Scotland

Supporting democratic scrutiny

- develop an integrated forward work programme for the Auditor General and the Accounts Commission, involving consultation with:
 - the Audit Committee of the Parliament and taking account of the views of subject committees
 - the Scottish Executive
 - audited bodies and other stakeholders
- produce reports that are timely, objective, relevant, informative and easy to read
- communicate the findings clearly and concisely in other ways.

Focusing on governance and financial stewardship

- implement the new Code of Audit Practice which will apply to the work of all auditors appointed by the Auditor General and the Accounts Commission
- keep abreast of modern audit practice, especially risk management approaches and the audit of electronic systems and controls
- consult widely on regularity audit work, and develop audit reporting to provide a level of assurance that takes account of the expectations of elected representatives and the public
- develop regularity work to take account of new ways of funding and delivering services
- support the introduction of resource accounting and budgeting, adapting the audit approach as necessary, and support the introduction of whole of government accounts.

Promoting continuous improvement

- develop performance audit by establishing value for money studies, performance information and management arrangements work and new forms of integrated reports
- develop performance audit processes that provide support and incentives for improvement while safeguarding the independence and objectivity of auditors
- develop audit and assurance reporting in support of performance reports produced by public bodies
- explore how best to balance national and local priorities in performance audit work
- support the development of cross-cutting performance indicators
- build understanding of and commitment to performance audit work among key stakeholders.

Responding to new forms of accountability

- review the guidance available to public bodies in relation to the funding of external bodies, and develop guidance for pooled budgets.

Taking a citizen perspective

- maintain an emphasis on the interests of service users in the national study programme
- promote innovative approaches to local audit that look across the whole local picture and deliver products which are not constrained by organisational boundaries
- ensure that, where appropriate, equal opportunities issues are fully considered in planning and delivering performance audit studies
- explore how to improve consultation with the public
- explore how to communicate more effectively the results of studies to members of the public.

Using information effectively

- consider Audit Scotland's role in gathering, verifying, analysing, interpreting, storing, generating and disseminating information, and in making it available to public bodies for benchmarking
- consider how to make Audit Scotland's comparative information more openly available for the benefit of the public, elected representatives and public bodies
- improve the analysis of its information to maximise the added value to public sector managers
- make greater use of the local knowledge of auditors as a source of information
- use the opportunities presented by electronic communication, including the internet, for enhancing audit products and services.

Working with auditors

- ensure the continued availability of auditors committed and equipped to work in partnership with Audit Scotland to achieve its objectives for public audit
- maintain national audit standards while encouraging innovation by suppliers to develop efficient approaches that are responsive to local circumstances
- review the planning of audit specifications and technical guidance to auditors, to ensure that demands are co-ordinated and in line with the new Code of Audit Practice
- review the role of auditors in local performance audit work, to ensure that the most effective balance is achieved between national development and local application
- review the arrangements for assuring the quality of audits in line with the new Code of Audit Practice while containing the overall costs of quality assurance and compliance
- encourage greater co-operation between auditors, including work to identify and promote best practice
- identify, resource and encourage successful local audit initiatives that could have a wider application nationally.

Strengthening partnerships with regulators, inspectors and funding bodies

- identify and assess effective ways of working in partnership with inspectors and funding bodies that reflects statutory duties of these organisations and their skills and knowledge
- develop processes for managing partnerships with other inspectors, regulators and funding bodies to secure their full potential, minimise compliance costs and avoid duplication

- share learning and good practice on performance assessment methodology
- develop joint methodologies and apply them in a co-ordinated way.

Working with other audit agencies

- continue to develop effective communication and partnership working with other UK audit agencies
- develop links with regional audit agencies in Europe, mainly through EURORAI.

Establishing Audit Scotland as an effective, well-managed organisation

- encourage Audit Scotland staff to consider the mission of the new organisation and their own contribution and ensure that they are equipped to play their roles effectively
- demonstrate best value, sound stewardship, value for money and continuous improvement in its own use of resources
- report on the financial stewardship and performance of Audit Scotland so that the organisation can properly be held to account by its principal stakeholders
- ensure that Audit Scotland is a best practice employer in relation to the recruitment, management and development of its staff.



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ISBN 1 903433 47 9